2.2 Investing

The reasons for investing

Figure 2.2a illustrates why people may choose to *invest* their money. We invest our money in order to increase our wealth (that is, the stock of things we possess, such as money, a house, works of art and shares) and provide for future needs. There are four main reasons why people decide to invest. These are:

- investing for extra income
- saving for a 'rainy day'
- saving for a major purchase
- investing for retirement.

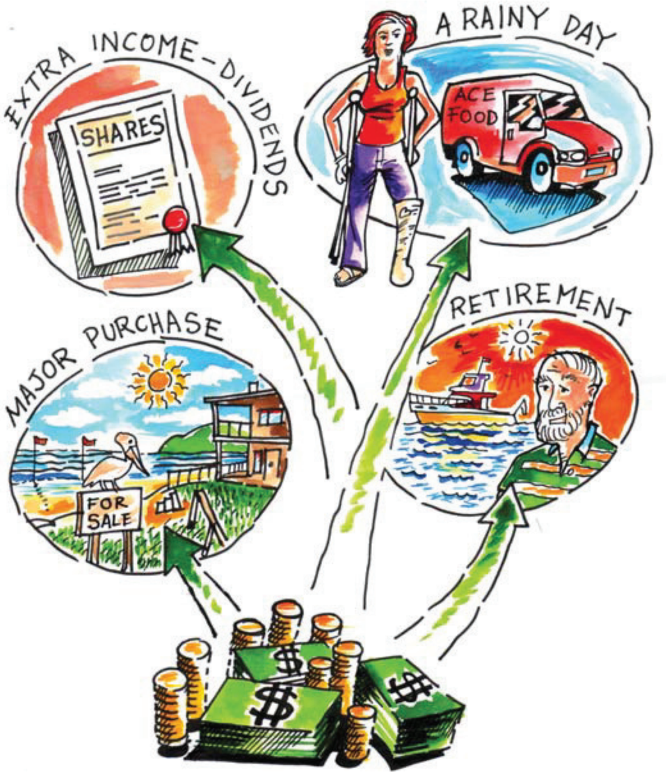

Figure 2.2a Why invest?

The different investment options

When we invest our money we do so on the expectation that there will be a return; that is, we will receive a financial benefit for allowing the person or organisation we invested with to use our money. An important point to remember is that the higher the return, the greater is the risk that we could lose our money. Figure 2.2b illustrates the different investment options available in Australia and their relative levels of risk and return.

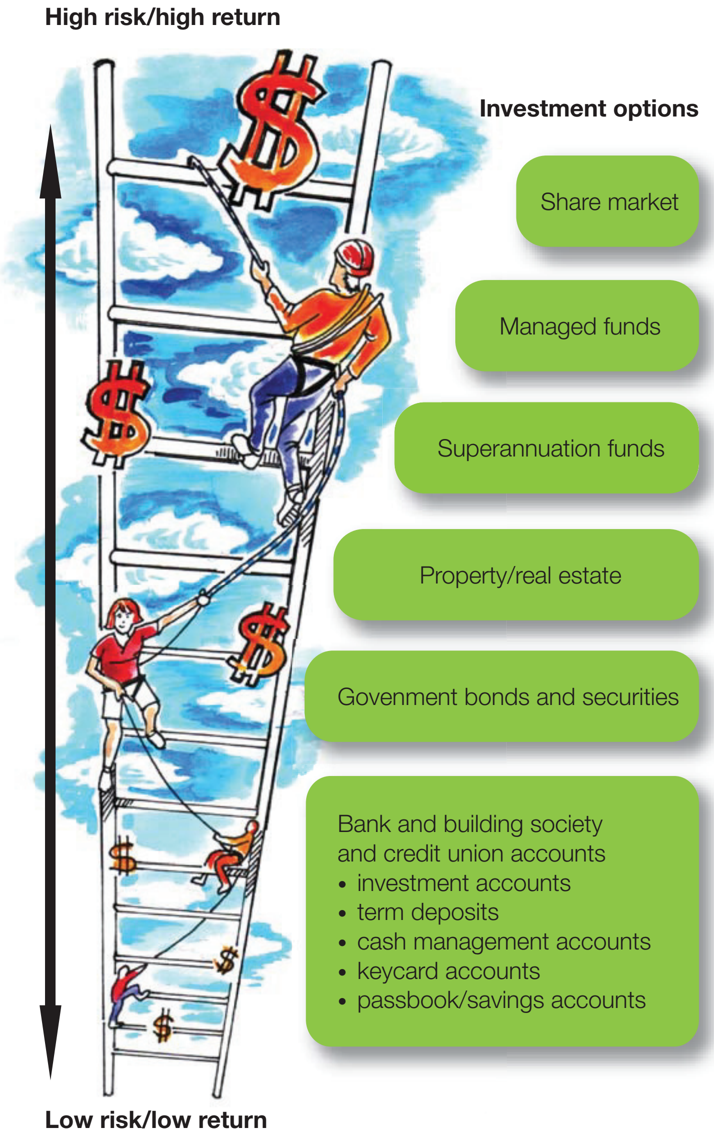

Figure 2.2b The risk and return ladder.

As mentioned earlier, most Australians have bank accounts and you are probably aware of the different types of bank accounts. In Australia, banks are the most secure of all the investment options. Because there is a low risk of losing money invested in a bank account, the returns that banks provide on savings and investments are at the lower end of possible returns. However, different bank accounts do have different levels of returns. The return will be directly related to (or a function of) the level of risk and how easily the money can be accessed. For example, a term deposit of five years will have a higher rate of return than that of a keycard account because the bank is able to use your money for five years and you can only access it after this time. By comparison, you can access the money in your keycard account at any time. There is also a risk that interest rates may rise significantly. Banks compensate for this risk by giving you a higher rate of return on longer-term accounts than for those accounts where your money is available on demand.

Info.com.tech

Bank accounts

Activity

Access the following bank websites and note down what types of bank accounts they offer. Do they differ at all?

a Commonwealth Bank <www.commbank.com.au/>

b St George <www.stgeorge.com.au/>

c Citibank <www.citigroup.com.au/>

d Illawarra Mutual Building Society <www.imb.com.au/>

e Macquarie Bank <www.macquarie.com.au/>

At the top of the investment ladder in Figure 2.2b is the investment option of the share market. In Australia, shares are traded on the Australian Stock Exchange (ASX)-a marketplace where public companies are listed and their shares open for trade. When you buy a share you purchase an ownership stake in that company. You will then receive part of the company's profits through dividend payments. However, you also take on board the risk that the company may not make profits and, in a worst-case scenario, go bust.

During the late 1990s and up to 2002, the Australian share market was considered 'bullish', where share prices rose and returns were high and the market strong i.e. a bull market. Beginning in early 2003 however, the market turned 'bearish' i.e. a bear market, with share prices falling for the majority of companies listed on the ASX. Rather than experiencing returns on their investments, shareholders experienced losses. This changed by 2005 when the share market again picked up. On the other hand, the property market continued a boom period that started in the late 1990's and returns for investors have been high. Only in the last two years have housing prices remained stagnant with the property market coming off the boil. The question to ask is, whether these trends will or can continue. When there is the possibility of high returns, there is also the greatest risk of small or even negative returns. Further information on investing can be found in Chapter 5.

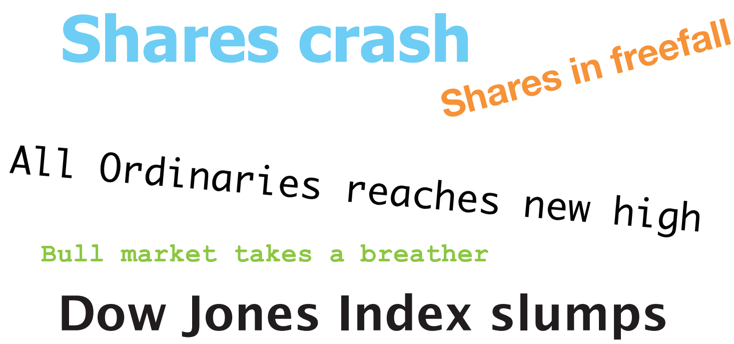

Figure 2.2c When you buy shares you purchase a stake in a company.

Comprehending the text

1 What does it mean to invest?

2 Why do people invest?

3 What is the relationship between risk and return?

Activities

1 Copy the table below into your notebook. Then complete the table by answering the questions: What types of investments would the following people be likely to have? Why?

Possible investments		
18-year-old	**35-year-old**	**65-year-old**

2 Go to the investment section of a daily newspaper and find the company with the highest share price and the company with the lowest share price. Track the share price of each of these companies for four weeks. Use a graph to record the changes in their share price. At the end of this period, discuss as a class the possible reasons for the share price movements.

3 Go to the financial section of the *Sydney Morning Herald* and research the rate of returns for the following investments:

a savings account

b one-year term deposit

c five-year term deposit

d five-year government bond

e managed fund

f shares in BHP Billiton Pty Ltd.

If you had $100 000 to invest, how would you invest this money? Why?