INVESTMENT SECURITIES

PAPER 2

TOPIC 2

JOHANNESBURG SECURITIES EXCHANGE (JSE)

Outline/Explain/Discuss the functions of the JSE. (4)

- Serves as an indicator of economic conditions in South Africa.
- Keeps investors informed on share prices by publishing the share prices daily.
- Acts as a link between investors and public companies.
- Shares are valued and assessed by experts.

INVESTMENT DECISION FACTORS

Outline/State/Describe/Explain/Discuss the following factors that should be considered when making investment decisions:

Return of investment (ROI) (2)

- Refers to the amount of money the investor gets in addition to the original investment amount.
- ROI will be higher if the risks involved in the investment are high.
- ROI Will be lower if the risk involved in the investment is low.

Risk (2)

- Different investment opportunities have different risks linked to them.
- Certain shares do have a low risk over an extended investment period.
- Shares with higher risks have a greater potential for higher returns.

Investment term/period (2)

- The Investment period refers to the duration of the investment from the initial date of investment until its termination.
- The investor will be able to access his/her investment within a short period if the investment is of a short-term nature.

Inflation rate (2)

- Inflation refers to a general increase in the price of goods and services over time, while the value of money decreases as a result thereof.
- The higher the inflation rate, the lower the purchasing power of money.

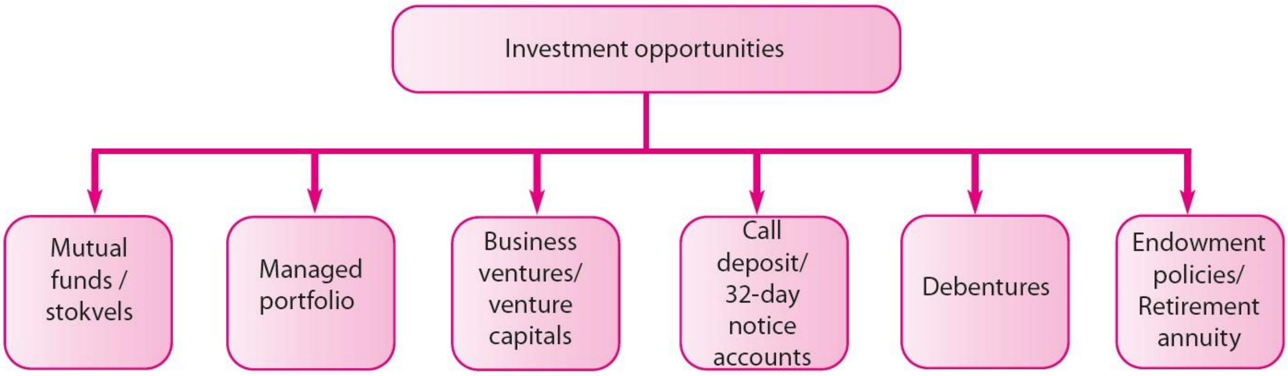
Taxation (2)

- A good investment will be determined by the percentage of return after payment of taxes due to SARS.
- The investor must make provision for income tax payable to SARS to ensure a high net after-tax return.

Liquidity (2)

- Liquidity refers to the speed with which an investment can be converted into cash.
- The easier it is to convert an investment into cash, the more liquid the investment.

INVESTMENT OPPORTUNITIES AND RISK FACTORS



Explain/Discuss the various types of investment opportunities and their risk factors:

Mutual funds/Stokvel (2)

- Stokvels are established by a small group of people who informally/voluntarily make contributions into a savings fund.
- Members of the stokvels are encouraged to save monthly for a specific goal.

Risk (2)

- Members could be contributing to an illegal financial scheme and could lose all the money they contribute.
- The possibility exists that a member would be unable to contribute his/her monthly savings.

Managed portfolio (2)

- An investor has the opportunity to make use of a financial advisor to manage all his/her investments in one portfolio.
- The financial advisor has full control over the investments in the investor's portfolio and may change investment options based on their performance in the market.

Risk (2)

- The risks linked to a managed portfolio is lower over a longer period.
- The risks linked to the investments are spread out because investments are made in several companies.

Venture capital (2)

- Investors make funds available to prospective business to start a business, and they become co-owners of the business.
- An investor must familiarise himself/herself with the market in which the business will be operating before making his/her investment.

Risk (2)

- The risks linked to this type of investment could be high if the investor did not familiarise himself/herself with the market in which the business will be operating his/her business.
- Entrepreneurs with limited experience may not be able to manage the business successfully, causing the investor to lose some/all of his/her investment

32-day notice account (2)

- The investor will earn interest at a higher rate as compared to current/savings account.
- The investor earns interest at a higher rate than what he/she would have earned if the investment was made into a savings account.

Risk (2)

- Low risk, as investment plus interest will be paid out on the maturity date of investment.
- The interest is compounded daily, and this increase the value of the investment.

Debentures (2)

- Debentures are issued to raise borrowed capital from the public.
- The lender/debenture holder agrees to lend money to the company on certain conditions for a certain period.

Risk (2)

- Debentures have a low risk as they need to be paid back.
- Companies are liable to repay the original amount of the debenture plus interest, which decrease the risk for the investor.

Endowment/Retirement annuities (2)

- An investor makes monthly premium contributions to an insurance company and is guaranteed a predetermined fixed amount at the end of the period/at his/her death.
- This investment provides the investor/his dependants with financial security in the event of his/her death.

Risk (2)

- The risk to the investor is low because payments will be made on the occurrence of a future event/at his/her death.
- The investor may lose his/her money if the insurance company is declared bankrupt before the occurrence of the event insured against.

FORMS OF INVESTMENT

Explain/Discuss/Analyse/Evaluate (positives/advantages and/or negatives/disadvantages) of the following forms of investment:

Government/RSA retail savings bonds

- ✚ The interest rate is fixed for the duration of the investment, thereby providing the investor certainty of a return on his/her investment.
- ✚ The investor has free access to his investment and may withdraw cash after the first year of the investment.
- ▪ People younger than 18 do not have the option of investing in this form of investment.
- ▪ Investors do not have the option of freely exchange retail bonds amongst themselves.

Unit trusts

- ✚ The fund manager chooses from a variety of share options that offer low to high risks investments.
- ✚ The investments are managed according to predetermined rules and procedures, which makes this type of investment a safe option.
- ▪ The funds of the unit trust are limited to the contributions of members and may not be increased by other borrowings.
- ▪ This investment option is not recommended to investors who want to invest for a limited period.

Shares

- ✚ The shares may be freely sold and purchased on the JSE.
- ✚ The investors have voting rights at the Annual General Meetings of the public company.
- ▪ Investors must rely on the goodwill of the company to declare a dividend.
- ▪ Shareholders could lose their investment should the company be declared insolvent, making the risk high.

Fixed deposit

- ✚ The duration of the investment period is determined solely by the investor.
- ✚ The return on investment of this type of investment is higher.
- ▪ The return in investments may be lower than the general rate of inflation.
- ▪ Penalties may be charged for early withdrawal.

TYPES OF SHARES

Identify the following types of shares from given scenarios/statements:

Ordinary shares

- Ordinary shares only receive dividends when profit is made.
- Normally the higher the net profit, the higher the dividend.

Preference shares

- Some of these types of shares receive dividends regardless of whether a profit is made.
- A fixed rate of return is paid on this type of shares.

Bonus shares

- Payment in the form of shares to shareholders.
- Issued as compensation for unpaid dividends.
- Shareholders receive these shares without being required to pay for them.

Founder's shares

- Issued to the founders and incorporators/promoters of the company.
- They receive dividends after all other shareholders were paid.

PREFERENCE SHARES

Name/Outline/Explain/Discuss types of preference shares.

Participating preference shares

- The investor is certain of receiving a minimum fixed dividend from the company.
- Any **surplus profit** the company may have made must be **shared** with the investor.

Non-participating preference shares/Ordinary preference shares

- The investor is certain of receiving a minimum fixed dividend from the company.
- They **do not share** in any **surplus** profit the company may have made.

Cumulative preference shares

- Investors will receive **payments for past dividends** that were not paid out because of poor financial performance by the company.

Non-cumulative preference shares

- Investors will **not receive payments for past dividends** that were not paid out because of poor financial performance by the company.

Redeemable preference shares

- Investors **can sell the shares back** to the company they bought them from at a **fixed price** should the company so desire.

Non-redeemable preference shares

- Investors **can only sell the shares back** to the company they bought them from should the **company close down** for reasons other than bankruptcy/insolvency.

Convertible preference shares

- The investor **can convert** the shares into a fixed number of ordinary shares on a future date determined on the date the shares were issued.

Non-convertible preference shares

- The investor **cannot convert** the shares into a fixed number of ordinary shares.

Outline the rights of ordinary and preference shareholders.

Rights of ordinary shareholders

- The shareholders has a right to receive notice of and attend the Annual General Meetings of the company.
- The shareholders has the right to participate and vote at the Annual General Meetings of the company.
- Attend the Annual General Meeting to learn about the company's performance.
- The shareholder must be allowed to vote for the directors of the company.

Rights of preference shareholders

- The investor is entitled to receive dividends irrespective of the profit levels of the company.
- They only have voting rights at the AGM under particular circumstances/for certain resolutions.
- In the event of the company being declared bankrupt/insolvent, they have a claim on the assets of the company before ordinary shareholders.
- Full disclosure must be made to the investors by providing them with copies of all financial reports.

Identify types of preference shares from given scenarios/statements.

Differentiate/Distinguish between ordinary and preference shares.

ORDINARY SHARES	PREFERENCE SHARES
The shareholder is only entitled to receive a return on his investment when the company makes a profit and declares a dividend.	The shareholders of a certain type of preference shares are entitled to dividend payment regardless of whether the company declares a dividend payment or not.
A higher dividend is payable to the shareholder if the profits are higher.	The shareholder will receive a fixed rate of return regardless of the amount of the profit.

INVESTMENT CONCEPTS

Define/Explain the meaning of debentures, dividends, capital gain, simple interest and compound interest.

Debentures

- It is a financial instrument that allows companies to borrow money from the public.

Dividends

- The return on an investment in shares which is paid regularly by a company to its shareholders.

Capital gain

- This refers to the growth in value of property/assets/investments in relation to the original amount invested over a certain period.

Simple interest

- Refers to the amount of interest earned based on the original investment of the investor.

Compound interest

- Refers to the amount of interest earned based on the original amount invested, as well as interest earned in the preceding years that were added to the original amount invested.

SIMPLE AND COMPOUND INTEREST

Differentiate/Distinguish between simple interest and compound interest.

SIMPLE INTEREST	COMPOUND INTEREST
Interest earned on the original amount only.	Interest earned on the original amount invested, and the interest earned in the preceding years is added to the original amount invested
The value of the original amount remains the same for the duration of the investment.	The value of the original amount increases as additional interest is added in subsequent years.

Calculate simple and compound interest from given scenarios.

Calculating simple interest

The following formula is used to calculate simple interest:

Interest = P × r × t, where:

- P is the principal/original amount of the investment
- r is the interest rate
- t is the period of the investment

Calculating compound interest

The following formula is used to calculate compound interest:

Interest = P × (1 + i)n – P, where:

- P is the principal/original amount of the investment
- r is the interest rate
- n is the number of investment periods

Recommend the best investment option based on the calculations.