

# INVESTMENT SECURITIES

PAPER

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## 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 income from the investment, namely interest/dividends/increased capital growth on the original amount invested.
- The return should be expressed as net after-tax gains on the investment.
- High risk investments yield higher returns.

#### Risk (2)

- The higher the potential return, the higher the risk of a potential loss.
- Investing in shares has a higher risk than investing in a fixed deposit.
- Shares have low/medium risk over a longer investment period.

#### Investment term/period (2)

- This refers to the duration of the investment which may influence the return on investment.
- The longer the investment period the higher the returns.

#### Inflation rate (2)

- Investors/People are affected by a high inflation rate because their money/purchasing power decreases.
- The return on investment should be higher than the inflation rate.

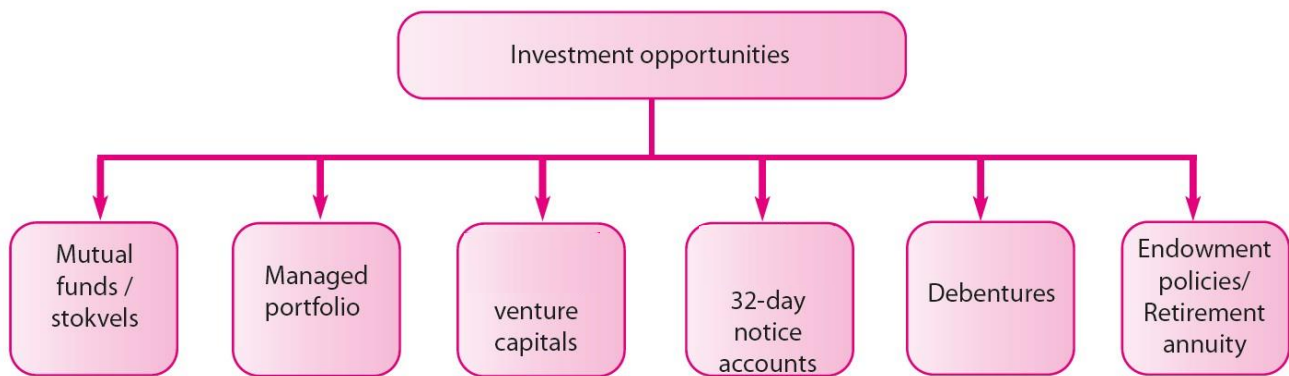
## **Taxation (2)**

- Refers to a compulsory payment made by citizens to the government.
- A good investment will yield good after-tax returns.

## **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)

- It is an informal savings scheme to which a relatively small group of people contribute.
- Each member takes a turn to draw from the scheme/fund/stokvels for their own personal gain.

#### Risk (2)

- Schemers who claim to be running stokvels may be running illegal pyramid schemes and pay-outs may not be possible as cash has run out/members may lose their savings.
- Money in a savings account is a safe investment, but with low interest rates/the returns are low.

#### Managed portfolio (2)

- An investor instructs a financial institution/bank/financial advisor to manage his/her various investments/assets in one portfolio.
- If the portfolio does not perform well/as expected, the portfolio/parts thereof may be changed with/without informing the investor.

#### Risk (2)

- Risk is lower over a longer term/period.
- Investments are made in various sectors/companies, therefore the risk is spread and better managed by the portfolio manager.

#### Venture capital (2)

- Venture capital is given by investors/businesses to start up/expand a business in return to have a share in the new/expanded business.

- Investors should know the type of business/market/economic conditions before a business is bought/started.

### **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)**

- Money is invested at a fixed rate, although withdrawals may be made provided the bank is given 32 days' notice of the withdrawal.
- It earns more interest than a current/cheque/savings account, but less interest than a fixed deposit.

### **Risk (2)**

- Low risk, as investment plus interest will be paid out on the maturity date of investment.
- Interest rate may fluctuate with market conditions, increasing the risk.

### **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)**

- A monthly payment is paid to an insurance company with the expectancy of receiving a pre-determined amount on a date in the future.
- To provide for a future expenses/give peace of mind to the dependants of the insured.

### **Risk (2)**

- Low risk, as the insured amount will be paid out regardless of circumstances.
- Only the closing down/bankruptcy of the insurance company may result in losing the monthly contributions made up to the close date.

## FORMS OF INVESTMENT

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

### Government/RSA retail savings bonds

- + Guaranteed returns, as interest rate is fixed for the whole investment period.
- + Interest rates are market related and attract more investors.
- Retail bonds are not freely transferable amongst investors.
- Investors need to have a valid SA identification which may discourage foreigners to invest.

### Unit trusts

- + Managed by a fund manager who buys shares on the stock exchange/JSE.
- + Easy to cash in when an investor needs money.
- Share price may fluctuate.
- Unit trusts are not suitable for people who want to invest for a short period.

### Shares

- + The shares may be freely traded on the JSE.
- + Shareholders have voting rights at the annual general meeting (AGM).
- Companies have no legal obligation to pay dividends to shareholders.
- Risk may be high, as investment may be lost when companies are liquidated.

### Fixed deposit

- + Investors can choose the investment period that suits them.
- + Principal amount plus interest earned is paid out on the maturity date.
- The investor cannot withdraw their funds before the maturity date.
- Low returns compared to other investments

## 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

Shareholders:

- are guaranteed minimum fixed dividends.
- are entitled to share in any surplus company profits.

### Non-participating preference shares/Ordinary preference shares

Shareholders:

- will not get extra dividend in case of surplus profits.
- entitled to receive only a fixed rate of dividend every year.

### **Cumulative preference shares**

- Shareholders are compensated for past dividends that were not paid out when profits were too low to declare dividends/Receive dividends not previously paid out.

### **Non-cumulative preference shares**

- Shareholders are not compensated for past dividends that were not paid out when profits were low.

### **Redeemable preference shares**

- Shares can be redeemed/bought back at the option of the issuing company, at a fixed price on a specified date/over a certain period.

### **Non-redeemable preference shares**

- Shares are only bought back when the company closes for reasons other than bankruptcy.

### **Convertible preference shares**

- Shares can be converted into a predetermined number of ordinary shares on the date specified when the preference shares were issued.

### **Non-convertible preference shares**

- Shares cannot be converted into ordinary shares.

### **Outline the rights of ordinary and preference shareholders.**

#### **Rights of ordinary shareholders**

Shareholders have the right to:

- vote at the Annual General Meeting.
- attend the Annual General Meeting to learn about the company's performance.
- receive interim and annual reports.
- claim on company assets in the event of bankruptcy after all other creditors and preferential shareholders have been paid.

## Rights of preference shareholders

- Receive dividends regardless of how much profits are made.
- Receive a fixed rate of return/dividend.
- They are paid first/enjoy preferential rights to dividends.
- Receive interim and annual reports.

*Identify types of preference shares from given scenarios/statements.*

### Differentiate/Distinguish between ordinary and preference shares.

ORDINARY SHARES	PREFERENCE SHARES
Ordinary shares only receive dividends when profit is made	Some of these types of shares receive dividends regardless of profit made.
Normally the higher the profit, the higher the dividend.	A fixed rate of return is paid on this type of shares .

## INVESTMENT CONCEPTS

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

#### Debentures

- It is 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.

#### Dividends

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

#### Capital gain

- The return on property/fixed assets/investments.

#### Simple interest

- The interest is calculated on the original/principal amount invested.

#### Compound interest

- Interest is calculated in every period on original/principal amount plus interest.



## SIMPLE AND COMPOUND INTEREST

Differentiate/Distinguish between simple interest and compound interest.

SIMPLE INTEREST	COMPOUND INTEREST
Interest earned on the original amount and not on the interest accrued.	Interest earned on the original amount invested, and the interest earned in the preceding years is added to the original amount invested
The principal amount remains the same over the duration of the investment.	The principal amount grows with the addition of interest to it.

*Calculate simple and compound interest from given scenarios.*

### Calculating simple interest

The following formula is used to calculate simple interest:

Interest =  $P \times r \times t$ , 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 =  $P \times (1 + i)^n - P$ , 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.*