SECURITIES AND EXCHANGE COMMISSION OF ZIMBABWE

Investment 101

Book Summary

Investment 101 Handbook: Chapter 1 - History of Financial Markets

Financial markets have been around for many centuries and they keep changing as the global economy changes. Markets were a critical part of global capitalism which took centre stage during industrialisation in the 17^{th} and 18^{th} centuries. Industrial growth during that time was partly financed through equity capital from investors.

The basis of any share investment is the principle of limited liability which says shareholders are only legally responsible for the company's debts only to the extent of the amount of capital invested. This principle encouraged people to invest in companies as shareholders without worrying about personal liability for its debts. Limited liability principle provided the platform for the formation of the public company and international capital markets as we know them today. Probably the most recognisable feature of capital markets is a stock exchange.

Stock exchanges are markets where shares and stocks are bought and sold. It is also a platform where capital is raised to fund operations of businesses as well as local authorities (municipalities and rural district councils) and central government. The buying and selling of securities has existed for centuries. The first reported organised exchanges were in Japan where rice growers and merchants traded future contracts to hedge seasons. For a greater part of the history of stock exchanges, the most commonly traded asset classes were foreign exchange and government bonds. Equities (shares) only became dominant in the 20^{th} century. The other name for the stock exchange is 'bourse'. Earlier traders and merchant used to meet in front of the house of the Van Der Buerse family in Bruges, Belgium for trading and the name Buerse became synonymous with the stock market. It then evolved over time to bourse.

The London Stock Exchange (LSE) traces its history to 1698 at Jonathan's Coffee House where stockbrokers would meet for trading because during the 17th century, they were not allowed in the Royal Exchange due to their rude manners. At that coffee house, a broker named John Castaing started listing the prices of a few commodities, such as salt, coal, and paper, and exchange rates in 1698. The first stock exchange in the US was formed in 1791 at 68 Wall Street, in New York but the formalised New York Stock Exchange came into being in 1863.The first stock exchange in South Africa was founded in 1881 in Kimberley to cater for the companies operating in the booming diamond mining and exploration. The Johannesburg bourse was established in 1886 when the gold rush came to Witwatersrand.

Investors provide risk capital in exchange for a share of the potentially vast profits of the company. As early as the introductory stage of investing, investors learnt the hard way that investing involves taking risks. Investors lost money in the infamous South Sea bubble in the 17th century when share prices of the company (South Sea) which had rallied for a while on rising enthusiasm collapsed as it became clear its prospects were exaggerated. Another infamous market crash had occurred a century earlier in Netherlands when prices of tulips, then a coveted fashionable and luxurious item, crumbled suddenly after gaining prominence with investors who were paying large amounts for the plant's future contracts.

Then there was the Wall Street Crash of 1929 which heralded the beginning of the Great Depression. Another crash occurred on what came to be known as the 'Black Monday' on 19 October 1987.

Zimbabwe has one of the oldest exchanges in Africa. In 1891 a broker, named S. Hyman established a firm which acted as an intermediary for settlers who wanted to buy shares on the JSE and LSE. The first stock exchange was established on 20th June 1894. At inception there was an exchange in major towns namely Harare, Bulawayo, Gweru and Mutare. These were formed primarily to meet capital needs of the gold mining industry. A unified exchange, then called the Rhodesian Stock Exchange (RSE) was officially opened on 2nd January 1946 in Bulawayo. By 1963 there were 98 listed companies from only 7 in 1946. At independence in 1980, the Zimbabwe Stock Exchange had 61 listed companies and two brokers. Since then the market has gone through different experiences including a crash during the infamous Black Friday on 14 November 1997 when the Zimbabwe dollar lost

72%. There was hyperinflation between 2003 and 2008, transacting in US dollar between 2009 and 2018 and its transformation to electronic trading on July 2015. A notable feature for the ZSE over the years has been the significant involvement of foreign investors with peak years between 2013 and 2016 seeing more than half the trades linked to offshore participants.

Investment 101 Handbook: Chapter 2 - The Economy - Understanding the Economy

What determines the share price and the direction it will take over time? There are many factors but the most critical one is the performance of the economy. An investor needs to know that a company in whose shares s/he is investing does not operate in isolation. It is part of a big ecosystem called an economy. To invest effectively on capital markets an investor needs to know some basics economics.

Economics is the study of how people interact with production, distribution consumption of goods and services. It studies how individuals, businesses, governments and nations make choices about how to allocate limited resources to meet unlimited wants. Decisions around allocation of scarce resources by individuals and companies is called microeconomics. Macroeconomics is the study of resource allocation within the economy as a whole. It studies the influence of macroeconomic fundamental factors such as inflation, economic growth, unemployment, interest rates, and exchange rates on economic activities. The effects of these factors on business, consumer, and government economic decisions represent an intersection of micro and macroeconomics.
There are four basic macroeconomic sectors and these are: -

1. Household - this includes every individual who consumes goods and services.
2. Business - this produces the goods and services consumed by the Household sector. It does this by combining four factors of production namely land, labour, capital and entrepreneurship.
3. Government - this affects resource allocation and production by imposing laws and regulations on businesses and households.
4. Foreign (International trade) – this is about trading which takes place between organisations from different counties.

Generally, modern economies tend to have the following goals: -

- Full employment- utilizing all available resources for production.
- Stability- Avoiding inflation and fluctuations in the economy.
- Growth - lessening the problem of scarcity by increasing production capabilities.

Economic problems

Macroeconomic problems fall roughly into three categories: -

- Production - this could be demand side (production suffers because people do not have income to buy goods) or supply side (production is constrained because producer has limited resources, suffer bottlenecks, over regulations and limited technology etc.)
- Unemployment - exists when resources, especially labour, are able to produce goods but are not employed because no one is buying products.
- Inflation - this is the general rise in the price level in the economy over time with the consequence that each unit of currency buys few goods and services. It also arises as demand increases more than supply. It gets worse when the source of demand is not money earned in production of goods and services but rather stocks of money created usually by central banks through printing.

Besides the above three, other macroeconomic problems include: -

- Government interference through excessive regulations.
- International competition which dumps goods at cheaper prices making local suppliers uncompetitive.

Gross Domestic Product (GDP) - it is a measure of economic activity in a country. It is defined as the total market value of all final products and services produced in a country over a year. GDP per capita is GDP divided by population and this metric is often used a measure of economic status among countries. Rich countries have higher GDP per capita while poor countries have low. Whenever economists talk about economic growth, they are basically alluding to the percentage change in real GDP over the period being covered.

Economic (Business) cycle

Analysts and economists spend time and effort trying to predict real GDP, which is affected by business cycles. Economy-wide fluctuations in economic activity are called business cycles.

Phases of economic cycle may include the following: -

- Expansion - production increases while both inflation and interest rates tend to rise.
- Peak- economic growth reaches a maximum level and begins to slow or contract.
- Contraction - economic growth slows.
- Trough- marks the end of the contraction phase and the beginning of recovery.
- Recovery - this is when the economy will start to grow again as business investment starts to increase and consumer spending grows.

The financial market

Financial markets provide systems where part of the national income from household which is not consumed is channelled (as savings) to the business sector as investment. Trading legal claims through financial markets diverts income from consumption to investment. Saving is a non-consumption use of income, like making a loan a supplying income to the financial markets in exchange for a legal claim.

The role of Government

Government plays a key role in the economy through its spending and taxes. Government expenditure is usually on national security and defence, roads, educational system, etc. Taxes are used to divert household sector income to the government to pay for national expenditures.

The Foreign sector

This refers to households, businesses and governments outside the domestic economy. This works through exports and imports. Exports are goods and services produced by the domestic economy and purchased by the foreign sector. Imports are goods and services produced by the foreign sector and are purchased by the domestic economy. For example, Zimbabwe exports (sells) beef to Europe and import (buys) fuel from the Middle East.

Net exports are exports minus imports and measure the balance of trade between Zimbabwe and another country. Net exports are a quick indicator of the health of the foreign sector. Governments always seek to encourage growth of exports and simultaneous decline in imports.

Current account is a record for the international trade in goods and services. A surplus on the current account means more goods and services have been exported than imported, and vice versa.

Balance of payments (BOP) is a record of a country's trade dealings with the rest of the World. BOP is especially important for emerging economies like Zimbabwe as their economic growth and inflation outlook often relies heavily on exports.

Stabilization policies

When faced with business code instability governments can use either fiscal or monetary policies or both to avoid or correct the problems. Fiscal policies involve the use of taxes and government spending. Monetary policy involves the use of interest rates and amount of money in circulation to influence economic performance.

Money supply

It is the total amount of money in circulation and this includes physical money (notes and coins) plus bank deposits and money market funds. Manipulating money supply is one of the most effective ways government can direct the economy.

Investment 101 Handbook: Chapter 3 - Financial Markets Essentials

Financial markets are very important in the modern world of capitalism as they provide marketplace where buyers and sellers participate in the trade of financial assets such as equities, bonds, currencies and derivatives among others.

Capital markets

Capital markets provide a platform for the trading of securities such as shares in companies, debentures, government stock, corporate bonds and municipal bonds and they also enable issuers of the securities to raise money or capital. The two main activities or functions of capital markets are:

- A marketplace where companies, municipalities, governments, etc., can issue shares, bonds or other securities to **raise capital**, i.e. the **primary market**.
- The subsequent trading, **buying and selling**, of these issued securities or other instruments in the **secondary market**.

There are four broad **types of instruments** that are issued and traded on the capital markets as follows:

1. **Equity** – ordinary shares, preference shares
2. **Debt-** Bonds, Debentures
3. **Hybrids -** Convertibles
4. **Derivatives -** Options, Future swaps

Ordinary shares are often referred to as common stock, equity shares or equities while preference shares are sometimes called preferred stock.
Shares and bonds are collectively described as **securities**.

Capital market participants

There are three main players operating in the capital markets:

1. Issuers
2. Investors
3. Intermediaries

Issuers

Types of issuers:

- **Governments and sovereign entities**: e.g. Zimbabwean Government.

- **Government agencies and parastatals (government corporations)**: e.g. National Railways of Zimbabwe (NRZ)
- **Supranational organisations**: e.g. World Bank
- **Banks**
- **Companies**.

Companies and banks will issue debt and equity securities, whereas governments, their agencies and supranationals will issue debt only.

Investors

The main types of investors are the following:

Institutional investors which include:

1. Pensions funds
2. Insurance companies
3. Fund managers
4. Banks
5. Companies
6. Individuals

Private investors

A private investor is an individual who holds shares solely for his own benefit.

Corporate investors

A corporate investor is a company that holds shares in another company solely for its own benefit.

Institutional investors

The term institutional investor usually refers to an organisation that invests money on behalf of others, for example, pension funds and insurance companies.

Collective investment schemes (CIS) – unit trusts

These are funds that **pool the contributions of many investors** and invests them in a portfolio of shares and other investments. The funds are set up and managed by a professional manager.

Pension schemes

A pension is an income payment paid to a person who has retired from work. A pension is either provided by the state, usually paid out of current taxes, or by a private pension scheme which is set up by a company to pay pensions to retired employees.

Insurance companies

Insurance companies receive premiums on policies that are invested prior to the payment of claims and the distribution of profits. Insurance companies are, therefore, major investors.

Intermediaries

Intermediaries may be divided into three main groups:

1. **New security issues experts:** Investment banks (lead managers) and corporate advisers who help bring together issuers and investors by arranging new issues of securities for companies and governments.
2. **Trading experts:** Brokers, who act as agents and arrange deals on behalf of clients. The broker charges the client a commission for arranging the deal.
3. **Clearance settlement and custody:** Clearing houses are organisations that arrange for the transfer of ownership of securities and the transfer of cash following a trade. Prominent ones are securities depository, custodians and transfer secretaries.

Stock markets

Increasingly more countries are establishing stocks exchanges in their countries to support growing business sector raise capital.

Options and the options market

An option is a contract that gives the holder the right, but not the obligation, to buy or sell a specific amount of a financial instrument at a pre-specified price on or before a specific date in the future.

Futures

A futures contract is an agreement to buy from or sell to a futures clearing house, a standard quantity and quality of a specific asset, commodity or notional asset, on a fixed date in the future at a price determined at the time the contract is entered into. Futures contracts are available on government bonds, stock exchange indices, short term interest rates, currencies and commodities, but not on individual equities.

Types of futures contracts

Futures contracts can be divided into four main groups:

1. **Currency future**
2. **Interest rate futures**
3. **Stock index futures**
4. **Commodity futures**

Commodities

Commodities are the raw materials used by industry and are classified under the following headings:

- base metals, e.g. copper, nickel and tin
- precious metals, e.g. gold, silver and platinum
- soft commodities, e.g. coffee, cocoa and sugar
- agricultural, e.g. beef, grain and wheat
- energy, e.g. oil and gas

Dealings in commodities may be either in the commodity itself, called the cash market, or in derivatives.

Forward contracts

Forwards are closely related to futures with the major difference between them being that while futures are standardised with respect to the size of the contract and the delivery date forwards are customised and do not involve a clearing house in settlement.

Swaps

A swap is a contractual agreement between two parties to make periodic interest payments to one another on the basis of an underlying asset/instrument or a notional principal amount.

Money markets

The money market is where the buying, selling, lending and borrowing of short-term funds occur. This market constitutes an aggregation of markets with various participants and no physical location.

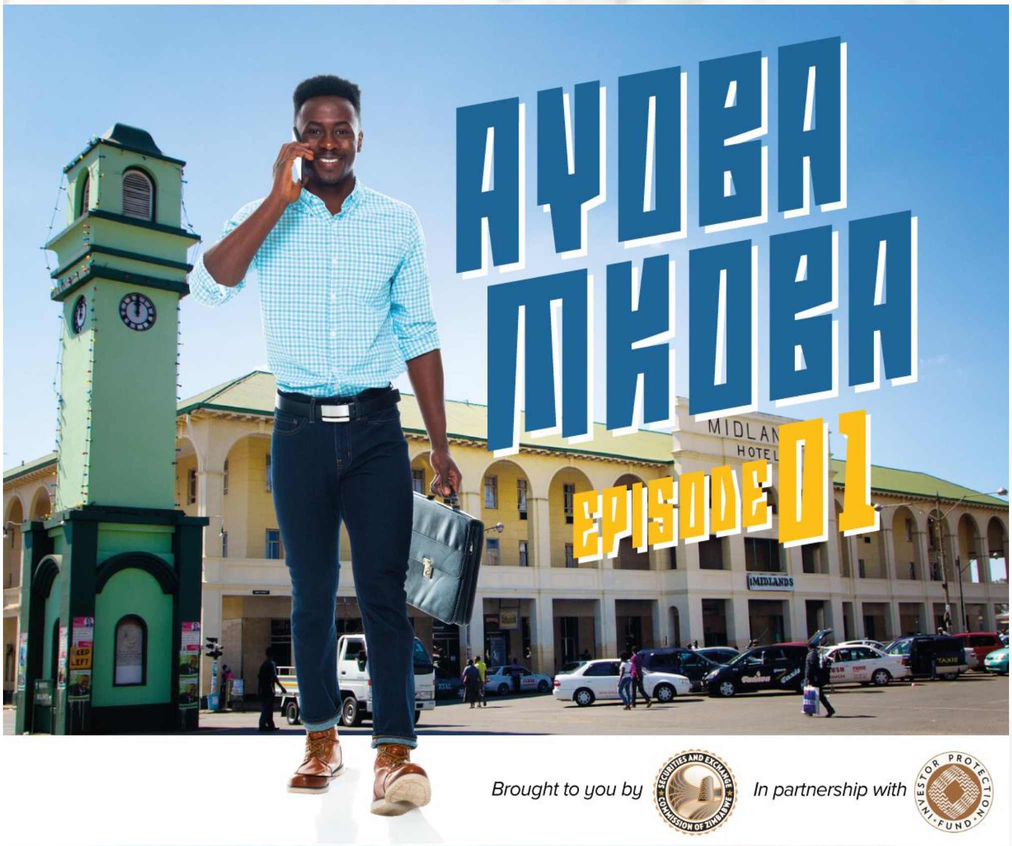
Deposit markets

Deposit markets are wholesale markets used by banks, corporate and financial institutions to borrow and lend money.

Treasury bills Treasury bills are negotiable, short-term securities (bonds are used for long-term borrowing), issued by governments (the US is the largest market) at a discount to its face value.

The foreign exchange market

The foreign exchange or forex market is not a physical market based in one building. It is an international network where players are connected by telephone, telex and computers and it is open 24 hours a day.



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Investment 101 Handbook: Chapter 4 - Regulation and Taxation

Regulation

Financial markets handle huge amounts of money on behalf of customers and to keep the players' behaviour in check and to maintain strong public confidence in the systems, regulation is always necessary.

The need for regulation

Regulation is necessary to ensure that markets operate in an orderly fashion and that investors are protected against fraudulent activities of unscrupulous operators. It is also needed to maintain a sound and stable financial system.

The regulation of investment activities is a responsibility of government and either a government department or a government agency will have overall responsibility. The Securities and Exchange Commission of Zimbabwe (SECZ) regulates the local Capital markets.

Any country wishing to develop a successful investment and financial services industry must ensure that investors, whether they are individual investors, corporate investors or institutional investors, have confidence in the financial systems.

Overview of Regulation in Zimbabwe

SECZ has the overall responsibility as the Apex regulator of capital markets.

As a capital market regulator, SECZ has a 5-fold duty to perform:

- **Regulatory Role -** To ensure that the market participants behave in an orderly manner.
- **Developmental Role** - To ensure the continuity of the securities market as a major source of finance for individuals, corporates and the Government.
- **Investor Protection Role** – To protect the interest of investors.
- **Educational Role -** to raise awareness on capital market operations to the Zimbabwe populace.
- **Advisory Role-** To Advise the Government of key policy issues for consideration in National Budgets.

The regulation of dealers and brokers

To protect the public from unscrupulous operators most countries have a regulatory system that requires companies and individuals who undertake investment business to be authorised or registered in some way. In Zimbabwe the Securities and Exchange Commission of Zimbabwe licenses market players in terms of the Securities & Exchange Act [Chapter 24:25], the Asset Management Act [Chapter 24:26] and the Collective Investment Schemes Act [Chapter 24:19]. This includes regulation of key personnel, stipulating capital adequacy, custody and settlement.

Central Securities Depositories (CSDs)

In Zimbabwe like some countries, securities are held in a central depository. The depository, Chengetedzai Depository Company, has custody of certificates and maintains records of the true underlying owners.

Insider trading

One of the areas which regulators focus on is flushing out inside trading from the market. Insider dealing occurs when a person dealing in a particular share has information about the company which is not publicly known and if it was publicly known would affect the share price. There are severe punishments for insider trading including suspensions from trading and even imprisonment of offenders.

Money laundering

Money laundering refers to a wide variety of practices by which the proceeds of criminal activities are placed into the financial system. The last few years have seen concerted international action against money laundering as it is believed that depriving organised crime of the facilities of the financial markets is a way of curbing their criminal activities.

Taxation

Taxes are the way in which most, but not all, governments raise the money to fund their expenditure. Because most people generally would prefer to pay less tax, or ideally no tax at all, there is a continual interest in tax planning. Tax planning is a method by which a taxpayer may organise his affairs so that his tax liability is minimised, subject to commercial and legal limitations.


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Investment 101 Handbook: Chapter 5 - The Equity Market

The Equity markets

Where does capital come from?

To carry on business and allow for growth a company needs resources and capital. There are two basic means of obtaining this capital:

- by issuing shares to investors.
- by borrowing.

Investors (shareholders) contribute capital in exchange for shares. Shares are evidence that the holder, whose capital is permanently employed in the company, is **part-owner** of the company and as such participates in the business risk, assets and potential profits of the company.

Investing in Shares

In most developed countries at some point in their lives, many people participate in the stock market either directly, such as by buying shares, or indirectly, perhaps by contributing to a retirement plan or by investing through a unit. Whether or not they participate in the stock market, most people tend to be aware of shares and stock markets because stock market information, such as stock market indices, is widely reported.

People choose to invest their money on the basis of the return they will receive. The return comes through capital gains (the increase in share price) and dividends (a portion of profit which is paid out to shareholders).

Ordinary share

Ordinary shares, **common stock**, equity shares or equities mean same thing. All companies have ordinary shares which represent ownership stakes in a listed company. With ordinary shares the holder has voting rights. Shares represent units of ownership in a company and constitute ultimate control of the company. The ordinary shareholders are the true owners of the company. They are entitled to the remainder of the income of the company after all expenses have been paid. A company's capital is divided into a number of equal shares which represent the interest of shareholders in a company. A shareholder's interest in the company is expressed through the number of shares he or she holds.

Shareholders' rights

Many investors who buy the shares of a company are oblivious of the rights that come with stock ownership. While specific rights depend on the type of security, the laws of the country where the company is incorporated and the by-laws and charter of the company itself, some shareholder rights are standard.

The detailed rights of a shareholder depend on many factors, but typical rights include:

- the right to **attend and vote** at meetings of shareholders.
- the right to receive the annual report and **financial accounts** of the company.
- the right to share in the **dividends** of the company:
- the right to **appoint and remove the directors** of the company - the directors manage the company on behalf of the shareholders.
- the right to **share in the assets** of the company if the company goes into liquidation
- the right to receive a **script issue** in proportion to existing holdings (more about this later).
- the right to **transfer ownership** of their shares.
- the right to **inspect** the corporate books and records and view the list
- the right to **sue** the corporation for wrongful acts.

Public companies

The company law of a country may distinguish between public companies and private companies. A public company can offer its shares to the public, but a private company cannot. However, only a public company can have its shares listed on a stock exchange.

Distributable profits (dividends)

A dividend is a payment to shareholders out of the profits of the company. To ensure that the assets of a company are not depleted at the expense of the creditors, the company law of the country concerned may restrict the type of profit that can be distributed to shareholders.

Preference shares

A preference share is one that gives the holder preference over ordinary shares in two respects:

- dividend payments
- payment in a liquidation

Scrip issues

In a scrip issue (also called a bonus issue) existing shareholders are given new shares in proportion to their existing shareholding. No payment is made for these new shares which are issued **fully paid up**. No additional capital is raised from the issue of new shares but the reason for making a scrip issue is usually to reduce the share price.

Rights offers (issues)

A **pre-emption right** is the right of existing shareholders to be offered a new issue of shares by a company in proportion to their existing holdings. The rationale behind a rights issue is to prevent a shareholder from reducing his stake or interest in the company after a transaction without being accorded an opportunity to participate as well. In contrast to a scrip issue, a rights offer raises extra capital for the company and it increases the net assets of the company. It will also have an effect on the share price.

Share buybacks

It is common for many exchanges, including the ZSE, to allow companies to repurchase their own stock on the open market, usually ordinary shares. Companies would want to buy back their issued shares for many reasons. Typically, these purchases are done with free cash flow, but not always.


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Investment 101 Handbook: Chapter 6 - Stock Exchange and Equity Trading

Issuing and trading shares

A stock exchange serves two purposes namely:

- As a **primary market** which provides a mechanism for companies and governments to raise money through new securities issues. Transactions such as new listings, rights issues and companies buying back their own shares fall within the ambit of the primary market.
- As a **secondary market** which provides a platform for investors to buy and sell existing securities. The secondary market affects the flow of money through the market. Market liquidity, share prices and market capitalisation are all affected by the buying and selling transactions in the secondary market.

New issues

New issues of shares can be divided into two categories:

- **Primary issues** - a primary issue is an issue of shares when a company is first admitted to an exchange. Such an issue is often described as an **Initial Public Offering (IPO).** An IP0 could be of new shares created by the company, or it could be existing shares being sold by the existing shareholders, or it could be a combination of the two.
- **Secondary issues -** a secondary issue is an issue of new shares by a company that is already listed; examples are rights issues and scrip issues.

Why float a company?

A company may be floated for one or more of the following reasons:

- To **raise finance** for the company
- To allow the existing owners to sell some or all of their shares thus **realising their investment** in the company.
- To **privatise** a company previously under State control

Issue methods

The methods of issue will vary from market to market but the common methods are the following:

- **A placement -** where the securities firm or investment bank handling the issue will sell the securities to their clients only (also called a private placement).

- **A syndicated issue -** the securities firm or investment bank handling the issue arranges a syndicate of banks, each member of which takes a part of the issue and sells the securities to their own clients.
- **A public issue** - the securities are offered to the general public.

Listing particulars or prospectus

A new issue of shares is made according to the law of the country concerned and usually the company will have to prepare and make public a document known as the listing particulars or prospectus.

The secondary market

The secondary markets of the many stock exchanges around the world fall under basically two types of market structures. These are known as:

- an order-driven market
- a quote-driven market

Participants in the secondary market include:

- brokers
- dealers (also called jobbers)
- market makers
- investors who buy and sell shares (usually via their brokers)

The order-driven market

In an order-driven market a buyer and a seller of shares each has a broker acting on their behalf. The role of the broker acting for the buyer is to find a matching counterparty, i.e. find a matching seller. This matching may either take place on the floor of an exchange, or via a computerised system, or both.

Quote-driven market

In quote-driven markets there are firms called **market makers**. The role of market makers is to buy and sell securities under all market conditions. They must always quote a price for buying and a price for selling during normal market hours and they make their profits through such dealing.

The role of the broker

Supposing you now have a working understanding of the securities business and are ready to invest some of your money, the person to talk to is a broker. To find one, you may get a recommendation from friends or associates or you may find advertisements in the financial section of your newspaper or check the websites of the Securities and Exchange Commission of Zimbabwe and the ZSE which lists all licensed brokers in the country.

Stock exchange indices

An index is a number that gives the value of something relative to some base value. Every stock exchange prepares one or more indices that are calculated from the prices of a certain number of shares. For example, the ZSE a number of indices the benchmark All Share Index encompassing all listed counters on the exchange and the Top 10 Index consisted of the ten biggest counters by market capitalisation reviewed every quarter. Indices provide a measurement of the **performance** of the market as a whole or of certain sectors of the market.

The Exchange operates three types of markets: the Main Market, the Secondary Market, and the Debt Market.

The Main Market and Secondary Market comprise the following boards, namely:

- **Equity Board** – for the trading of listed ordinary shares, preference shares and other securities. Trading unit is in multiples of 100 subject to a minimum of 100, except for ETFs where the trading unit will be one.
- **Odd Lot Board** – for the trading of listed ordinary shares, preference shares and other securities. Trading unit is one subject to a maximum of 99.
- **Special Terms Boards** – for undertaking specific types of trades, during business hours of the exchange as and when the need arises based on market requirements.

Transaction costs on the ZSE

Transaction costs are levied on buying and selling of securities on the ZSE. Fees are determined from time to time by the Ministry of Finance and Economic Development. The fees are charged based on the security type and currently stand as follows:

Equities	**Buying**	**Selling**
Brokers Commission	0.92%	0.92%
VAT (15% of brokerage)	0.138%	0.138%
CSD Levy	0.10%	0.10%
Stamp Duty	0.25%	Nil
ZSE Levy	0.10%	0.10%
SECZ Levy	0.16%	0.16%
Investor Protection Levy	0.025%	0.025%
Capital Gains tax	Nil	1%
Total	1.693%	2.443%
Round-trip costs		**4.136**

Automated Trading System (ATS)

ZSE recently migrated from the open outcry system to a computerised Automated Trading System (ATS). An ATS is a computer system designed to match buy and sell orders placed by an authorised trader.

Financial Securities Exchange (FINSEC)

FINSEC is an Alternative Trading Platform which provides an electronic platform for firms that may not qualify or want an alternative to the ZSE.

Central Securities Depository (CSD)

Securities trading on the two exchanges are kept at the CSD. A CSD is simply a computerized system that maintains an electronic register of securities such as shares, instead of paper-share certificates.


SECURITIES AND EXCHANGE COMMISSION OF ZIMBABWE
Supporting economic growth by regulating over 100 licensed entities and funds
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58 Unit Trust Funds
54 Investment Advisors
24 Asset Managers
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Investment 101 Handbook Summary: Chapter 7 - Financial Statements

There are basically two forms of analysis for stock market investing:

- fundamental analysis and
- technical analysis

Fundamental analysis is the detailed analysis of a company and the industry in which it operates. It examines the fundamentals of the company's financial condition and then tries to ascertain the value of the company. The valuation is based on the earnings and the forecast earnings of the company.

Technical analysis looks at trading and share price behaviour with investment decisions made on the basis of trends that predict future share price movements. Technical analysts claim that all fundamental information is accurately reflected in the share price chart of a particular stock. So instead of focusing on one, it is better to examine both technical and fundamental factors in deciding on their investment strategies.

Company financial reports

Listed companies are obliged to publish their financial reports in newspapers but surprisingly very few people pay particular attention to them. Off course, it requires a certain expertise to read and analyse the financial reports, and the financial analysts are professionals well trained to do that and advise the public accordingly.

Financial statements are the primary and only **direct source of information** on the profit or loss performance of a business, and on its financial condition and cash flow.
Financial statement users generally are interested in three main things about a business:

- Its **profit** (or loss) performances.
- Its financial condition, and particularly the solvency of the company, i.e. the ability of the business to pay its liabilities on time and to avoid getting into financial trouble.
- Its **ownership** (capitalisation) structure, i.e. the classes of securities issued by the company.

The **chairman's and chief executive's** messages are often overlooked as vital sources of information, but they may provide an analysis of problems, opportunities and a picture of management's intentions for the following year.

The auditor's report is a summary of the findings of an independent firm of accountants, which states whether or not the financial statements give a true and fair view as well as a fair representation of the company's results and its financial position.

Common financial statements published by listed companies are the statement of profit or loss and other comprehensive income (popularly known as the **income statement),** the statement of financial position (popularly known as the **balance sheet)** and statement of cash flows (popularly known as the **cash flow statement).**

Statement of Financial Position -balance sheet

The balance sheet shows the financial history of a firm at one point in time-normally the end of a company's fiscal quarter, six-month term or year. Its major components are assets, liabilities and owners' equity. The term balance sheet indicates an important characteristic – the balance sheet must balance. Asset values must equal the sum of liabilities and owners' interest (or equity):

Assets = Liabilities + Equity

The assets consist of the items owned by the firm and used to conduct business. The liabilities and equity represent the claims against the value of the assets. Liabilities are what the company owes to others, while the owners' (shareholders') interest or equity essentially is what is left over. Equity is the value of all your assets less all your debts, similar to your personal net worth.
The order of presentation is as follows:

Left side (top)	• Current assets • Property, plant and equipment (PPE)
Right side (bottom)	• Current liabilities • Long-term liabilities • Shareholders' funds (owners' equity)

Statement of Profit and Loss – income statement

The income statement reports on the most critical company figures, its earnings per share and profits. In the long run, a share's value is dependent upon its earnings potential. Investors closely monitor earnings announcements.

The goal of the income statement is to determine revenue for the period that it covers and then match the corresponding expenses to the revenue. The income statement, sometimes referred to as the statement of earnings or statement of operations, presents a picture of a company's profitability over the entire period of time covered. The **top line** is the total amount of proceeds or income from sales to customers, and is generally called **sales, revenue or turnover**. The **bottom line** is called **net income** (or net earnings). Net income is the **final profit** after all expenses have been deducted from sales revenue.

The income statement presented below has six basic income components:

- turnover or revenue
- gross income
- operating income (operating profit)
- income before taxes (pre-tax profit)
- income after taxes (after-tax profit)
- net income

The cash flow statement

Companies are required to provide a statement of cash flows alongside their income statement and balance sheet. The purpose of the cash flow statement is to disclose information about the events that affected cash flow during an accounting period. The statement looks at the changes in the levels of cash directly. The statement divides company uses and sources of cash into three mutually exclusive segments-operating activities, investing activities and financial activities.


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Investment 101 Handbook Summary: Chapter 8 - Financial Analysis using ratios

One common tool for analysing financial accounts is ratio analysis. This technique helps investors analyse the three main financial reports (income statement, balance sheet and cash flow statement) to assist them in the investment decision making process.

Investors typically spend considerable time analysing a firm's financial statements before investing in the company. For the most part, investors turn to key documents such as the income statement, balance sheet and statement of cash flows found in corporate annual reports. While everyone knows the quantitative aspects of a company, not everyone takes the time to understand its qualitative nature. Some of the factors including:

1. **Sales and key clients -** *Companies generate revenue by selling goods and services. Some companies sell a broad range of products to a large cross section of customers, while others depend on a few key customers. Each scenario has its pluses and minuses.*
2. **Order book (backlog) -** *Depending upon the industry, the order book (backlog) may be a key indicator of future sales. The order backlog indicates the amount of contracted sales that have not yet been delivered, providing a key clue to the potential sales.*
3. **Major products -** *a company that depends upon the success of a single product is riskier than one that has a number of varied products.*
4. **Foreign sales -** *represent a large proportion of revenue for many companies. During a domestic economic decline, foreign sales may help to stabilise revenue.*
5. **Bargaining power of suppliers -** *Before investing, it is helpful to understand the position of the company, such as its reliance on critical parts supplied by outsiders that may be subject to shortages or delays.*
6. **Government regulation -** *Some industries are subject to very strong government regulation that may have a large impact on earnings.*
7. **Research and development -** *Unless an adequate amount of money is being spent to develop new goods and services, a company is limiting its potential growth.*
8. **Legal proceedings** - *The monetary drain of legal costs comes quickly to mind but the hidden costs of distracting and redirecting management resources may be even more critical.*

Cooking the books

As we read the financial statement it is important to note that beyond choosing between alternative accounting methods, business managers may go two steps further in manipulating recorded profit. The first technique is called **massaging the numbers** or **income smoothing**. Business managers may control the timing of some expenses and sales revenue to some extent and therefore boost or dampen recorded profit for the year.

The second technique, informally called **cooking the books** goes beyond massaging the numbers or doing some profit smoothing. Cooking the books means, for example, that sales revenue is recorded when in fact no sales was made, or that actual expenses or losses during the period were not recorded.

Ratio analysis

Financial ratio analysis uses historical financial statements to quantify data that helps investors gauge a company's investment potential based on factors such as its competitive position, financial strength and profitability. A ratio expresses a mathematical relationship between two items.

Investor ratios

Long-term investors buy shares of a company with the expectation that the company will produce a growing future stream of earnings. Some of the common investor ratios are:

Earnings per share (EPS) - One of the most widely used ratios in share value and securities analysis is earnings per share (EPS).

Price-earnings ratio (PE) - The market price of the shares of a public company corporation is compared with its basic EPS. In a fairly valued environment, the PE should roughly equal a company's future EPS growth rate.

Price-earnings growth ratio (PEG) - PEG stands for price/earnings growth and is calculated by dividing the PE by the projected earnings growth rate.

Earnings yield - The reciprocal of the PE ratio is the E: P ratio, which is called the earnings yield or simply the yield.

Dividend yield - The dividend yield number refers to the percentage of the purchase price that the company will return to the investor in the form of dividends.

Dividend cover - Dividend cover is calculated by dividing earnings per share by dividend per share.

Price-sales ratio (PS) - The price-sales ratio expresses market price per share to sales per share, or commonly company market capitalisation divided by total revenue. This ratio is increasing in popularity because unlike earnings, sales are much harder to manipulate and thus can be trusted.

Price-to-book value ratio - Book value is a company's assets minus its liabilities or what would be left over for shareholders if the company was sold and its debt retired. It is also referred to as the net asset value (NAV) of a company.

Market capitalisation

Market capitalisation, or market value, is the number of shares a company has outstanding in the market, multiplied by the share price. For example, large-capitalisation stock: are the biggest players in the market.

Profitability measures

Profits point to the company's long-term growth and staying power. There are a number of interrelated ratios that help to measure the profitability of a firm.

Gross profit margin - This expresses gross profit as a percentage of turnover.

Operating profit margin - This ratio examines the relationship between sales and management-controllable costs before interest, taxes, and non-operational expenses. Operating profit margin is a ratio of operating profit to revenue.

Profit margin - Also called the return on sales ratio, this is the 'bottom line' margin frequently quoted for companies. It indicates how well management has been able to turn revenues into earnings available for shareholders.

Return on Equity (ROE) - Dividing annual net income by shareholders' equity gives the return on equity ratio (ROE).

Return on total assets - This ratio examines the return generated by the assets of the firm. A high return implies the assets are productive and well managed.

Business efficiency ratios

Asset management ratios examine how well the firm's assets are being used and managed, while profitability ratios, as those discussed above, summarise earnings performance relative to sales or investment.

Total asset turnover ratio - It measures how well the company's assets have generated sales and is calculated as proportion of net revenue to total assets.

Accounts receivable turnover ratio - This ratio measures the effectiveness of the firm's credit policies and helps to indicate the level of investment in receivables needed to maintain the firm's level of sales.

Liquidity or cash flow ratios

Liquidity ratios examine how easily the firm could meet its short-term obligations, while financial risk ratios examine a company's ability to meet all liability obligations and the impact of these liabilities on the balance sheet structure.

Current ratio - The current ratio compares the level of the most liquid assets (current assets) against that of the shortest maturity liabilities (current liabilities). A high current ratio indicates a high level of liquidity and less risk of financial trouble.

The quick ratio - The quick ratio or acid test ratio is similar to the current ratio, but it is a more conservative measure. Only cash, marketable securities investments (if any) and accounts receivable are counted as sources to pay the current liabilities of the business.

Financial risk ratios

Debt-to-equity ratio - The debt-to-equity ratio is an indicator of whether a company uses debt prudently, or perhaps has gone too far and is overburdened with debt that is likely to cause problems.

Interest coverage ratio - Times interest earned, or interest coverage ratio, is the traditional measure of a company's ability to meet its interest payments. This ratio indicates how well a company is able to generate earnings to pay interest.

Gearing or leverage - The debt-to-total capital ratio, or commonly referred to as gearing or leverage is the most popular. It expresses long term debt as a proportion of total capital. Total capital (also called permanent capital) refers to all sources of long-term financing long-term debt (such as debentures and loan stock) and shareholders' equity:


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Investment 101 Handbook Summary: Chapter 9 - Technical analysis

Technical analysis involves using trading and share price behaviour to make investment decisions on the basis of trends that (are perceived to) predict future share price movements. According to technical analysts all fundamental information is accurately reflected in the share price and trading volume chart of a particular share (or that of a commodity, stock index, currency, etc.) and therefore rather than try to find the intrinsic value of a company, it is best to determine trends of share price behaviour that act as signals to either sell or buy a particular stock.

Be that as it may, there is a connection between fundamental and technical factors. For instance, if a share has favourable upward potential (it has broken through a price resistance level or has become oversold), it could well reflect good fundamental factors such as higher earnings or the introduction of new products that could boost profits.

Charting basics

1. Bar charts

A bar chart displays a security's open, high, low and closing prices. Bar charts are the most popular type of share chart. A closing 'tick' is displayed on the right side of the bar to designate the last price at which the security traded.

2. Volume bar chart

Volume is usually displayed as a bar graph at the bottom of the chart. Relative adjusted volume bars make it easier to see trends in volume by ignoring the minimum daily volume.

3. Line charts

A line chart is the simplest type of chart. A simple line chart provides an uncluttered, easily understandable view of a security's price.

4. Candlestick charts

Japanese candle charts are the earliest known form of charting. Their use date back to the rice futures market of Japan in the 16005. Candle analyses use open, high, low and closing prices for analysis. If the closing price is below the open then the candle is coloured black (bearish), and if the close is above the open then the candle body is left clear or white (bullish).

5. Trends

A line depicting the overall course of the movement of a graph is called a trend line. In a general sense, the trend is simply the direction of the market, which way it is moving. Trends might tend to perpetuate themselves for either of two reasons. When investors see the price of a speculative favourite going higher and higher, they want to jump on the bandwagon and join the rise. The price rise itself helps fuel the enthusiasm in a self-fulfilling prophecy.

Trendline support and resistance

A support level is a price which a share does not easily penetrate on the downward side perhaps a previous low reached. A resistance level is the opposite: a price level on the upside which the share or index does not easily breach, perhaps a previous high. Support and resistance levels can be penetrated by a change in investor expectations (which results in shifts of the supply/demand lines). This type of change is often abrupt and is news based, i.e., negative or positive news or earnings report from a company, or a hike in interest rates with regard to an index.

Once a trend assumes a certain slope (or rate), as identified by the trendline, it will usually maintain the same slope. The trendline then helps not only to determine the extremities of the corrective phases but, maybe even more importantly, tells us when that trend is changing.

Support and resistance

Think of security prices as the result of a battle between a bull (the buyer) and a bear (the seller). The bulls push prices higher and the bears push prices lower. The price at which a trade takes place is the price at which a bull and bear agree to do business. It represents the consensus of their expectations. The bulls think prices will move higher and the bears think prices will move lower. The direction prices actually move reveals who is having the upper hand. A share's support level is where buyers feel that investing is worthwhile and sellers are not willing to sell for less. Similarly, a resistance level is the point at which sellers take control of prices and prevent them from rising further and buyers find levels too high to invest.

Head and shoulders

The Head-and-Shoulders reversal pattern is the most reliable and well-known chart pattern. The reason this reversal pattern is so common is due to the manner in which trends typically reverse from a bull to a bear market or vice versa.

Continuation patterns

Continuation patterns usually indicate that the sideways price action on the chart is nothing more than a pause in the prevailing trend, and that the next move will be in the same direction as the trend that preceded the formation.

Symmetric triangles

A triangle occurs as the range between peaks and trough narrows. Triangles typically occur as prices encounter a support or resistance level which constricts the prices. The symmetrical triangle (or the coil) is usually a continuation pattern. It represents a pause in the existing trend after which the original trend is resumed where the price fluctuates in an increasingly narrow range until it eventually breaks out in one or the other direction.

Moving averages

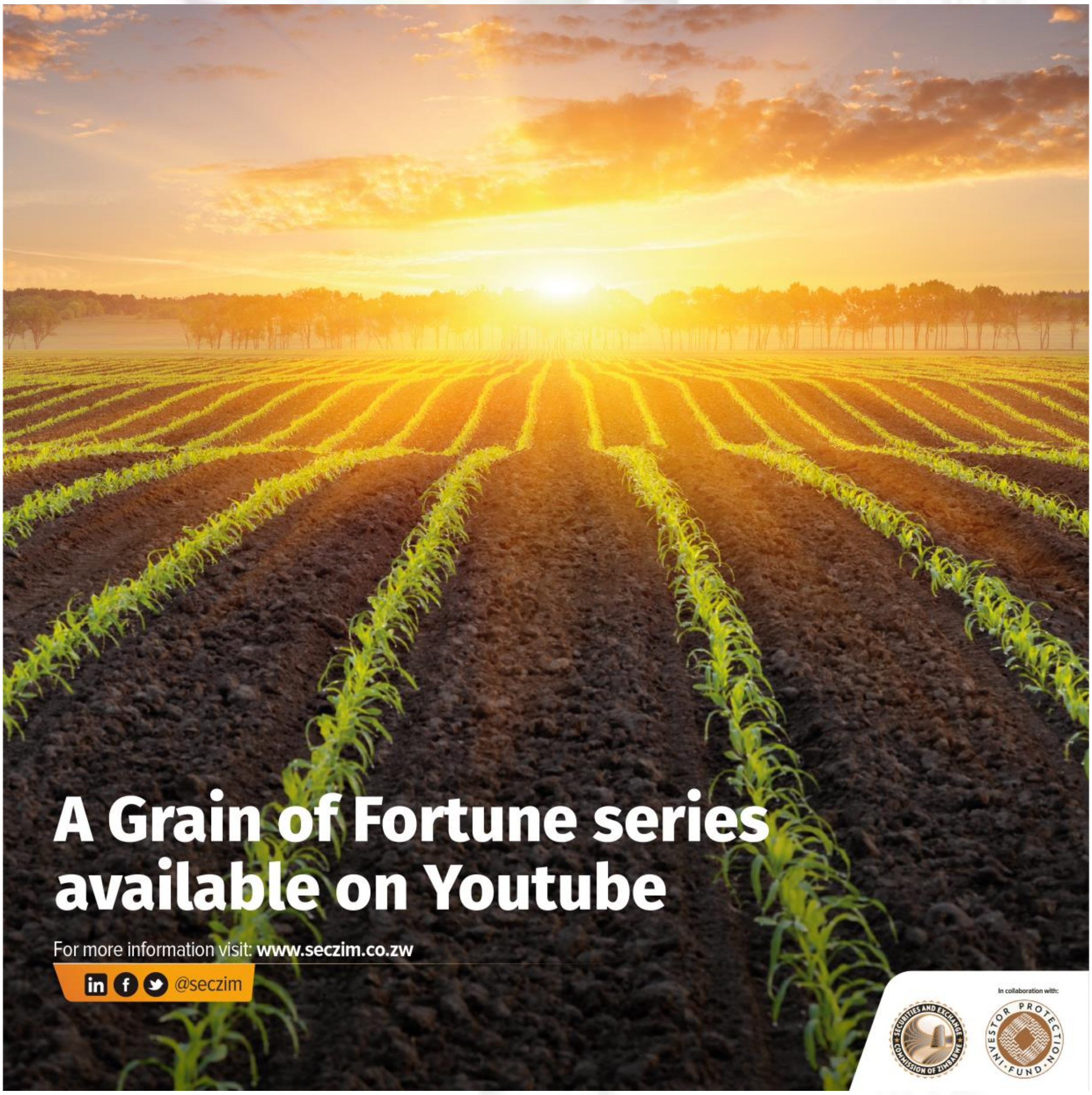
A moving average (MA) is an indicator that shows the average value of a security's price over a period of time. For example, a 40day moving average is the average of the closing prices for the last 40 days. In calculating the MA each day, the earliest day is dropped and the latest day is added to the 40 being averaged. There are five popular types of moving averages: simple (arithmetic), exponential, triangular, variable and weighted.

Relative strength index (RSI)

The relative strength index is also a type of oscillator and one of the most popular overbought/oversold indicators. RSI calculates the difference between closing prices over a chosen observation period. The RSI is basically an internal strength index which is adjusted on a daily basis by the amount by which the market actually fell or rose. A high RSI occurs when the market has been rallying sharply and a low RSI occurs when the market has been selling off sharply.

Conclusion

Clearly there is merit in using technical analysis for making decisions on when to buy or sell shares. As noted in the introduction of this chapter, if technical and fundamental analyses are used together the investor will introduce chances for making the successful investment decisions.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Investor 101 Handbook Summary: Chapter 10 - Fixed interest and bond markets

Fixed income securities are an important part of any financial markets. The history of the ZSE has shown us that the fixed income instruments such as government and municipal bonds were the dominant in the early stages of the exchange.

Borrowing and lending money

There are many ways in which money can be borrowed. Individuals can be given credit by banks or other financial organisations which would judiciously evaluate the borrower's capacity to repay the loan and any interest on it. Ability to repay loans depends on the customer's future earnings. Companies also borrow money, but for them the reason is most likely to be to fund a project which is planned to make profits.

How does a government borrow money?

Governments organise their borrowings through the issue of securities such bonds and treasury bills (TBs). Securities may be defined as **tradeable or negotiable** financial instruments. The loan is arranged in such a way that the original lender can transfer the benefits of the loan to someone else, i.e. trade the loan.

What is a bond?

A bond is a debt instrument which requires the issuer (borrower) to repay the lender (investor), the principal sum borrowed plus the interest at fixed rates of interest over a specified period of time. It is for this reason that bonds are often referred to as fixed-interest securities.

The principal (nominal value)

The **nominal value** of the bond is the **principal value**. i.e. the sum of money on which the interest percentage is calculated and the amount of the loan that will be repaid in the future. This is also referred to as the **redemption value**, **maturity value**, **par value** or **face value**. The repayment date or **maturity date** is specified at the time the government issues the bond. The **coupon rate** (the rate of interest payable as per the definition) is contractually set at the time the bonds are first issued and is paid through the life of the loan at predetermined intervals.

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The rate of interest (coupon rate)

Interest is the return for the use of money and the rate varies according to various factors. Governments decide what rate of interest they need to offer so as to attract potential lenders.

Accrued interest

Interest is earned on a daily basis, but paid only every six months or annually to cover the last six months' or year's payment. Bonds may be traded at any time, but as the interest is only paid periodically there is a potential mismatch of timings which could cause one person to gain an unfair advantage at someone else's expense. This problem is solved by making an adjustment to the bond price. The buyer of the bond should compensate the seller that portion of the next coupon that the seller has earned, but the buyer will receive. This compensation amount or adjustment is called **accrued interest** and depends on the number of days between the last coupon date and the settlement date of the purchase.

The universal terminology for this is:

- **clean prices** - prices before adjustment
- **accrued interest** - value of the interest adjustment
- **dirty prices** - prices after the accrued interest adjustment

Most countries quote a bond's clean price. The buyer, however, pays the seller the dirty price.

The pricing of bonds

Bonds are tradeable or negotiable financial instruments, i.e., they can be bought and sold during their life. As the bond carries rights to a fixed stream of income (the coupon) throughout the life of the bond and repayment of the nominal value at the scheduled redemption date, investors must determine what these are worth. Two important factors affect the price:

- time left to maturity
- anticipated market interest rates

Interest rates and bond prices

It is an axiom of the bond market that interest rates and bonds prices move in opposite directions.

Income yield

The income yield is the monetary return provided by the coupon as a proportion of its current price. Investors need to measure the total return on owning a bond, which will be a combination of the annual income and the profit or loss made if the bond is held to redemption. This is measured by the yield to maturity.

Yield curves

It is usual to plot the different yields available on bonds with different remaining lives to maturity, the resultant line on the graph being described as a yield curve.

Issue of government bonds

Securities are said to be issued when they are first created and sold to new investors who could be individuals and institutions, e.g., insurance companies or pension funds, who may be domestic or foreign. It is only at the time of original issue that money is raised for the issuer. Subsequent trading in the bonds raises no money at all for the issuer. As is the case with equities, two markets exist:

Bond primary market

As a rule, major financial institutions with large distribution networks and consequently large purchasing power are the major players in the primary market.

Bond secondary market

In the secondary markets investors buy and sell bonds according to changes in their specific circumstances and perceptions of the market. The more liquid the secondary market, the more willing investors are to invest in a particular bond as such liquidity will ensure pricing efficiency.

Government securities as a benchmark

Government bonds act as the reference points by which all non-treasury bonds and derivative instruments may be valued. Treasuries being the safest investment, they are also said to represent the **risk-free rate**. Non-treasury bonds will have a higher risk profile and will bear a higher coupon to attract investors.

Eurobond market

A Eurobond issue are bonds targeted for sale to investors outside the issuer's country of domicile e.g., a Swiss franc denominated issue by a Swiss or non-Swiss issuer sold to Japanese investors outside the jurisdiction of any one government.

Investment risks of fixed-income securities are:

Market or interest rate risk

Due to the inverse relationship between the price and the yield of a bond, a capital loss will be realised if a bond is sold when interest rates have increased. This risk of loss is referred to as market or interest rate risk.

Timing (call) risk

Bonds may sometimes contain a provision that allows the issuer to call all or part of a particular issue before the maturity date. The issuer would normally refinance the bond issue if market rates decline to below the coupon rate of the current issue.

Reinvestment risk

The cash flows from a bond are normally reinvested. The variability of reinvestment returns due to a change in market interest rates is called reinvestment risk.

Other risks of fixed income securities are credit (default) and liquidity.


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Investment 101 Handbook Summary: Chapter 11 - The Derivatives market

Introduction to derivatives market

Too many people believe futures and options are complex, dangerous instruments that are used by people within the financial services industry to make or lose vast sums of money, and that they are the preserve of wild speculators and risky investment vehicles like hedge funds. These views were reinforced by various losses ranging from Orange County in America through to the spectacular collapse of Barings Bank in the United Kingdom and the vast losses at hedge fund Long Term Capital Management in the summer of 1998 which at one time threatened to destabilise the entire world economy.

Whilst it is true that the abuse of these instruments and the use of excessive gearing and risky strategies may cause significant losses, the derivative market has become a vital part of the global financial system and is of significant assistance to businesses in allowing them to plan and operate efficiently and reduce risk.

A general definition of derivatives is that they are financial instruments derived from securities or physical markets.

Forward contracts and futures

A forward may be defined as follows:

An agreement between two parties to exchange a specified quantity of a specified item at a specified price on a predetermined future date.

It is an entirely private arrangement tailor-made and flexible to suit the purposes of the two parties involved. Tailor-made products that do not follow certain standards or are not subject to the regulations of for instance an exchange fall under the generic title of **Over the Counter** or OTC instruments.

Features of a futures contract

A futures contract may be defined as follows:

- A contract agreement between two parties to exchange a standard quantity and quality of a fixed asset at a predetermined date and place at a price agreed today.

Contract obligation

Futures are traded on an exchange that specifies the standard terms for which prices may be negotiated. The price is fixed at the time of buying and selling and may change frequently in the market. As a legally binding agreement, a futures contract imposes specific obligations on both parties.

Futures market participants

Many different types of market practitioners use futures buyers and sellers of futures will either be hedgers, speculators or arbitrageurs.

- **Hedgers.** A person who seeks to reduce risk by protecting an existing position or known commitment. Hedgers have a real interest in the underlying asset and are by far the most important component of the futures market.
- **Speculators**. Unlike hedgers, speculators try to profit by taking a position in the futures market and hoping the price moves their way. Speculators have no desire to actually own the physical commodity; they use the futures markets for capital gain only.
- **Arbitrageurs**. Arbitrage represents the simultaneous purchase and sale of the same asset in different markets in order to take advantage of price differences in the two markets. The arbitrageur tries to profit from these differences without incurring risk.

Options

An option provides the buyer with the right but not the obligation to buy or sell a specified financial asset at a specified price on or before a specific date sometime in the future. An option holder, therefore, only exercises the option, i.e., takes up the rights of the option if and when it is profitable to do so. The person selling the option is being paid for accepting the risk that he may be required to fulfil the obligation.

Exchange-traded contracts and liquidity

Liquidity is the ability to buy or sell an item when you want to, at an open-market price. A trader should ensure that the market he trades offer sufficient liquidity so that any position may be quickly closed or opened. A trader might have a sound risk policy in place, but might not be able to close a position because there is no other participant in the market to take the other side of his trade.

OTC vs Exchange-traded products

The advantages, liquidity in particular, of trading derivatives on an exchange are clear from the above, but the standardisation of products is also limiting investors to what is available. Over the Counter (OTC) is the generic name for any product that is arranged outside the auspices of an exchange.

Margin

Margin is a crucial feature of the derivatives market and is collateral that must be supplied in a futures or options contract to ensure that the parties involved have adequate funds to meet their commitments.

Gearing

As only a small fraction of the value of the contract is supplied as margin, the proportionate effect on the money invested is much larger.
Who should provide margin depends on the type of derivative instrument investment:

- **Futures**. Both the buyer and seller. This is necessary because the price may move against both parties.
- **Options**. It depends on the system used.
- **Equity and index options**: The premium is paid on the day following the option trade and the buyer has no further potential responsibility. This is known as premium upfront. Sellers have an open-ended risk and therefore only they supply margin.

- **Options on futures**: All other options are settled through the margining system. Buyers do not pay the premium at the time of the contract but supply margin which is eroded over the life of the option (assuming no change in prices). See below.

There are two types of margin: initial margin and maintenance (or variation) margin.

Initial margin

The clearing house, in conjunction with each exchange, calculates an initial margin for every contract traded on it, which is a set figure per contract. The amount attempts to cover one day's price movement and therefore varies substantially according to the contract and its volatility.

Variation margin

This is the adjustment to margin requirements calculated daily on the basis of the movement in prices. Variation margins must remain in the account as long as the position is open.

Marking to market

The variation margin is calculated on a mark to market basis. This means that at the end of each day's trading all open contracts are registered, or revalued anew, at the day's closing price.


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Investor Protection... What is that?
What type of investment leads to financial independence?
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The Investor Protection Fund (IPF) and the Securities and Exchange Commission of Zimbabwe (SECZ) have collaborated in an investor education initiative to equip Zimbabweans with knowledge on Capital Markets. The Investment 101 Handbook is a recommended starting point for all Zimbabweans considering their first step into investing in the Zimbabwe Capital Markets. The Investor 101 Handbook, is now available in ChiShona and IsiNdebele. The aim is to promote Investor confidence in order to stimulate participation in Capital Markets, as this contributes to the development of our economy.
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Investment 101 Handbook Summary: Chapter 12 - Portfolio and Investment Management

Introduction

People invest for different reasons including to produce income, realise capital growth and combine income and growth. Competent investment management is critical to achieving returns and helping investors meet their financial goals.

Investment objectives

There are many different reasons for investing but the dominant one tends to be to make a profit. This can be done through conservative and safe investment or risky speculation depending on the investor's risk tolerance and return objectives.

Income: is the regular cash inflow needed in order to meet expenses. Income is usually in the form of dividends or interest, but liquidating capital would serve the same purpose.

Capital growth: may be achieved through growth in share price from the price at which the investor bought the share or in the case of fixed income securities growth comes through the compounding of interest (interest on interest).

Return objective: Return is simply the reward that someone gets above the invested capital and tends to be divided into required and desired components. Required return is what is needed to meet high priority or critical goals like meeting living expenses in future, children's education, health care etc.

Risk

Sometimes things do not work out the way we anticipated and an investment fails to achieve its expected return, making losses instead. This is called investment risk - the probability or likelihood of occurrence of losses relative to the expected return on any particular investment.

Risk-return trade-off

The two principles governing the return on investment are:

- The greater the risk the greater the return expected by investors.
- The longer money is tied up the greater the return expected by investors.

Investment risk

Ability to handle risk (i.e., the volatility of investment returns) is closely related to individual circumstances, including your age, time horizon, liquidity needs, portfolio size, income, investment knowledge and attitude toward price fluctuations. The main risks are the following:

Market risk - Market risk is simply when the share price of an individual stock falls as a result of an overall fall in the stock market.

Investment specific risk - This is when a share price falls as a result of some event or circumstance specific to that company, such as a management problem, the losing of a patent, fraud, etc.

Interest rate risk - A bond or other fixed-interest security drops in value as a result of an increase in interest rates, or the income from a variable rate bank deposit decreases as a result of a fall in interest rates.

Other investment risk relates to default, inflation, currency, asset-class and liquidity.

Portfolio diversification
By investing in a number of different, uncorrelated securities, overall risk can be reduced. However, diversification cannot remove all risk.

To sum up, it is possible to view risk in terms of two main types:

- diversifiable risk, or investment-specific risk
- undiversifiable risk, which we can call market risk

Therefore:

Total Risk = Diversifiable Risk + Undiversifiable Risk
Total Risk = Investment - Specific Risk + Market Risk

Risk management

Two techniques for managing investment risk are:

- diversification
- hedging

Portfolio planning

A portfolio is constructed with either of the following objective:

- achieve a particular level of income and capital growth at the lowest risk, or
- the highest level of income and capital growth for a given level of risk.

Factors to consider when designing a portfolio are:

Liquidity needs - means having cash for emergencies, or any short-term liabilities that have to be repaid.
Tax status – consideration should be made to one's marginal income tax rate and expectations of a change of tax rate taking into account government policy and other economic factors.
Time horizon – affects ability to bear risk. An investor's time horizon is the expected remaining years of life or the total number of years the portfolio will be managed to meet the investor's objectives and constraints.

Risk tolerance

The risk tolerance of the investor will have a considerable impact on investment strategy.

Investment strategy

Portfolio management strategies may be classified under two titles:

- Active management - using analysis to achieve above average returns.
- Passive management - Passive management does not require active intervention, but will be self-maintaining. Passive management does not attempt to out-perform the market but simply tracks it.

Asset allocation (AA)

Asset allocation means deciding what proportions of the portfolio will be held in broad asset classes, for instance committing 60% to equities, 35% bonds, and 5% cash and money market instruments.

Sector selection

After deciding on the spread of assets to be included in the portfolio, the next stage (before drilling down to select individual equities) is sector selection.

Stock selection

After sector selection the final phase of the portfolio design is for the portfolio to select individual stocks on the basis of results of investment analysis.

Portfolio diversification and rebalancing

Potential returns should compensate an investor for risk taking but there are some risks that will not be compensated for, and therefore they should be avoided.

Investment strategies: Value vs. Growth

Value and growth investment styles or strategies make use of fundamental analysis to decide on shares for inclusion in a portfolio. Investors who use fundamental analysis usually focus on two separate approaches to picking stocks: growth or value or a combination of both.

Growth stocks - Investors who focus on growth try to predict which companies will grow faster in the future faster than the rest of the stocks in the market, or faster than other stocks in the same industry.

Value stocks – Value investing is finding companies that have been overlooked by other investors and that may have intrinsic value not perceived by the majority of investors.

Trading

Once you have decided on your investment objectives and risk profile, planned your investment strategy and picked the equities and other instruments that you want to include in your portfolio, it is time to find a broker either traditional or online. The Securities and Exchange Commission of Zimbabwe has a list of all registered stock broking firms and it is a good place to commence the broker search.

Portfolio tracking

Once the portfolio is in place it is important for an investor to track and monitor. Internet is a good source for information and so do broker provided data which can be used to mark the investments to market regularly.

Benchmarking

Comparing a share or mutual fund managed portfolio to an appropriate benchmark may provide insight into its performance. Generally, securities indices and market averages are the most widely used benchmarks, for instance the ZSE All Share index, FTSE-100, the Dow Jones Industrial average, etc.

Conclusion

Investing in securities and other financial instruments offer rewarding and exciting means to take control of your own finances. There are a myriad of ways and places to invest and the goals investors set themselves vary greatly, but the intervening goal is still to make money.

This book summary is brought to you as part of the Securities and Exchange Commission of Zimbabwe's Investor Education Campaign in partnership with the Investor Protection Fund (IPF). For more information contact: seczim@seczim.co.zw