

## **Why Should I Invest In Equities?**

The simple answer is ... to achieve returns in excess of inflation over a period of ten or more years. But if you would like to know a bit more.....

### **What is an Equity Share?**

An equity share is a right to (a share in) the profits of a large company. If you want to share in the company's profits, you have to buy an equity share. The prices of equity shares are widely available, for example they are quoted in daily newspapers.

### **How do I make a Profit?**

Every year, when the company draws up its accounts, the company profit for the year will become apparent. The directors of the company will decide how much of the profit to plough back into the company, and how much to distribute to the owners of the equity - i.e. the shareholders. The profit is then distributed as an amount per share - called a dividend. Companies like to increase their dividend year on year.

As well as the profit from the dividends, equity share owners will also benefit if the share price rises. This means that the shareholders can sell their equity shares at a higher price than they were bought originally.

So the investment return from equity shares comes from two sources :- the dividends paid from the profits of the company, and the rise in the equity share price. This return, combining these two sources of profit, has comfortably exceeded the rate of inflation in the past.

### **Why does the Equity Investment Return Exceed the Rate of Inflation?**

Companies make profits because they provide something that someone wants to buy, either a product or a service. The purpose of a company is to make bigger and bigger profits every year for its equity shareholders. To do this, the company charges for its products/services. This charge has to at least cover all the costs in providing the product (e.g. raw materials, people, advertising, distribution) and also make a profit.

The costs in providing a product or service will increase with inflation year on year. The company has to make a profit, so it naturally increases its charges. So, in a good business, the profits will at the very least keep in line with inflation.

But that is not all. Companies want to make even bigger profits than they did last year, so they will look for ways of selling more of their product or service, or introduce efficiencies, or new products, or take advantage of new technologies etc., etc... Such initiatives should, in the long run, and in a well managed company, increase profits still further.

Companies are well aware that investors could just keep their money in the bank, and watch it grow, practically risk free. The Directors therefore have to ensure that the return they provide to the equity shareholders is commensurate with the higher level of risk that their investors face - so they aim to achieve a return in excess of that which would otherwise be available from a bank account.

## **Why Does the Share Price Rise?**

The price of equity shares is determined by supply and demand in the market. When a company's profits are expected to be particularly high, the equity share price normally rises - more people want to share in those profits. In a similar way, when one company makes a bid for another, the share price of the company being taken over generally rises, because the demand for the equity shares has risen (the market knows that the company doing the taking over has to buy out the existing holders of the equity shares).

## **Where Does Professional Investment Management Add Value?**

Most investors do not have the time to constantly study individual companies and analyse their earnings potential across all market sectors. Instead, they delegate investment management to professional investment managers. These managers specialise in one sector or country. They analyse companies both individually and by comparing with other similar companies (for example, companies which make the same product or are in the same part of the World).

From this careful analysis, the managers will aim to spot those companies with good prospects before other investment managers. They then buy the equity shares whilst they are still cheap. In exactly the same way, the investment managers can sell those equity shares in companies where the profits have now peaked.

Rather than invest in just one or two companies, the professional investment manager will have a fund of sufficient size to allow investment in a large number of top rated companies. This diversification means that the fund returns will be protected to a degree if the equity shares of a particular company were to fall rapidly in value.

Finally, because the professional investment manager is investing on behalf of a large group of investors, he or she can deal in bulk, thus reducing the administration costs borne by the individual client.

## **So what does all this mean to the investor?**

*Returns on equity shares will generally...  
outstrip inflation, and...  
...outstrip returns on bank deposits...  
over the medium to long term*

*Professional Investment Managers will...  
...add value by careful study and analysis of specific market segments...  
...expose investors to shares in many companies, not just a few...  
... mean reduced administration costs to clients.*

**Equities....Today's home for tomorrow's money**