Column/Banking

Personal finances: Investing in financial assets

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A few days ago, I was invited to share insights on personal finance to the members of staff of a public institution. These are some of my talking points. Apart from emphasized the necessity of Personal Financial Planning as an important activity in the process of earning, spending, saving and investment. I also shared the investable space for those with savings, among others, this include investing in financial assets:

What are 'financial assets?' Financial assets are non-physical asset whose value is derived from a contractual claim; these are financial instruments such as cash, savings in banks, term/fixed deposits, Units in a Unit Trust/Mutual Fund, tradable bonds, and tradable shares. Financial assets are more liquid (i.e., can easily be converted into cash) than other tangible assets, i.e., precious metals/jewellery, cattle, commodities or property.

Why invest in financial assets? Because, among other things: (i) financial assets can be easily and quickly be converted into cash at the time of need, without losing value; (ii) they provide regular stream of income – i.e., if invested in selected liquid shares, Treasury bonds, Fixed deposits, distributable and redeemable unit in Unit trust schemes; (iii) create a consistent cash flow to investors by paying steady returns to investors, and liquidity in times of need; (iv) financial assets such as equity helps to preserve and build wealth as the asset invested multiply over time through the magic of compound interest; (v) it requires little capital to invest in financial assets relatively to physical assets; (vi) financial assets provide for diversification opportunity and risk management - "don't put all your eggs in one basket"; (vii) financial assets are more transparent, overseen by regulating bodies, with rules and regulations guarantee smooth execution and transparency in operations; and (viii) in terms of their valuation, the up-to-date value of financial assets can also be checked and tracked on the daily basis from the stock market data and reports.

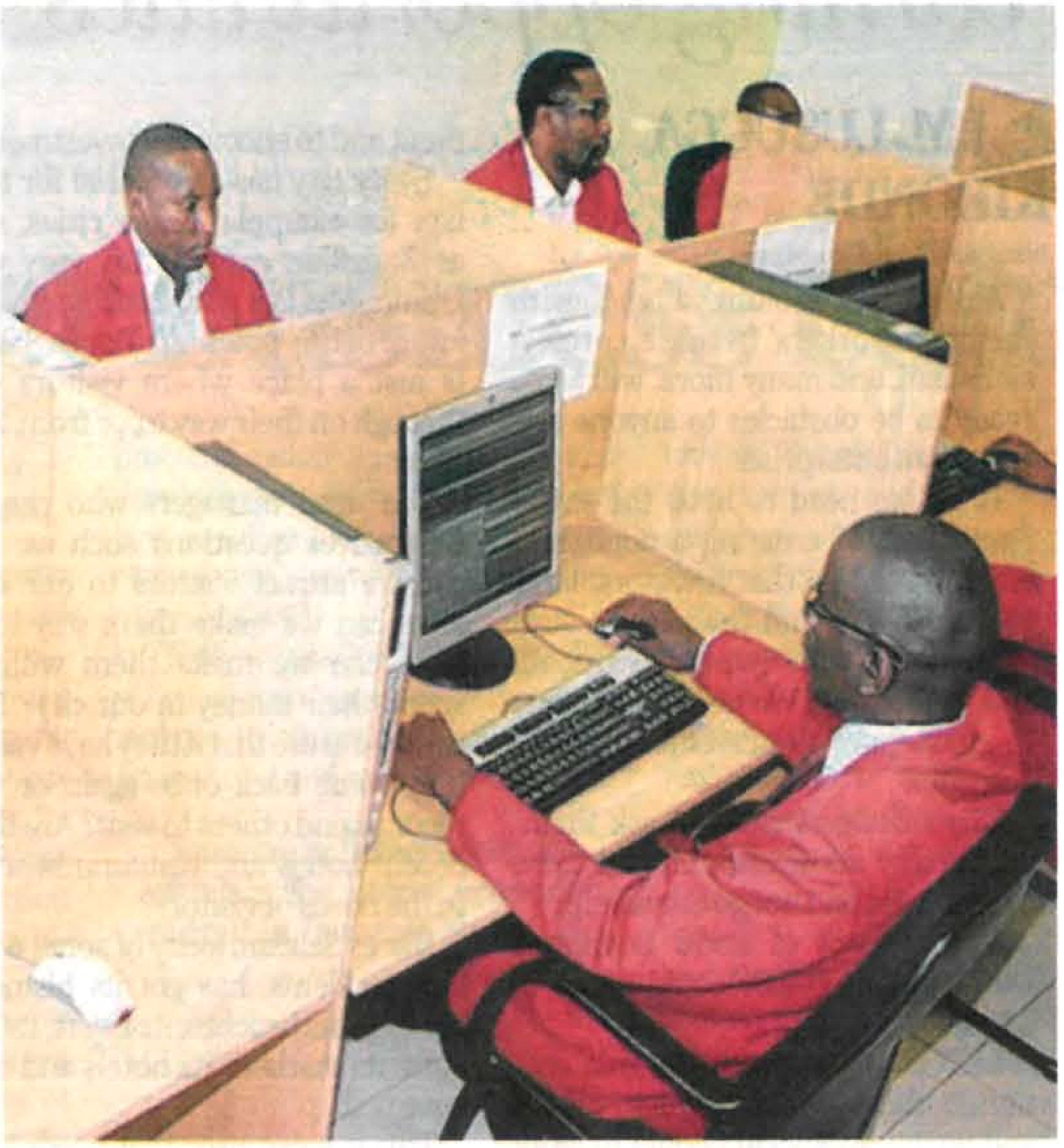
What are shares? Shares are units that represent equity ownership in a company.

They are financial assets owned by investors who exchange capital injection in a company in return for a portion of share-holding to the company.

Shareholders enjoys ownership rights, including participation in the distribution of residual profits in the form of dividends; they also enjoy capital gains if the price and value of the company rises.

Once shares have been issues via IPO, they are then listed in the stock exchange for trading by investors and traders.

What are some of the strategies for investing in shares? In investing in shares, focus on: (a) minimizing the odds of suffering irreversible losses; (b) maximizing chances of achieving sustainable gains; (c) controlling self-defeating behaviours that keeps investors from reaching their full potentials; and (iv) do not lose money.



DSE officials at work during a past trading session. PHOTO|FILE

> IN CHOOSING A FUND, INVESTIGATE THE FUND'S CONSISTENT PERFORMANCE

How? (i) by being value-investors, not by speculating; (ii) by carrying thorough analysis of the company, and the soundness of its underlying business, before buying its shares; and (iii) by avoid investing in companies that do not have competent leaders and managers.

When carrying analysis prior to investing in shares, Benjamin Graham – known as the "father of value investing" (in his seminal book *'The Intelligent Investor'*) recommend that you consider the following: the company should have a simple, easy to understand business; it should have some form of durable monopoly; It should be selling universal habit-forming products; Its products should be easy to make and cheap to sale; and it should commend significant profits margins while products raise its prices with inflation. In my opinion companies operating in the Fast-Moving Consumer Goods (FMCGs), Health-care, Banking, Construction, Utilities, Technology are some of the best to consider.

Another financial asset worth considering is bonds. What is a Bond? A bond is a type of fixed-income security issued by either the central government, local government, government agencies or private companies in exchange for funds lent to them.

A bondholder is the lender, and the bonds instrument states how much money is owed, interest rate, payments, bond's maturity date, etc. There are various types of bonds – depends on the issuing entity or the use of the proceeds from the bond issuance. Bond instrument contains a contractual claim.

What are some of the key consideration on investing in bonds?

Ask yourself some of these questions: (1) should you buy taxable or tax-free bonds? (corporate vs. Treasury bonds); (2) should you buy shorter-or-longer term maturities? (secondary market liquidity, pricing); (3) what yield and benchmarks to use? (active *vs.* passive investment approach; (4) do you want to assure yourself against decline in prices of bonds? (staggered investment, and different maturities); (5) coupon [(2 Years: 7.82 percent, 5 Years: 9.18 percent, 7 Years: 10.08 percent, 10 Years: 11.44 percent, 15 Years: 13.50 percent, 20 Years: 15.49 percent)] *vs.* Yields?; and (6) should you invest in bonds or bond fund? (Sh1 million *vs.* Sh50,000 for monthly reinvestment).

Diversification: how much risk should one take?

Can one diversify risks by Investing via investing in collective investment schemes using investment managers?

Yes. One of the investment approaches for risk diversification is via putting money into a fund/investment manager by buying units.

These units, if invested in an "open-end fund", are redeemable on demand by the holder, at net asset value. The Unit Trust of Tanzania (UTT) operates several fund schemes.

In choosing Funds, investigate a given Fund's consistent performance (beware of erratic behaviours). Avoid choosing a Fund whose returns are less than the market average and chose a Fund whose overhead expenses are not excessive.

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