M&G Investments

The M&G guide to

Equities

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Please refer to the glossary found on page 11 for an explanation of the words highlighted in **bold** throughout this guide.

What are equities?

Equities in a nutshell

When you buy **equities**, you become part-owner of the company and have a share in its profits. As you buy more equities, your share in the ownership of the company becomes greater. You may also have certain voting rights if you buy the shares directly; however, generally, you'll have very little say in how the company is run. Usually, if you own shares with voting rights you'll be entitled to one vote per share to elect the board of directors at annual general meetings.

- An equity is a share in a company
- Buying shares makes you part-owner of the company
- Because you're part-owner, the value of your investment will rise or fall with the company's successes or failures

How do they work?

A company will sell shares to raise money for the business – to expand, to invest in new ventures, or sometimes to pay off its debts. A company may choose to **issue** and trade shares through the following ways:

Primary market

When a company sells its shares to investors for the first time on a stock exchange, such as the London Stock Exchange. This is called an **Initial Public Offering (IPO)**. IPOs may be available to all investors or may be restricted to institutions only, such as pension funds, insurance companies and investment funds.

Secondary market

Once shares are issued through an initial public offering, they can then be sold and subsequently bought by other investors on the secondary market of the stock exchange. That is to say, secondary markets enable the buying and selling of previously owned shares.

How you could make money from equities

Capital growth

Share prices rise and fall depending on supply and demand. Interpretation of company news, economic data and information regarding the industry or competitor companies will all affect the number of buyers and sellers of a share at any point in time. Share prices change constantly and participants in the market will make different assessments of the value of the company.

When a company is successful, the price of each share is expected to rise. When it's less successful, the share price is expected to fall. If you sell shares at a higher price than you bought them, you should make a profit from them. However, if you sell shares at a lower price than you bought them, you will make a loss from them.

- Share prices rise and fall depending on supply and demand
- You can make money from shares if you sell them at a higher price than you paid for them
- Dividends are another way of making money from shares – this is a percentage of profits from the company distributed to its shareholders

Income from dividends

You don't have to sell your shares to make money from them. As a shareholder, you are part-owner of the company you invest in.

Sometimes companies choose to give shareholders a percentage of their profits at intervals. If the company you invest in does this, you can earn an income through **dividends**. Dividends are a percentage of profits paid out by the company on a regular basis (usually quarterly) directly to its shareholders.

When you're thinking about investing in equities, you should find out if the company or companies you're considering pay out dividends and if so, how they're paid.

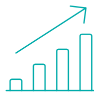
If you've invested in equities through a fund (where investors pool their money and a fund manager invests on their behalf), the dividends are paid to the fund. The fund may pass the dividends to its investors in the form of **distributions**. Before investing, you may wish to find out whether a fund makes distribution payments, and if so, how frequently. More on investing through funds later.

As a shareholder, you're part-owner of the company you invest in.

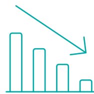
Understanding how equities increase or decrease in value

How supply and demand affect equities

If a lot of investors would like to buy shares in a company, but not many existing shareholders want to sell, this is likely to push the share price up.



The opposite is also true – if more people want to sell shares than want to buy them, the price is likely to go down.



How a company's performance affects equities

A company will issue statements about its expected earnings and profitability in the coming months and years, and investors use this information to decide whether or not to buy or sell shares. This affects supply and demand, which ultimately determines the share price.

How market trends and outside factors can affect equities

If reports from research analysts predict a company is likely to do well, this may increase demand for its shares and push up the share price. On the other hand, if the reports say a company will likely perform less well in the future, the share price may fall.

Outside factors, such as how a competitor company is performing or acquisitions and mergers, can also influence share prices either positively or negatively.

- Supply and demand have a big influence on the value of an equity
- If more people want to buy shares in a company, the price is likely to rise – if more people want to sell, the price is likely to fall
- Speculation about a company's stability and future growth can also affect the share price

Equities compared with other types of investments

Differences between equities and bonds

Choosing between equities and **bonds** depends on the level of risk you're willing to take and whether you want a regular income or you want your initial investment to grow.

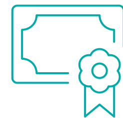
Equities represent a share in a company's **assets**. While equities can enjoy higher returns in the longer term (10 years or more) than **fixed income securities** – also known as bonds – they can also pose greater risk to your capital.

Equities could be right for you if you are comfortable with taking a risk and are willing to have a variable income from your dividends or distributions.

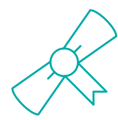
Bonds are debt instruments and can be particularly attractive if you're looking for regular income. They're generally seen as a more secure investment when compared with equities because there is an obligation to pay the bondholder back. Income from bonds is usually fixed and the price of bonds tends to be less **volatile**.

Bonds could be right for you if you're less willing to take a risk and want a regular income for a given period of time.

A **diversified** portfolio made up of both bonds and equities could give you more stability as the market rises and falls.



equities — high risk, high yield



bonds — low risk, low yield

For illustrative purposes only

- There are many ways to invest your money: in a bank or building society, in property, in bonds or in equities – these are just a few of the options
- Cash savings are perceived to be the safest way to invest but returns are not high
- Bonds are like a fixed-term loan to a company – they offer the potential for a regular income and tend to be lower risk than property and equities
- Bonds can give you a regular income through interest payments
- Equities are higher risk than cash savings or bonds but also offer the most potential for strong growth

Are equities right for you?

Equities could grow your money more than cash or bonds

Looking at past information, shares have tended to perform better than investing your money in bonds, cash savings or property. Past performance is no guarantee of future performance.

Equities can carry more risk because they're unpredictable

The benefit of equities is that there is no limit to how high the price of a share could rise – no cap on how much you could make from your investment. But with this benefit comes a risk – there's also no limit to how low a share price could fall and the company could go bankrupt, making your shares worthless.

Equities are more suited to long-term investment

If you're not looking for a quick return on your money, investing directly in equities or an equity fund may be right for you. Investing for the long term (10 years or more) means although there may be short-term dips in the share price from month to month, there could be an overall rise after three to five years. The value of your investment can go down as well as up so you might not get back the amount you put in.

Equities as part of a diverse portfolio

Choosing equities as part of a diverse portfolio that includes other types of investment, such as bonds or cash savings, means that you could lower your overall risk while still potentially benefiting from the higher returns equities may give. The percentage you invest in equities should reflect the level of risk you're willing to take.

Different ways you can invest in equities

Direct

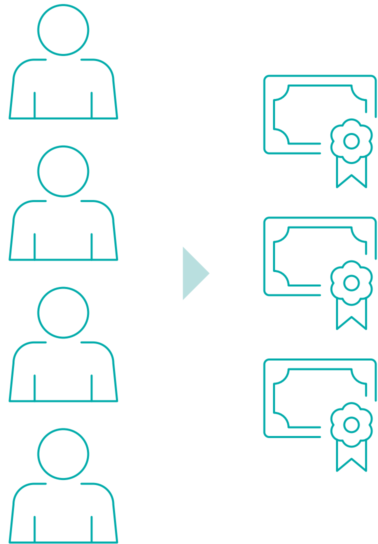
You can invest directly in equities by going through a stockbroker or using an online trading site. This can involve time and resources to manage your investments and can sometimes prove to be expensive.

invest directly

Fund

Invest through a fund and you'll pool your capital with other investors to buy equities. Different types of funds have different investment objectives, for example, investing for **capital growth** or investing for regular income, or sometimes both.

Funds typically impose a fee to manage your investments. This is normally referred to as ongoing charges.



invest through a fund

- Equities could give you higher returns than other investments but they're higher risk
- Equities are more suited to long-term investment – that way your money can ride out short-term dips in the market

Questions you'll want to ask before investing

- What's the aim of the fund you're investing in – to grow your money, generate a regular income or give you a total return?
- What's the level of risk involved and how will it be minimised by the fund manager running it?
- How does the fund manager engage with company management?

Choosing a fund with the right aims, objectives and charges

Choosing the right equity fund depends on your investment goals – are you looking for an income from your investment, to grow your initial investment or to benefit from both? Asking your financial adviser or researching the aims of a fund and the types of investment it makes will help you decide if it's right for you.

Different types of fund and investment companies impose different fees. Therefore, investors should be aware of this when choosing their investments.

Make sure you have determined your investment needs and your level of risk

The fund you choose could be a low risk/low return or a high risk/high return fund. You should decide on the level of risk you're willing to take before looking for the right fund. It's important to understand the level of risk involved in a fund, and the methods by which the fund manager may seek to manage risk.

You should also decide on the outcome you'd like from this investment – whether you'd like regular income, long-term growth or both (called a **total return**) will help you choose the fund that's right for you.

How does your fund manager engage with company management?

If your fund manager's investment firm has an analyst team to research companies, your fund manager will benefit from relevant information about the marketplace. This specialist expertise complements the fund managers' more generalist knowledge and focus.

With this added knowledge, they should be able to make more informed investment decisions on your behalf.

What is an ongoing charge?

Ongoing charges are payments deducted from the assets of a fund. They only include direct costs to the fund that'll affect the client. This is based on the total of all charges made over a year, and includes charges such as the fund's annual management charge, custodian charge and administration charge.

Broadly, there are two types of fund

Actively managed fund

This is where an experienced fund manager invests and manages on your behalf. Investing in this way gives you the benefit of the fund manager's experience and expertise as well as the resources of the investment house they're part of.

Tracker fund

A tracker fund follows the ups and downs of a market index. Your investment will increase or decrease in value in line with the performance of that index. A tracker fund is 'passive' because it simply follows a chosen index.

Please note, for an actively managed fund, there are typically higher fees imposed than with a passive/ tracker fund. ☐

Glossary of investment terms

The following are explanations of some of the terms you would have come across in this guide.

Asset Anything having commercial or exchange value that is owned by a business, institution or individual.

Actively managed Your investment is looked after by a fund manager who will use your invested money (capital) to buy and sell shares on your behalf, with the aim of beating the average stockmarket returns.

Bond A loan in the form of a security, usually issued by a government or company, which normally pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.

Capital growth Occurs when the current value of an investment is greater than the initial amount invested.

Distributions Refers to the periodic paying-out of interest or dividends received by funds to their shareholders. Dividends represent a share in the profits of a company and are paid out to the owners of company shares at certain times during the year.

Diversified/Diversification The practice of investing in a variety of assets. This is a risk management technique where, in a well-diversified portfolio, any loss from an individual holding should be offset by gains in other holdings, thereby lessening the impact on the overall portfolio.

Dividends Dividends represent a share in the profits of a company and are paid out to a company's shareholders at set times of the year.

Equities Shares of ownership in a company.

Fixed income security A loan in the form of a security, usually issued by a government or company, which normally pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.

Initial Public Offering (IPO) The first sale of shares by a private company to the public.

Issue A set of shares/bonds that were released at a particular time.

Issuer An entity that sells securities, such as fixed income securities and company shares.

Primary market Where equities and other securities are sold by the issuer to the purchaser for the first time.

Total return The term for the gain or loss derived from an investment over a particular period. Total return includes income (in the form of interest or dividend payments) and capital gains.

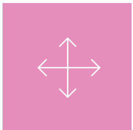
Volatile When the value of a particular share, market or sector swings up and down fairly frequently and/or significantly, it is considered volatile.

The M&G guides

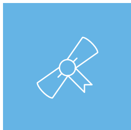
The M&G guides aim to give you the basics about investing, to help you make informed decisions about your financial goals and how to reach them.

We're unable to give financial advice. If you're unsure about the suitability of your investment, speak to a financial adviser. The views expressed in this document should not be taken as a recommendation, advice or forecast.

This brochure is part of our range of M&G guides:



Investing



Bonds

Equities

Risk

Multi-asset investing

Income

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