Janus Henderson INVESTORS

# A SIMPLE GUIDE TO EQUITIES

Equities... shares... stocks – in the financial markets they mean the same thing: slices of company ownership. In this guide we explore their structure, why their prices go up and down, and some of the key benefits and drawbacks of investing in them. By speaking to a financial adviser, you can discuss whether investing in equities may be right for you.

## What are equities?

**1** A company may choose to raise money for a number of reasons.

For example, it may want to expand its operations, invest in research and development, or reduce its level of debt. It may even be starting out and need money to form the initial business.

**2** It can do this by splitting its ownership into 'shares' and selling these to 'shareholders'.

**3** It typically offers them on the stock market, where investors can buy and sell them.

**4** In return for buying equities the shareholders become part-owners of the company. Their level of ownership depends on how many shares they purchase.

**5** Shareholders have the potential to receive a share of the company's profits and the right to vote on how that company is run.

**6** Their interests at the company are protected by the Board of Directors they elect.

## What affects the price of equities?

Technically speaking, 'equity' is the value of a company's assets less the value of its liabilities. The value of those assets and liabilities is dictated by market forces, i.e. the stock market. Share prices are constantly changing because people in the stock market make different assessments of the company's value. If more investors want to buy a company's shares than sell, the price will normally increase. Similarly, if there are more sellers than buyers, the price will normally fall.

More investors predict improved prospects for a company
= more buyers than sellers
VALUE INCREASES

More investors predict deteriorating prospects for a company
= more sellers than buyers
VALUE DECREASES

The main force that drives a company's value, and therefore its share price is its past and forecast profitability. This can be affected by a number of factors. These include:

- **Company factors**
  An earnings update or management change
- **Sector factors**
  Industry news, competition
- **Economic factors**
  Exchange rates, interest rates, inflation
- **External factors**
  Natural disaster, war, terrorism

A multitude of funds that invest in shares are available catering to investors' interests and risk profile. For example, some funds may focus on a sector such as technology, in a single region such as emerging markets or in a theme such as clean energy.

There are many ways of researching the equity market and choosing which companies to invest in. For fund managers, there are four main things to think about:

**Industry analysis:** What is happening to the industry in which the company operates? How will it perform at certain stages of the economic cycle?

**Company analysis:** What is the company's strategy, and how is it adapting to changing conditions?

**Financial analysis:** Are the company's profits sustainable and are they being distributed to shareholders?

**Valuation:** Is the company's share price expensive, and how does it compare to its peers?

## Active vs Passive Management

Active managers seek to outperform the overall market in which a fund invests. An active equity manager's performance will typically be measured against an index of companies in the region or industry in which they invest. This is known as a 'benchmark'. For example, a European equities fund may be benchmarked against the MSCI Europe Index, which represents about 430 large and mid-sized companies across 15 developed markets in Europe. The fund manager will aim to outperform the index, as well as seeking to protect investors' capital when the wider market is falling. Some funds may have objectives alongside outperformance, for example, to promote environmental, social and governance factors.

Some equity funds may not seek to outperform at all. Passive funds are funds that are structured to mimic an index. A FTSE 100 passive fund would include all companies included in the FTSE 100 index in the same proportion. As such, the expectation is for a passive fund to match the returns of the index it tracks.

Passive funds offer investors low-cost exposure and liquidity. Passive index funds and ETFs (exchange traded funds) can also offer targeted exposure as they can be structured to track an index of any asset class.

SHAREHOLDER RETURN = CAPITAL GROWTH + DIVIDEND PAYMENTS

### Equities vs. other asset classes

| | Capital growth | Income | Price volatility |
|---|---|---|---|
| **Equities** | High growth potential | Depends on dividend and will rise and fall | Generally high |
| **Bonds** | Moderate growth potential | Generally higher than equities. Usually stable and regular | Generally low |
| **Commercial property** | Moderate growth potential | Generally high and more stable than equities | Generally lower than equities |
| **Cash** | Low growth potential | Low. Depends on interest rates | Very low |

The above table is a generalisation of the asset classes. Individual securities in each asset class may behave differently.

## What are the benefits and drawbacks?

Equities could potentially give you a higher return than other investments, but they are also higher risk. There is no limit to how high the price of a share could rise.

Investors, such as fund managers, buy shares in companies they believe will rise in value. If they are proved right, they have the potential to benefit in two ways: capital growth (the share price rises) and dividend payments. A dividend is a cash payment made by a company to its shareholders. The amount is variable and is paid as a portion of the company's profits.

As a part-owner of a company an investor shares in its successes – but also its failures. **An equity investor's capital is at risk, because the share price and income received can rise as well as fall and you may not get back the amount originally invested.** This fluctuation in value is known as volatility.

## Glossary

**Benchmark:** A standard (usually an index) that an investment portfolio's performance can be measured against. For example, the performance of a UK equity fund may be benchmarked against a UK equity market index such as the FTSE 100, which represents the 100 largest companies listed on the London Stock Exchange.

**Bond:** A debt security issued by a company or a government, used as a way of raising money. The investor buying the bond is effectively lending money to the issuer of the bond. Bonds offer a return to investors in the form of fixed periodic payments, and the eventual return at maturity of the original money invested – the par value. Because of their fixed periodic interest payments, they are also often called fixed income instruments.

**Commercial property:** Any property used for commercial purposes. Commercial property has three main sectors: retail, office and industrial. It excludes residential property.

**Dividend:** A payment made by a company to its shareholders. The amount is variable, and is paid as a portion of the company's profits.

**Exchange Traded Fund (ETF):** A security that tracks an index (such as an index of equities, bonds or commodities). ETFs trade like an equity on a stock exchange and experience price changes as the underlying assets move up and down in price. ETFs typically have higher daily liquidity and lower fees than actively managed funds.

**Outperform:** To deliver a return greater than that of a fund's assigned benchmark. Also referred to as 'excess return'.

**Volatility:** The rate and extent at which the price of a fund, security or index, moves up and down. If the price swings up and down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. It is used as a measure of the riskiness of an investment.

## Top Tips

- ✓ Equities represent part-ownership in a company.
- ✓ Investors share in company profits through share price growth and dividends (income).
- ✓ However, this depends on the company's success as well as economic/external factors.
- ✓ Equities are generally higher risk than other asset classes.
- ✓ By speaking to a financial adviser, you can discuss whether such an investment may be right for you.

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GC-0122-117228 03-31-23

200-99-117228 01-22