INVESTING IN SHARES

I am regularly asked how people should start investing in the stock market. There are many different ways to be a share investor however, for novice investors, I believe the best way to start a portfolio is to use a combination of individual shares and indexed investments.

CORE AND SATELLITE
Your success as a share investor will be determined by two main factors; limiting your losses from mistakes and controlling your costs. If you start your portfolio by investing in an index as your main (or core) investment, you will be assured of limited costs. In addition, you will always get the return of the market which means your overall performance will not be compromised too badly by your own investment mistakes. Once you have built up your core holding in an index, you can start selecting individual shares (satellites) to compliment your core holding. When starting a portfolio, you should build up your index investment to a minimum value of R100,000 before you begin selecting additional individual shares. The total value of these individual shares should eventually comprise 30% of your overall portfolio.

WHAT IS A GOOD INDEX FOR YOUR CORE HOLDING?
I like the indices that have some form of fundamental filtering. This means an index that weights companies according to their real economic value i.e. value of dividends, actual profits or any other relevant measure. Most people can access these indices via an Exchange Traded Fund (ETF) which trades like a share on the JSE but it is actually an index. You can buy ETF's directly or via a stock broking account. One of my current favourites is the is the equally weighted Top 40 index which has the same shares as the Top 40 Index but each share is equally weighted. This prevents major losses when one share or sector becomes completely overvalued. Two other good options are the Rafi and Divi indices. One note of caution is that some ETF's can be quite expensive for example, the locally listed ETF's that invest in overseas stock markets are rather expensive and do not necessarily represent great value.

WHAT ARE GOOD SHARES TO COMPLIMENT YOUR INDEX HOLDING?
There are different ways of enhancing your portfolio of indices with individual shares, you can buy specific shares that are already in the index but are very undervalued or you can buy shares that are avoided by the market in general. The main group of shares that are avoided by the market are small companies that are too small to be on the radar of large institutions and pension funds. Personally, I prefer investing in large companies via an index and then directly in a few small companies that I have researched myself. The reason I like investing in small companies is that they are totally ignored by large fund managers and most analysts, which means they are often mispriced. The secret to investing in small companies is that you must do proper homework on each share before you invest. This also means that you should not have too many of them in a portfolio as you need to become knowledgable on each company.

JUST BUY THE INDEX
Many people think that investing in shares is a complicated business, it can be but often the best recipe is the simplest one. With share investing, this means that you can simply invest in one or two indices and build your wealth on them alone. There is an 80% chance that you will do better than most fund managers and other professionals over a 5 or 10 year period.

PATIENCE AND DISCIPLINE
Share investing is a great way of creating wealth over the long term, however you need to be patient and disciplined. The best way to make real money in the stock market is to buy shares and hold

them for long periods of time whilst you re-invest your dividends. More than 50% of your growth will come from re-invested dividends. You can only earn these dividends if you remain invested through good times and bad and this is where most people make the mistake. They tend to sell their shares because the markets are rocky so they do not earn the dividends and therefore never really get the benefit. Most private South African share investors only earn 40% of the real growth of the stock market because they buy and sell too often. Try to hold your indexed investments for a minimum period of 7 years and you are likely to see fantastic growth whereas if you try to trade your indexed investments, you are most likley to lose money over time.