

What is investing?

Investing means putting your money to work for a period with the expectation that you will receive more money than you first contributed.

A simple example would be where you put money into an interest-bearing bank account, with the goal of increasing your balance over time.

Banks pay you 'interest' to compensate you for not using that money for something else while you are storing it in their bank account. The higher the amount of money, and the longer you promise to keep it there, the higher the interest rate they offer you.

Let's look at an example of a term deposit. A term deposit is a bank account that holds your money for a certain amount of time, for example 3 months, 6 months or 1 year. The bank promises to pay you interest income over that time and your full money back when the period is up. Your money is locked over the period of investment so you can't access it and the amount of interest income depends on the amount and time your money is invested.

Case study: Investing

Sally invests \$5,000 in a term deposit with BigBucks Bank. Her money earns interest at the rate of 2.75% per annum (per year). After one year, Sally's balance grows to \$5,137.50. The total interest she earned on her original investment was \$137.50 over the year.

$(\$5,000 * 2.75\% * 1 \text{ year}).$

Types of investments and risks

The term 'investing' implies there is some risk involved. There are many different types of investments, each with different features that determine its level of risk. Riskiness can range from relatively safe (defensive) or on the higher side (growth orientated).

Defensive investments

'Safe' or 'defensive' investments focus on earning you income, meaning that it isn't likely that you will lose more than the original value of your investment **but** you may not earn much more than you put in.

Examples of defensive investments include:

- **bank accounts**
- **term deposits** and
- other investment vehicles known as **fixed interest investments** that offer you a flow of income and your money back after a certain period of time.

Growth investments

'Risky' or 'growth' investments are designed to earn you income as well as increase the original value of your investment, your capital. When you invest in growth assets, there is a higher likelihood of losing some or all of the original value of your investment depending where you place your money, **but** they can pay off by giving you a big return on your money.

For example, investing in a start-up company that has no history of success is a risky endeavour because you can't predict how much money they will make in the future. The company could be a huge success and provide you with a good income or profit, or fail and you could lose your money.

Examples of growth investments include:

Property

Property such as houses, apartments and land are popular investments. You can earn money on property from rent and capital gains.

Rent—Rent is the money that an investor is paid for allowing someone else to live on or use their property. Rent can be paid monthly, weekly, fortnightly or even longer depending on the property.

Capital gains—Investors make capital gains when the value of their property is higher than they originally purchased it for.

Case study: Property

If Sam bought a unit for \$500,000 in 2022 and it was worth \$520,000 in 2023, he made a \$20,000 profit or capital gain over that year. (If the value falls beneath \$500,000, then Sam has made a capital loss). In that year, Sam rented his unit out for \$350 a week. So over the year, he earned \$18,200 in rent ($\$350 * 52 \text{ weeks per year}$).

Finance facts: Investments

Shares

When you buy shares in a company, you become an owner of a piece of that company. The number of shares you receive depends on the amount you buy. Investing in shares doesn't mean you have to get involved with running the company. You are simply providing them with funds to run and grow their business. These profits may be returned to you in two ways—dividends and capital gains.

Dividends—the amount paid to you, usually twice per year, when the company makes a profit. The company may choose not to pay dividends.

Capital gains—Investors make capital gains when the value of their shares rises.



Case study: Shares

Julian bought 1,000 shares in Hoodies.com, a company that specialises in making hoodies for teenagers. He bought each share for \$5.00 costing him \$5,000 (1,000 shares * \$5.00). His reward for investing in Hoodies.com meant he received a dividend payment of \$100 in the first 3 months of investing because Hoodie.com's business was selling thousands of hoodies for a good profit.

After 9 months, Hoodie.com's share price increased to \$7.00. The new value of his shares was $1,000 * \$7.00 = \$7,000$ (up from \$5,000) giving him a capital gain of \$2,000.

There are so many other types of growth investments. People invest in things like stamps, coins, Pokémon cards, sports cards and designer products. The value of these items is based on what other people are willing to pay.

Some people earn more money than they originally invest, while others lose more money than they invest or only earn a little bit extra. Investing is a smart way of earning money if you do your research.

Rules for investing

- Never invest in something you don't understand.
- Seek advice from professionals. People who give advice about investments must have licences issued by the government. Just like you need a licence to drive. Never take advice from someone who doesn't have a licence.
- Be aware that if you invest in something that is risky, you could lose your money.
- Always check your investments on a regular basis.

Glossary

Interest rate	The interest rate is the amount paid to a person that deposits money at a bank, expressed as a percentage.
Risk	A financial risk is the likelihood of losing money, and is linked to a company's profitability.
Return	This is the money made or lost on an investment over some period of time.
Dividends	Share of profits made by a company to be paid to shareholders.
Profits	Money remaining in an investment or venture after expenses are paid.
Asset	Something belonging to you that has value like a property, shares, etc.

Links

To calculate interest on your bank account:

[Compound interest calculator—Moneysmart.gov.au](https://www.moneySMART.gov.au)

To learn more about investing:

[moneysmart.gov.au](https://www.moneySMART.gov.au)

Check that a financial adviser is licenced:

[Financial adviser register](https://www.fairfinancial.org.au)

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About Ecstra

Ecstra Foundation is an independent charitable foundation committed to building the financial wellbeing of Australians within a fair financial system.



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