Benefits of investing in the Stock Market

There are many benefits to investing in shares and we will explore how this common form of investment can be an effective way to make money. We will discuss some of the benefits of investing in shares such as diversification, tax benefits, capital growth as well as some of the disadvantages.

There are two types of returns that an investor can expect to earn from an investment.

1. Income Return

The income return represents periodic cash flows generated by the investment. These include dividends paid for ordinary shares and periodic interest paid for bonds. Stock that pay dividends typically distribute them quarterly. Government bonds pay interest on a semi annual basis, and debentures pay interest monthly, quarterly, semi-annually or annually. Investors whose primary objective is to generate periodic income from their investments focus on the income return.

2. Price Change

Price change is the increase ordecrease in price of the asset in relation to the purchase price or the market price in the previous time period. An appreciation in the price of the asset is called a capital gain while a price decline is called a capital loss. The prices of assets such as stocks, bonds, and real estate fluctuate over time in response to a variety of factors such as economic news, industry conditions, company`s performance, political conditions, as well as speculation. While the investor expects a capital gain, there is no guarantee that the price will always increased in value. Those investors whose primary investment objective is capital appreciation focus on the price change component of return.

Measuring Returns

The total rate of return of an investment can be measured in two ways. Rupee return and holding period return.

1. Rupee return

The rupee return is equal to the sum of the income and price change measured in the terms of the amount of rupees, during a specific period of time.

Total Rupee Return + Income Return+ Price Change

Example: You purchase a stock at Rs. 80 last year. It paid a dividend of Rs. 4.00 during the last year. The current market price of the stock is Rs. 100. What was the total rupee return to the investor in the last year?

Income return is the Rs. 4.00 dividend. Price change is Rs. 20.00, which represents the increase in price from the purchase price of Rs. 80 the current price of Rs. 100.

Total rupee Return + Rs. 4+ Rs. 20= Rs. 24

2. Holding Period Return

Holding period return is a very basic way to measure how much return you have obtained on a particular investment (HPR)i.e the sum of the income and capital gains generated during a specific period as a percentage of the initial purchase price or the beginning of the period price of the investment. The holding period return is given by the following equation

$$HPR = \left[\frac{\text{income + Price Change}}{\text{Purchase Price}} \right] * 100$$

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$$HPR = \left[\frac{4 + 20}{80} \right] * 100 = 30\%$$

Example: you purchased a stock at Rs. 80 two years ago. It paid a dividend of Rs. 4.00 in the first year and Rs. 4.25 in the second year. The market price of the stock at the end of the first year was Rs. 100. The current market price is Rs. 120.75. What was the holding period return to the investor in the last year?

$$HPR = \left[\frac{4.25 + 20.75}{100} \right] * 100 = 25\%$$

Voting Right

Shareholders have a say in the affairs of the company. One of the ways they express themselves is by voting at the Annual and Extra-ordinary general meetings of the company .The board of directors needs the ratification of shareholders, before any major decision is taken. For instance, shareholders must give their consent before a company embarks on a public offer or a right issue. They also have the rights to sack erring directors. They do this by exercising their voting right.

Shareholders do not necessarily need to be physically present at the site of the company's annual meeting in order to exercise their right to vote. It is common for shareholders to voice their vote by proxy by mailing in their response.

Right issues

A rights issue is an invitation to existing shareholders to purchase additional new shares in the company. More specifically, this type of issue gives existing shareholders securities called "rights", which, well, give the shareholders the right to purchase new shares at a discount to the market price on a stated future date.Each share holder is given to the option to purchase a number of shares in proportion to the number of shares already held by the share holder. For example, a right ratio of one-for-two means a share holder can subscribe to one new share for each two shares already held by the shareholder. An investor owing 100 shares prior to the right issue gets the right to subscribe to 50 new shares. This increase the firm`s number of shares outstanding.

Capitalization of Reserves

When reserves are paid out to shareholders in the form of extra shares is called capitalization of reserves. In other way, Capitalization of Reserves is the issue of shares by the company to its existing shareholders by capitalizing its revenue reserves. Share holders receive free shares in proportion to their ownership. For example, a free share issue of one-for-five means that each shareholder receives one free share for each five shares held. An investor who owns 100 shares before the free share issue receives 20 additional shares without cost. When the company issuing free shares by doing capitalization of reserves company`s stated capital and the total number of shares will be increased.

Stock splits

Sometimes, companies split their share into more shares. A stock split is where a company subdivides its outstanding shares so as to increase the number of shares. For example, one-for-two will create one new share for each two shares outstanding. A company with 100,000 shares will create new shares, and as a result, the total number of shares outstanding increase to 150,000 shares. A share holder who owned 100 shares will now own 150 shares worth the same.

The company does not receive any funds, and hence, there is no change in the value of the firm. The only change is that the company will transfer the value of the new shares from revenue reserves to share capital. However since the firm has more shares now, the price per share will decline to reflect this.

Liquidity

Another benefit of investing in shares is that it is a liquid asset. The stocks traded in the market also have greater liquidity than other securities. This means that it can be easily converted into cash by selling the equities with other traders in the market because it is relatively easy to find buyers. Compare this to selling property, where you may have only 1 or 2 interested buyers.

Accessibility

Another advantage of investing in stocks is its accessibility. There are many stocks available in the market today. With proper research and analysis of the stocks and the companies that issued them, anybody with sufficient capital can acquire ownership of stocks except some specific stocks.

Ease of Diversification

Diversification is simply not putting all your eggs in one basket. If you make smaller investment in various different companies, the likelihood that one of your investments fails means that it won't have a great effect on your total investment. If you have all your eggs spread between a number of baskets (investments), you are more insulated from any possible downturns. Because you can buy small parcels of shares ($500 is the minimum per parcel), you can get greater diversification though investing in shares. Compare this to say property where a large sum of money is placed in just one investment

Tax Benefits

Many of the costs associated with share trading are tax deductible, as you have to pay tax on your gains. Transaction fees, interest paid on margin loans and other costs associated with your investments can be deducted as an expense from your taxable income from the shares you've traded. Tax benefits can also come from franking credits (imputation credits) from shares. As companies have already pay tax on their profits investors receive franking credits on the dividends they receive.

Availability of Information

Information about a particular companies shares, especially Milanka Companies shares, are just about everywhere, news on TV, newspaper and most financial websites.

2nd part

There are many kinds of investments to choose from, but none have shown the consistent long term performance of a diversified portfolio of stocks. Stock market investing can offer an excellent way to build long term wealth over time. Of course, there are risks as well as rewards by investing in the stock market, and those risks and rewards are the focus of this article.

Some of the biggest advantages to investing in the stock market include:

- Superior long term performance - over the long term, stocks have consistently provided better returns than any other type of investment.
- Stocks have consistently stayed ahead of the inflation rate, something that is not always true of bonds and other fixed income investments. For instance, if your money market is yielding 2% a year, but inflation is 3%, you are actually losing money. The returns of the stock market provide investors with a better chance of staying ahead of inflation.
- Owning stocks allows the investor to participate in the growth of the economy. When you buy shares of stock, you actually become part owner of the company, and you therefore are entitled to share in the good fortunes of that company.
- Stocks can be an excellent choice for retirement vehicles, especially for those with a long time to retirement. The longer your time horizon, the more valuable stocks can be. A long time horizon will help to even out the inevitable ups and downs of the market.
- Of course these advantages do not come without their challenges. Some of the major disadvantages of investing in the stock market include:

- Stocks are volatile investments. The price of a single stock can vary quite widely from day to day, and the factors that cause these price fluctuations are beyond the control of the investor.
- Buying a widely diversified basket of stocks can be difficult for all but the wealthiest investor. Small investors are better off buying a quality stock mutual fund. Mutual funds pool the investments of many different people in order to buy a diversified set of stocks. This diversified approach helps to reduce the risk inherent in the stock market.
- As investors near retirement, the amount of stocks in the portfolio should be reduced. Investors who are close to retirement age can no longer afford to take chances with their money, and that means moving a significant portion of their retirement funds to safer and more stable investments.
- Buying and selling stocks costs money in the form of brokerage commissions, and many brokerage firms charge account maintenance fees as well. It is important to look for low cost alternatives when buying and selling stocks.

Every ordinary share represents a proportional ownership, or equity, in a company. If a company has only one ordinary share and an investor owns it, the investor owns the entire company and is entitled to one hundred percent of the company’s profits. If a company has 100,000 ordinary shares and an investor owns one of them, then the investor owns 1/100,000th of the company, and as such, has an interest in 1/100,000th of the company’s profits.

stocks have a number of advantages which make it a desirable investment vehicle, some of which are listed below:

- Ordinary shares have the potential for delivering very large gains, unlike bonds, Certificates of Deposit, or some other alternatives. Annual returns-on-investment (ROIs) of over 100% have occurred on a somewhat regular basis.

- The potential loss from stock purchased with cash is limited to the total amount of the initial investment. This is considerably better than that of some leveraged transactions, where the maximum loss can well exceed the total of the funds invested.
- Stocks offer limited legal liability. Passive stockholders (those who take no active part in the running of the company) are protected against any liability stemming from the company's actions beyond their financial investment in the company.
- Most stocks are very liquid; in other words, they can be bought and sold quickly at a fair price.
- Although past performance is not a guarantee of future performance, stocks have historically offered very high returns in relation to other investments.
- Stocks offer two ways for their owners to benefit, by capital gains and with dividends. As previously stated, each share of stock represents partial ownership in a company. If the company becomes more valuable, so will the ownership interest represented by each share of stock. This appreciation of the stock's value is known as a capital gain. In addition, if the company earns more profits than it needs to support its maintenance and growth, it may elect to distribute the excess to its owners, the shareholders. The periodic distributions of profits are called dividend payments.
- hile there are numerous advantages, ordinary shares, like all investments, have some distinct disadvantages which investors must remain aware of:
- Since ordinary shares represent ownership of a business, stockholders are the last to get paid, like all other owners. A company must first pay its employees, suppliers, creditors, maintain its facilities and pay its taxes. Any money left can then be distributed among its owners.
- While shareholders are company owners, they do not enjoy all of the rights and privileges that the owners of privately held companies do. For example, they cannot normally walk in and demand to review in detail the company's books.
- Investors in a company may not know all that there is to know about the company. This limited information can sometimes cause investment decision-making to be difficult.
- Stock prices tend to be volatile. Prices can be erratic, rising and declining quickly. Such declines often cause investors to panic and sell, which actually only serves to lock in their losses.
- Stock values can sometimes change for no apparent reason, which can be quite frustrating for the investor who is trying to anticipate the stock's behavior based on the actual performance of the company.