# The STAR Guide to Equity Investment

## Section 2 – Why Invest in Equities?

November 2021

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**Investing is a Positive Action**

We all need to decide why we are investing as opposed to saving.

Essentially, **saving** is the act of putting money aside from a regular income stream and diverting it from current expenditure for some future use. In many cases this actually involves lending your money to a bank or building society for them to use and for which, in the past at least, these entities have paid you, the saver, a fee in the form of an interest rate.

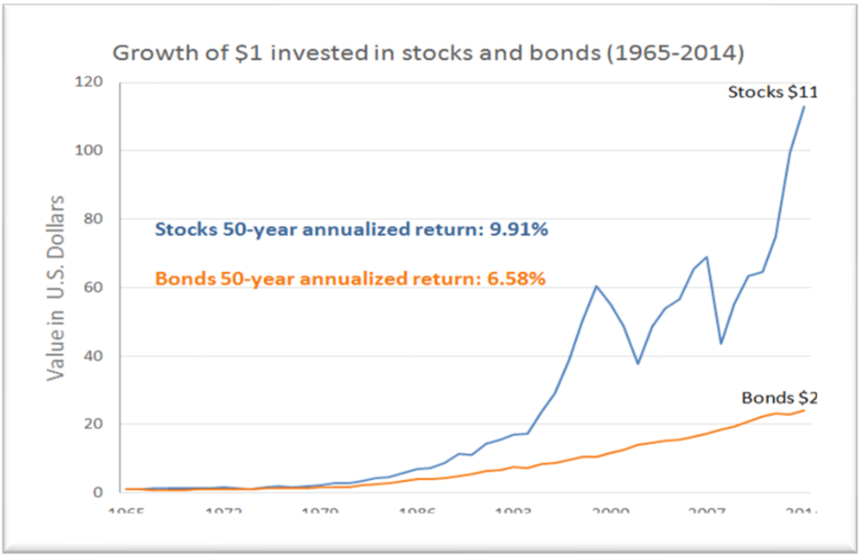
**Investing** implies a more positive and longer-term direction of cash into loans or the ownership of equity interests. These equity interests may cover the direct ownership of a vast range of asset classes from houses and other real estate to antiques, art and collectibles as well as the part ownership of businesses. This latter class is most easily accessible to private investors in the form of the part ownership of existing trading entities represented by shares listed on recognised stock markets. In this Guide we shall use the terms equities and shares interchangeably.

**Why invest in Equities?**

This Guide will concentrate on share investing, rather than any other asset class, for the following positive reasons:

- Most studies have shown that an investment in shares has outperformed that of all other accessible asset classes over the past century. Although there have been periods when equities have lost money, in the longer term and decade by decade, most studies demonstrate the massive outperformance of shares as an asset class when compared with the apparently safer medium of bonds and loan stocks. The chart, below, illustrates the comparative performance of an investment in US shares and bonds over 50 years to 2014.

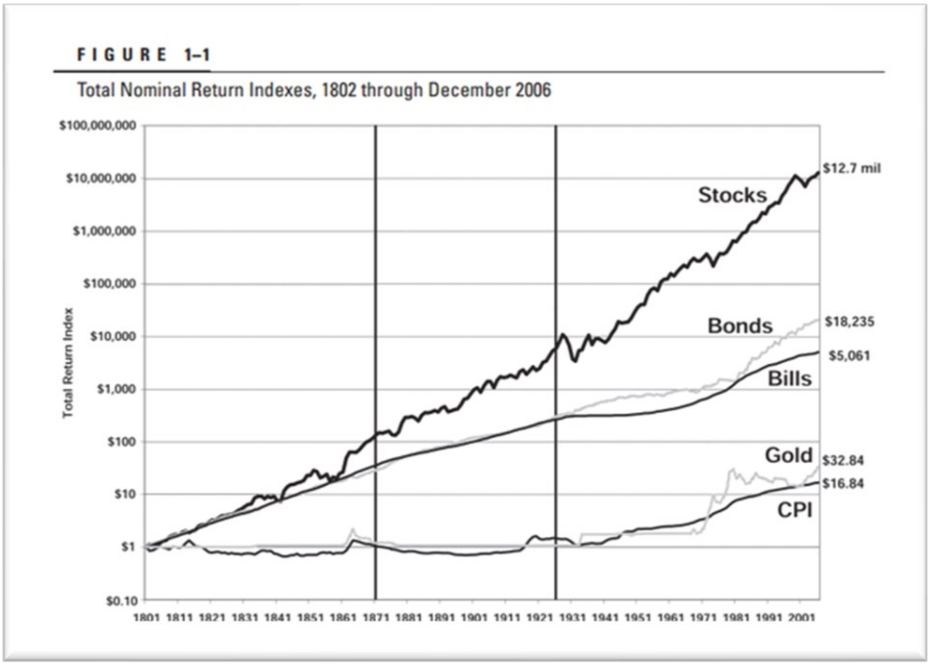
**US Bonds and Equities over 50 years**




**Source: Russell Indices**

The next chart demonstrates the same trend over the much longer period of 200 years from 1801.

**And the Very Long term – Over 200 Years**




**Source: Quora**

- It is now easy for anyone to invest in listed shares either through collective funds or directly into individual companies through stockbrokers, financial advisors or the cheaper investment platforms such as Hargreaves Lansdown, Interactive Investor or AJ Bell.
- There is also now much greater accessibility for private investors, with a computer connected to the internet, to access and download a vast range of information covering most equities that are listed on the major international stock exchanges
- There are many publications and websites covering, and containing analysis of, the majority of shares that are quoted on the main western stock markets.
- Although the latest analysis of companies undertaken by traditional City researchers may only be available to institutional investors there is a growing body of quality corporate analysis that is paid for by companies that is available free to private investors (for more information on sources such as Edisons and Equity Development see section 6)

**The Negative factors** relating to equity ownership must also be appreciated. These include:

- The risk of partial or complete loss should the individual underlying business fail
- There are periods, usually when interest rates are falling, when investment in bonds produces greater capital gains than in equities

- External factors, such as major falls in economies and stock markets, may drastically reduce the value of specific shares or whole sectors even if the business is itself quite sound
- Shifts in technology, such as the recent rapid growth in online retailing and the rise of financial technology, may render existing sectors (high street retailers and traditional banks) uneconomic

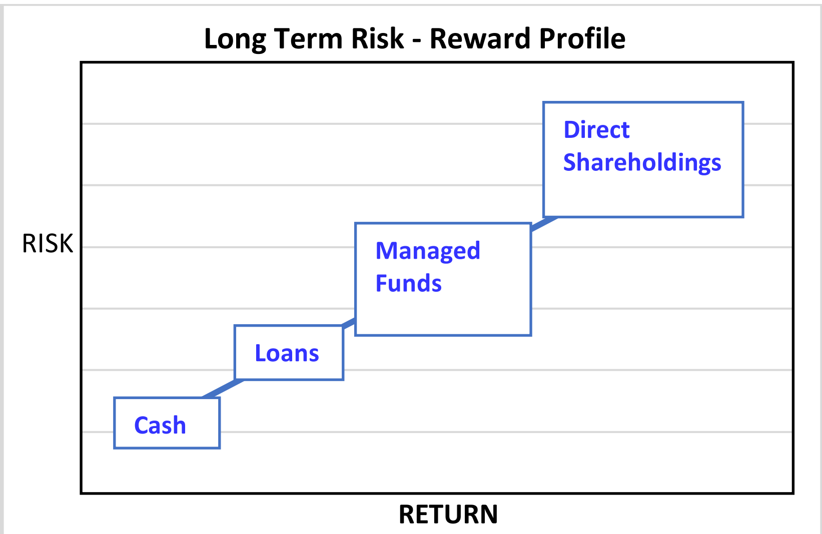
Given that the investment selection process in traded markets is driven by the interplay between fear and greed serious investors should employ an evaluation toolkit that uses methods for diagnosing both positive factors, usually featuring a combination of growth and value, as well as risk reduction ones that help to reduce losses. This Guide will include information and compare methods that deal with both these key features.

**Determining investment priorities and assessing your own attitude to risk**

The reasons for wanting or needing to invest are many. They include; building up a fund to provide an income in retirement usually referred to loosely as a pension, putting surplus cash aside for "a rainy day" and, not least, a desire to "make money". In this Guide we are dealing with what is generally termed long-term investing rather than trading. The latter referring to short-term buying and selling shares with the aim of making a quick profit over no more than a few days, weeks or even hours in some cases.

An equally vital decision to make is that of your personal attitude to risk. Any investment in shares is risky in that the amount invested could fall dramatically given adverse news relating to either the specific investment or the wider market. Assessing your own attitude to losing money is extremely important. Sleepless nights and damaging your health and well-being are rarely worth it. So, if the thought of seeing the value of your investment dropping suddenly, or slowly, is likely to fill you with dread it is probable that investing in shares is not for you.

On the other hand there is no such thing as complete safety given that monetary inflation can speedily erode the true value of nominal investment gains on cash deposits although the loss of worth, in what may be termed a "normal" economic environment often proceeds at a relatively slow pace and is therefore easily ignored. This aspect really brings us to the trade-off between risk and reward that may be simply illustrated in the chart below. This shows that risk and reward tend to march in tandem.



**Linking businesses with their owners – reducing the accountability gap**

Accountability is a vital factor in 21st century life and is particularly relevant to the need for communication between large companies and their private shareholders as ultimate owners of the business. The relationship between business managers and the owners of their businesses is greatly diminished when intermediaries such as professional investment managers and institutional investors are the primary link in the ownership chain. It can be argued that private investors have a more direct interest in their underlying investments than those with a more indirect stake. Thus, private investors have an important role in securing stronger accountability linkages in the investment sector.

The increasing employment of digital systems and management wrappers through which private investors hold their shares (in the UK these include SIPPs for pensions and ISAs for savings) has further reduced the linkages between corporate management and individual shareholders. This is because the shareholdings are held in nominee accounts rather in the names of each shareholder. However, not all developments have been negative as these same digital channels enable investors to access a wealth of information with the click of a button.

**The excitement and interest of discovering more about successful businesses**

From the personal viewpoint it can be fascinating to follow the developments taking place in the businesses in which you are an owner, even if your ownership is only of a small proportion of the total. Many senior company managers and directors also like to keep in touch with private investors giving them a more personal relationship than is often possible with the large institutional owners. Against this there are also many senior corporate managers and directors who view private investors as a pain in the neck and a distraction from the main business of running their company.

In terms of increasing the linkage between company management and investors it is fair to say that the two main entities representing UK shareholders, namely UKSA and ShareSoc, are arranging an increasing number of meetings between their members and company directors. These efforts are beginning to redress this information imbalance and lack of accountability but much more needs to be done and the STAR Investor Hub is intended to help in this process through the following initiatives:

- Providing a regularly updated register of reliable information sources on listed equities
- Meetings with company managements
- Competitions to encourage the testing of the most effective methods of share portfolio management adopted by private investors
- Occasional talks/seminars given by leading analysts and commentators