Perpetual Investments

# THE REAL VALUE OF INVESTING IN SHARES

2013

# CONTENTS

# WHAT IS A SHARE?

A share is simply that – a share of a company.

When you invest in shares you are buying a piece of a company and by doing so you are aligning your interests with the company's future growth and earnings potential.

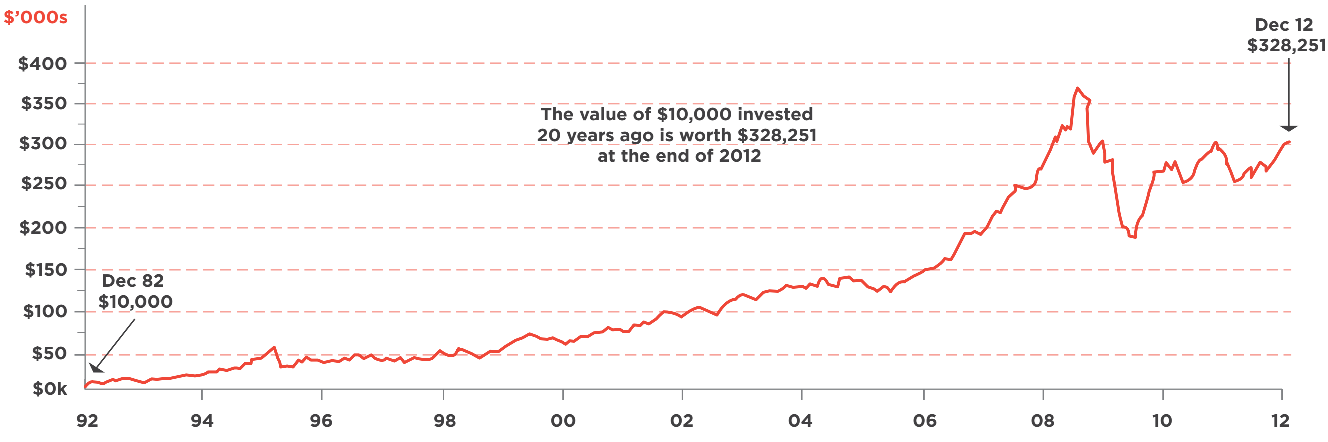
In effect, you could take part in the success of companies like Telstra, Westpac and BHP and actively participate in the economy.

Where things get more complicated is in choosing the right companies to invest in at the right price. That's where the expertise of seasoned professionals can make all the difference.

Although the sharemarket experiences peaks and troughs, history shows that it grows in value over time.

**GROWTH OF THE AUSTRALIAN SHAREMARKET (DIVIDENDS REINVESTED)**

Over the last 20 years




Source: Factset.
As at 31 December 2012

## THE SHAREMARKET

The sharemarket is a market in which buyers and sellers come together to buy and sell shares. In Australia, the leading market for shares is the Australian Securities Exchange. It is made up of close to 2,100 companies. It is the eighth largest sharemarket in the world, and the second largest in the Asia-Pacific region behind Japan.

Source: ASX, March 2013.

# INVESTING IN SHARES FOR CAPITAL GROWTH AND INCOME

# INVESTING FOR CAPITAL GROWTH

Share investments offer two different types of returns – capital growth and income.

Capital growth occurs when the value of your shares increase over time and is realised when you sell the shares. Income comes in the form of dividends paid by the companies you invested in.

Different investors place different importance on growth and income. In general, younger investors and those still working give priority to medium to long-term growth, whereas retired investors tend to look for income to help fund their retirement lifestyle.

Most share portfolios are built to offer a mix of both growth and income.

## HOW DO SHARES GROW?

Shares grow in value when their market price increases. For publicly traded shares, this is when their price increases on the stock exchange.

Under normal conditions this movement in a company's share price reflects changing expectations of its profits. That is, earnings per share directly influence a company's price per share.

## TARGETING GROWTH

Capital growth is essential if you want to increase the value of your investments without investing more out of your own pocket. The tendency of shares to grow in value over time is one of their key attractions as an investment type.

You can influence the growth of your capital by choosing shares with growth characteristics. A share with growth characteristics may be one in a company that reinvests the majority of its earnings to promote future growth, for example by financing expansion, new technology or equipment.

## PROTECTION AGAINST INFLATION

Inflation erodes your purchasing power and can also diminish your investment returns. So it is important that your investments provide some protection against inflation.

When you select shares with growth characteristics you are better able to protect the value of your capital. The idea is that as companies grow, the resulting increase in their share price will be higher than the rate of inflation.

Protecting your investment against the detrimental effect of inflation is especially important when you are investing for the long term.

### EXAMPLE
### THE EFFECT OF INFLATION

Abraham has invested $10,000 in cash and receives a one year return of 5%.

The inflation rate is 3%. Abraham's 'real' return after inflation is 2%.

**5% interest – 3% inflation**
**= 2% real return**

Paul has also invested $10,000, but in shares.

At the end of year one, he receives dividend income of 5% plus capital growth of 5%.

Before inflation, his total return is 10%. His 'real' return after inflation is 7%.

**5% income + 5% growth**
**= 10% return – 3% inflation**
**= 7% real return**

This example demonstrates how, even if inflation has eaten into your investment income, capital growth can provide some protection.

# INVESTING FOR INCOME

## A STRONG SOURCE OF INCOME

When you listen to the media it's easy to think that share investments are all about the current market price and capital growth. What's less obvious is that shares can provide a strong and steady source of income over the long term.

The income you receive from shares is in the form of dividends. Dividends are paid out of a company's earnings and can grow over time as the capital value of your investment also grows.

## A GROWING INCOME STREAM

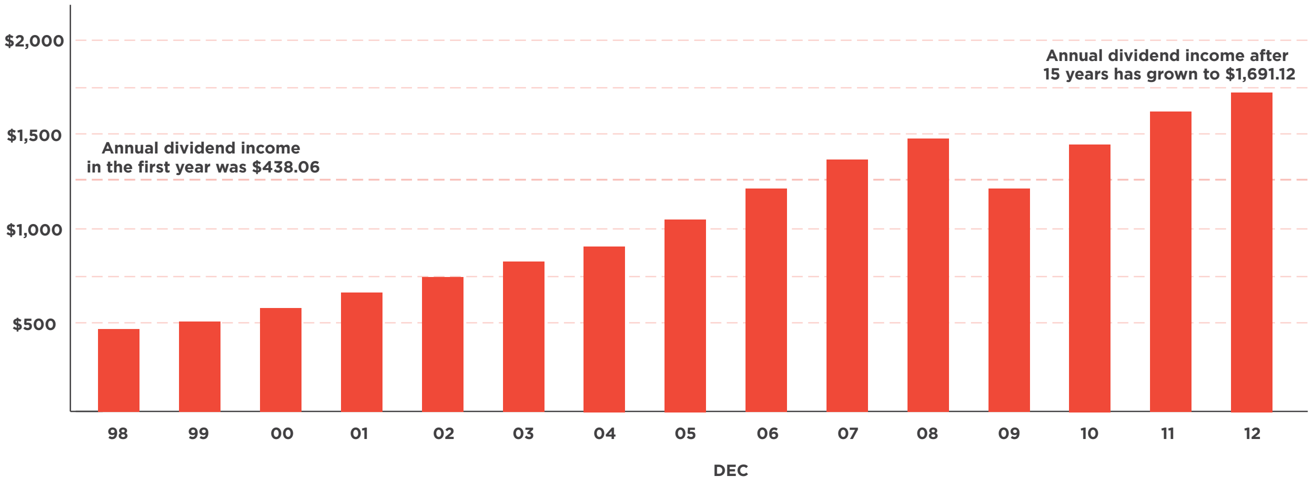
When it comes to an investment that pays regular income, you may think first of a term deposit. Although a term deposit can provide regular income, it's important to remember that it doesn't offer any capital growth, so the income doesn't grow over time as it does for shares. With shares, dividends generally increase as a company grows and earns more.

As your income stream increases you can choose to either reinvest the income and further increase your capital or use it to help fund your lifestyle.

An additional benefit of investing for income is that high income shares tend to be less volatile than growth shares. This is because they are usually shares in well established companies in more traditional business sectors, whereas growth shares are often newer companies or companies involved in more exploratory activities such as biotechnology.

### SHARES CAN PROVIDE A STEADILY GROWING INCOME STREAM

$10,000 invested in Westpac – growth in dividends




Adjusted for bonus issues.
Past performance not indicative of future performance.

Source: Factset.
As at 31 December 2012

EXAMPLE

## BENEFITS OF DIVIDEND IMPUTATION

Vanessa and Bill each invest $10,000. Vanessa invests her money in shares, while Bill chooses to invest in a term deposit.

The shares and term deposit both generate income of $500 (a return of 5% on the investment amount).

Bill and Vanessa pay tax at 46.5% (including Medicare levy). The table below shows the after-tax result.

While Vanessa and Bill are both paying tax at the same rate, their tax outcomes are quite different.

Overall, Vanessa has paid $115 less tax than Bill. This is because Vanessa received an imputation credit on the dividend income from her shares, while Bill did not receive any credit for his investment income.

The net result is that Vanessa's after-tax income is higher ($382) than Bill's ($267).

### THE BENEFITS OF DIVIDEND IMPUTATION

Marginal tax rate 46.5% pa

| | VANESSA (SHARES) | BILL (TERM DEPOSIT) |
|---|---:|---:|
| Initial investment | $10,000 | $10,000 |
| Dividend income from shares | $500 | – |
| Interest return from term deposit | – | $500 |
| Imputation credit | $214 | – |
| Taxable income | $714 | $500 |
| Tax due at 46.5% | $332 | $233 |
| Minus imputation credit | -$214 | – |
| Tax payable | $118 | $233 |
| **After tax income** | **$382** | **$267** |

Source: Perpetual.

## SAVE ON TAX

Not only are shares a good source of income, they can also be very tax effective. This is because Australian share income is taxed favourably through what is called 'dividend imputation'. In essence, this means that if the company has already paid tax on its income, you get a tax benefit for dividends received from that company. This is so tax isn't paid twice and makes income from shares more attractive than that from cash and term deposits.

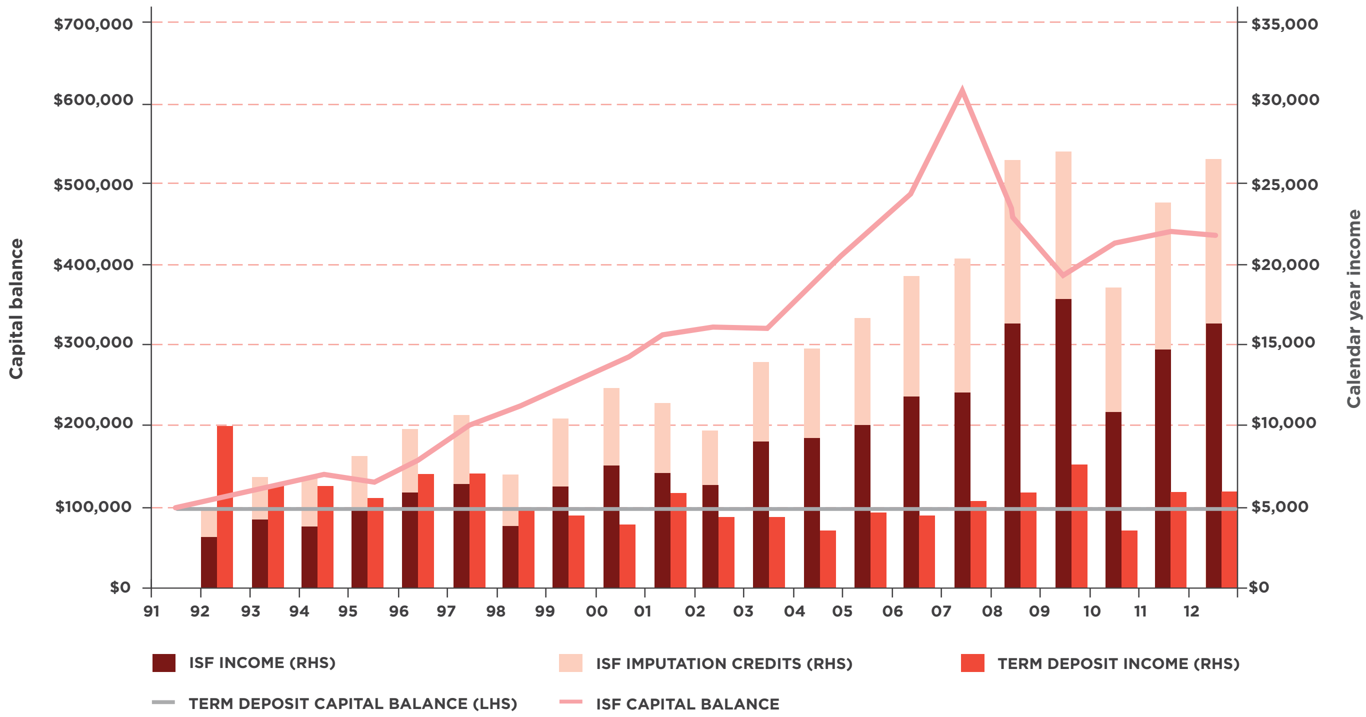
## BEST OF BOTH WORLDS

Even if your focus is on investing in shares for income there is a very good possibility that your capital will grow over time.

Similarly, if your focus is on capital growth you may also receive dividend payments, especially as growth companies reach certain milestones.

**INDUSTRIAL SHARE FUND AND TERM DEPOSITS**

Capital, Income and Imputations Credits (June 1991 – June 2012)




Source: Factset.
As at 30 June 2012

# SHARES CAN BE VOLATILE – DON'T PANIC

## UP AND DOWN

Sharemarkets fluctuate every day, because every day thousands of buyers and sellers of shares trade them. Sometimes, specific events will cause the value of certain shares to rise or fall. Events such as the Global Financial Crisis can cause dramatic falls, and increase volatility over the medium term. You may also be aware of the tech boom in the 90s and the recent resources boom that has caused the market to surge ahead temporarily.

## SUBSTANTIAL GAINS OVER TIME

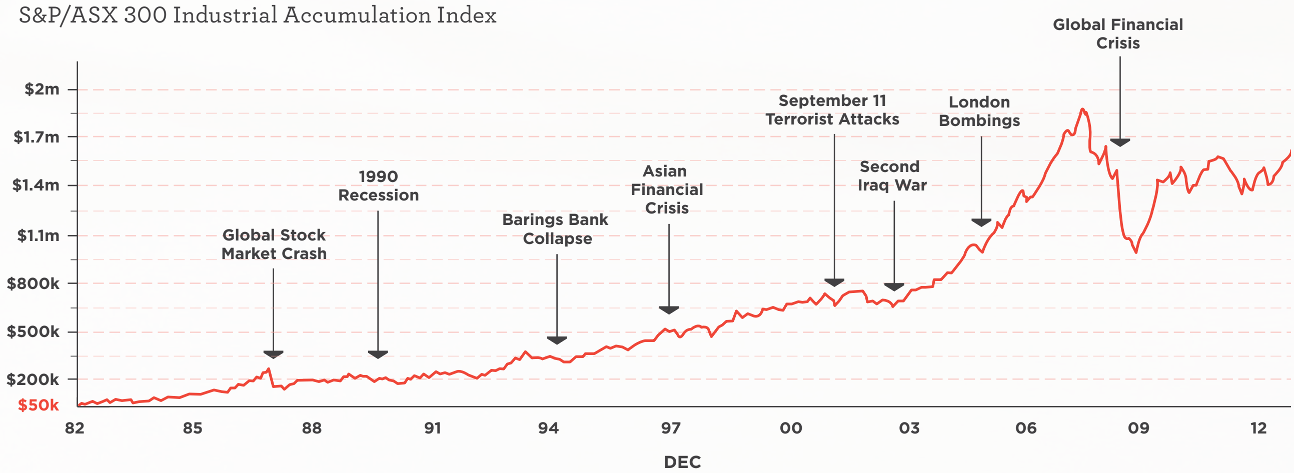
What can get missed in all the hype, especially the doom and gloom following a sudden fall, is that overall the value of the Australian sharemarket has risen substantially over time. While the swings in the market might look extreme over one year, they are less pronounced over the long term. Traditionally, sharemarkets have recovered from short-term setbacks with significantly higher gains.

Shares seem more volatile than other types of growth investments like residential property, because shares are regularly traded and are therefore valued more frequently than property. Residential properties are valued much less often, generally when the owner is looking to sell. If they were auctioned daily their values could go down depending on daily demand which would vary greatly.

It's also important to remember that volatility is not necessarily a bad thing. If there is volatility in the market, it means that there is liquidity. To achieve a high return it's generally necessary to accept some volatility or risk.

Despite the volatility of sharemarkets, shares have a place in almost every properly allocated investment portfolio. It is important though to diversify your investments to reduce your risk and seek help – experienced professionals understand how to best manage risk and do so according to your needs.

**GROWTH OF THE AUSTRALIAN SHAREMARKET FROM 31 DECEMBER 1982 ON $50,000**
S&P/ASX 300 Industrial Accumulation Index




No allowance has been made for taxation.
Past performance is not indicative of future performance.

Source: Factset.
As at 31 December 2012

# THE KEY TO SUCCESSFUL INVESTING IS TIME, NOT TIMING

## TIME IS ON YOUR SIDE

Many investors try to 'time' their investments to capture the best returns. However, experience shows that the key to successful investing is time in the market, not timing.

This is because it is extremely difficult to pick the right time to make an investment. Numerous factors come into play such as interest rates, exchange rates, commodity prices, consumer spending and confidence at local and global levels.

Some investors can get it right some of the time. But more often than not, 'market timers' sell when a market is low and are out of the market when the inevitable rally occurs. In this way, market timing exposes you to the very risks you are trying to avoid.

So, given that the overall trend is for markets to rise over time, you're better to make the best possible decision regarding the quality of your purchase and then stick with it.

## THE BENEFITS OF DOLLAR COST AVERAGING

Instead of trying to 'time' the market, you may be better off dollar cost averaging. Dollar cost averaging is an investment approach where you invest the same amount of money on a regular basis, usually monthly, into a share investment. It takes advantage of the only certainty of the sharemarket – that prices will continue to rise and fall.

Dollar cost averaging is a convenient and flexible way for investors to gain additional exposure to investments over time. The benefit of this strategy is that it reduces the risk of investing a large amount of money in a single investment at the wrong time.

By investing a fixed amount at set intervals, you are smoothing the ups and downs of the sharemarket. Your fixed amount will buy more units when the prices are low and fewer units when the prices are high. This means the average price paid can be lower than the average market price.

## ADOPT A REGULAR SAVINGS PLAN

A savings plan is a disciplined method of investing and also an excellent way to benefit from dollar cost averaging. With a savings plan, a set amount of money is automatically debited from your bank account each fortnight or month.

You do not need a large amount of money to be a successful sharemarket investor. What is important is making a commitment to a regular savings plan.

## VOLATILITY IS NOT NECESSARILY A BAD THING

1. Shares fell by more than 30% in 1930.
2. But for much of the decade returns were very strong, ranging between 10% and 20%.
3. They even rose by as much as 21% in 1933.

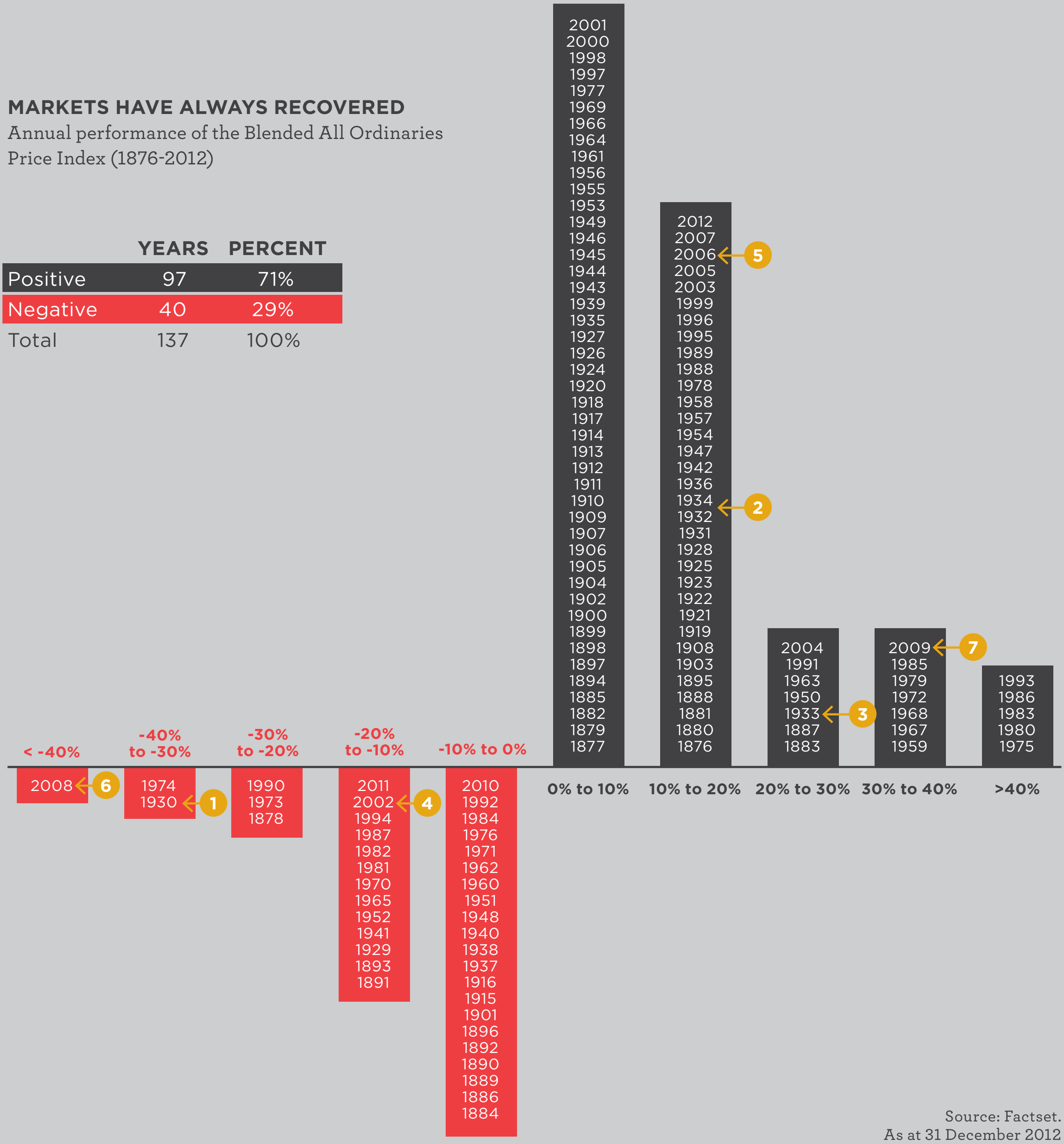
The 2000s is another example:

4. Shares had a poor year in 2002, returning -11%.
5. However, for much of the decade returns were very strong, ranging between 10% and 20%.
6. This was followed by a very bad year in 2008, when shares lost 43%.
7. They then delivered very strong gains of 33% in 2009.

### MARKETS HAVE ALWAYS RECOVERED

Annual performance of the Blended All Ordinaries Price Index (1876-2012)

| | YEARS | PERCENT |
|---|---|---|
| Positive | 97 | 71% |
| Negative | 40 | 29% |
| Total | 137 | 100% |




Source: Factset.
As at 31 December 2012

# DIVERSIFICATION CAN SMOOTH THE RIDE

## GOOD RETURNS OFFSET POOR RETURNS

A much better strategy than attempting to time the market is to diversify your money across a range of asset classes. By placing your money in a number of asset classes, good returns received from one investment can offset the bad performance of another over particular periods.

For example you will not want to just invest in shares, property or a bank account. If you do, you stand to lose money if that asset class performs badly – if the share market drops, property bottoms out or interest rates sink.

Diversification may sound complex but it's a simple concept. By spreading your investments across a range of asset classes, companies, sectors and countries, the good returns in one area can offset poor returns in another. The result will be much smoother performance over time and far less stress.

## REWEIGHTING TO REDUCE VOLATILITY AND IMPROVE PERFORMANCE

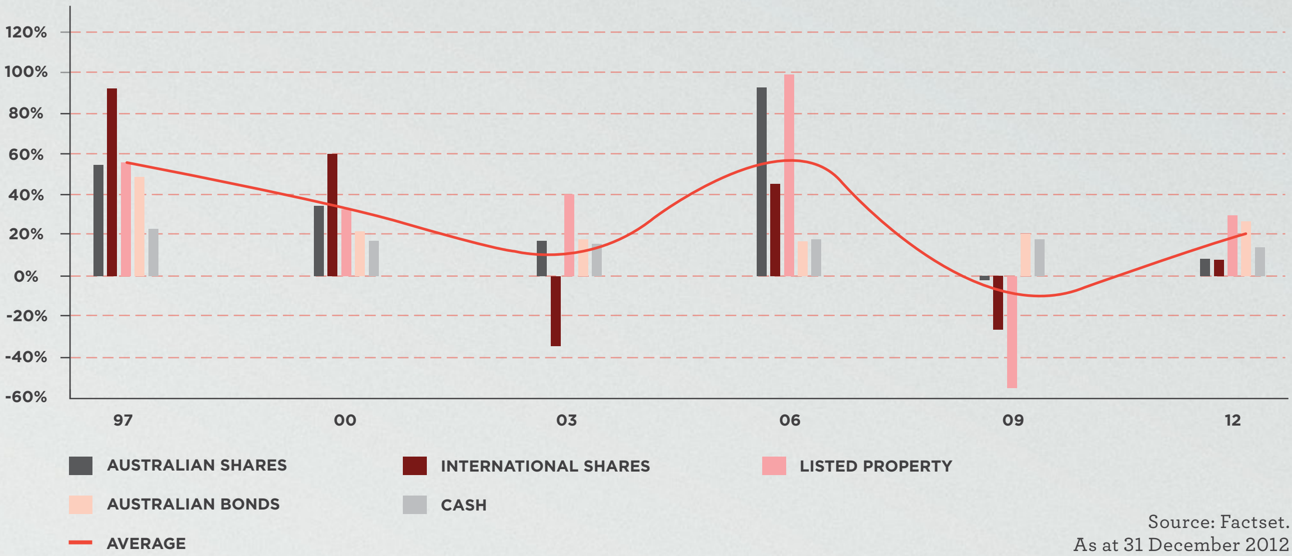
When you establish a diversified portfolio, it is tempting to leave your money in the asset classes which are performing well and to ignore the asset classes which are not performing as strongly.

However, to successfully maintain a diversified portfolio, you need to regularly review and reweight your investment. This can be done with the assistance of your financial adviser.

Reweighting a balanced portfolio can reduce volatility and improve performance.

Your financial adviser will be able to help you select an individual asset allocation that is appropriate for your risk profile, investment time frame and income requirements.

**THE BENEFITS OF DIVERSIFICATION ARE CLEAR**
Cumulative three-year return of each growth asset class since 1997




Source: Factset.
As at 31 December 2012

**EXAMPLE**

## THE BENEFIT OF A BALANCED PORTFOLIO

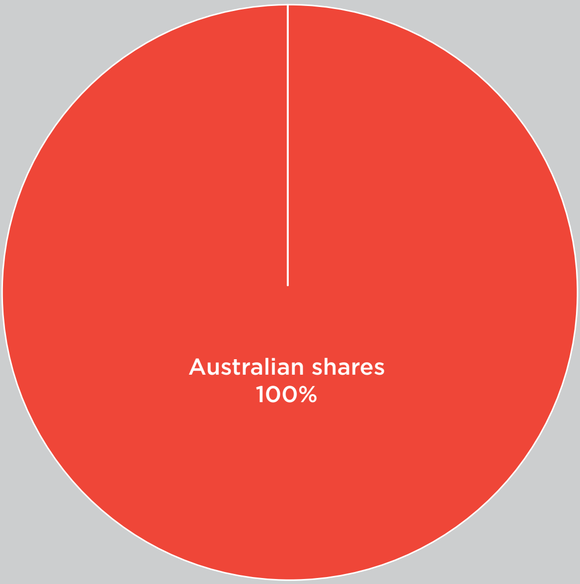
Andrew and Liu set up investment portfolios in December 1987. Andrew's portfolio is made up of 100% Australian shares.

Liu's portfolio is made up of 70% growth assets (40% Australian shares, 25% international shares, 5% property) and 30% income assets (20% fixed interest, 10% cash).

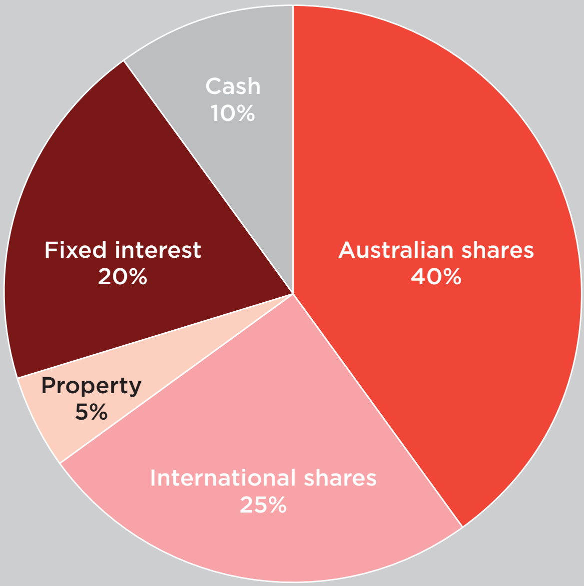
While their returns at the end of December 2012 are very similar, Liu's portfolio was significantly less volatile because it was diversified across asset classes.

### THE BENEFIT OF A BALANCED PORTFOLIO

#### ANDREW'S PORTFOLIO




#### LIU'S PORTFOLIO




| ANDREW (100% AUSTRALIAN SHARES) | |
|---|---|
| Return % pa | 9.65 |
| Risk (volatility) % pa | 13.55 |
| Worst one-year return (%) | -40.45 |
| Worst cumulative three-year return (%) | -27.96 |

| LIU (BALANCED, 70% GROWTH) | |
|---|---|
| Return % pa | 8.48 |
| Risk (volatility) % pa | 8.09 |
| Worst one-year return (%) | -23.37 |
| Worst cumulative three-year return (%) | -15.22 |

Annualised average risk versus returns Dec 1987 – Dec 2012.
Liu's portfolio is rebalanced each year.

Source: Datastream, Factset, Perpetual.
As at 31 December 2012

## UNDERSTANDING RISK

Australian and international shares form a very important part of a well-diversified portfolio. The percentage of your portfolio that you invest in shares will depend on your investment time frame and your tolerance to the volatility of the sharemarket.

Shares have historically demonstrated greater volatility and can be considered to have higher investment risk than other asset classes such as mortgages, fixed interest securities or cash. As such, shares are ideally suited to investors with a minimum investment timeframe of five years. For such investors, short-term volatility isn't important.

What is important is that:

- shares tend to regain any short-term lost performance and generally outperform all other asset classes over the long term
- shares can provide long-term capital growth, and
- shares can provide a strong and growing income stream.

By not investing in growth assets such as shares, you face the greater risk of earning less than inflation or not effectively diversifying your assets.

### EXAMPLE
### REWEIGHTING A PORTFOLIO

In the previous example, Liu invested $100,000 in December 1987 in a portfolio made up of:

- 40% Australian shares (measured by the Blended All Ordinaries Index)
- 25% international shares (measured by the MSCI World ex Australia Accumulation Index $A)
- 5% listed property trusts (measured by the Blended Property Trusts Accumulation Index)
- 20% fixed interest (measured by UBSA Composite Bond Index)
- 10% cash (measured by UBSA Bank Bill Index)

Liu's financial adviser reweighted her portfolio every month – in other words, the proportion invested in each asset class was maintained regardless of changes in valuation.

Over the 25-year investment period, Liu's initial investment of $100,000 has increased in value to $1,030,441.35 (to 31 December 2012).


Source: Datastream, Factset, Perpetual.
As at 31 December 2012

# WHICH TYPE OF SHARE OWNERSHIP IS RIGHT FOR ME?

Share ownership can be divided into two categories:

- Direct ownership – where you buy shares directly, usually through a stockbroker or online through a share trading platform
- Indirect ownership – where you buy units in a managed fund which invests in shares on your behalf

## MANAGED FUNDS OFFER EXPERTISE AND SCALE

A managed fund pools your money with money from other investors with similar aims to form an investment fund.

Specialist investment managers then invest the pooled money. The greater buying power available to the fund means you can benefit from opportunities not normally available to individuals.

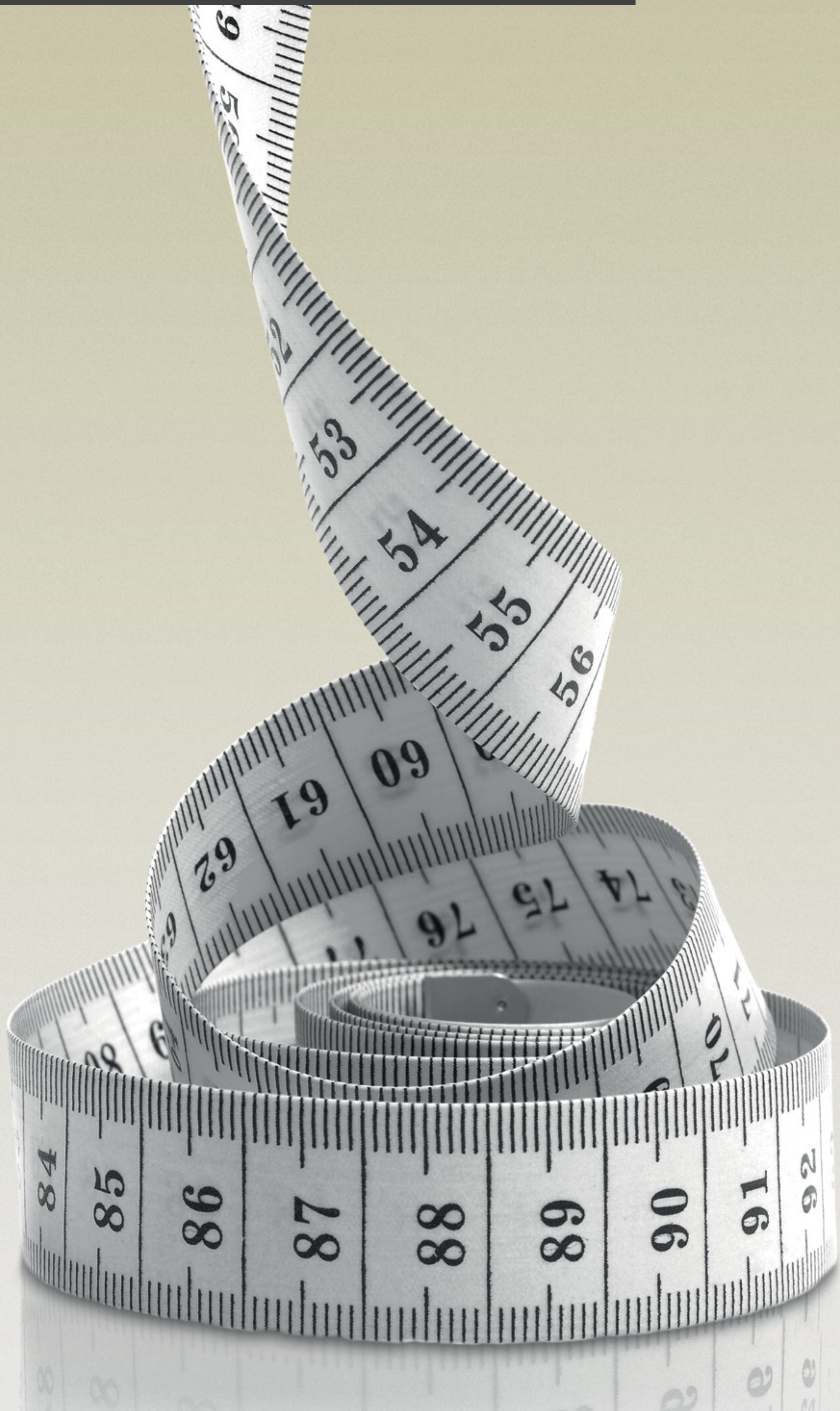
Managed funds come in many shapes and sizes. Some invest in just one type of investment such as Australian shares, others invest across a range of asset classes.

## STRUCTURED AS UNIT TRUSTS

Most managed funds are structured as unit trusts. When you invest, you buy units in a fund. The price of each unit reflects the value of the funds' investments and will rise when the value rises and fall when the value falls. Like shares, unit prices fluctuate daily. Companies that offer managed funds can provide you with the latest exit unit price over the phone or on their website.

| DIRECT OWNERSHIP | MANAGED FUNDS |
|---|---|
| **RESEARCH** | |
| Selecting the right shares takes careful research and knowledge.<br><br>You could do your own research and select the shares yourself. You could also pay a stockbroker for their expertise. | By investing in a managed fund, you are outsourcing the stock selection to the fund managers – trained investment specialists who constantly research and monitor the investment markets. |
| **TIME MANAGEMENT** | |
| The administration that comes with holding shares directly can be time consuming, especially if you have several stocks in your portfolio. | When you invest in a managed fund, your fund manager will handle all the paperwork and administration, provide you with regular information on the funds' performance and provide annual tax statements and tax guides. |
| **DIVERSIFICATION** | |
| A truly diversified portfolio of shares, property, fixed interest and cash can be very difficult for an individual investor to achieve. You need to invest in several shares to gain diversification benefits. | One of the greatest benefits of managed funds is that they allow you to diversify your investments. Managed funds can offer diversification benefits across asset classes, within asset classes, or around the world. |
| **COST** | |
| A truly diversified share portfolio can be expensive. | Managed funds is a low cost way to access professional investment expertise. |

# MONITORING THE PERFORMANCE



## BENCHMARKING PERFORMANCE

It's critical to have an objective measure of how well your share portfolio is performing. Professional fund managers compare their performance against an 'index' that best matches the composition of their fund. You may have heard about fund managers outperforming various benchmark indices. This happens when the investments they have selected perform better than the ones in the basket of investments in the index.

## AN INDEX MEASURES CHANGE IN VALUE

An index measures the change in value of a particular group of investments over time. There are two indices that measure the performance of the major companies listed on the Australian Securities Exchange (ASX) – they each capture 95% of the value of the Australian sharemarket.

## PRICE INDEX – CHANGE IN PRICE

The S&P/ASX All Ordinaries Price Index measures the price of the shares of the major companies listed on the ASX.

## ACCUMULATION INDEX – CHANGE IN TOTAL RETURN

The S&P/ASX All Ordinaries Accumulation Index measures the total return of the share price movements and dividends – assuming these dividends were reinvested to buy more shares – of the same group of companies as the Price Index.

As dividends are an important feature of share investments, the Accumulation Index is a much better gauge of medium to long-term total performance than the Price Index.

## OTHER INDICES

There are various other indices used to benchmark performance. The main one of these is the All Ordinaries Index. This comprises the largest 500 stocks on the Australian sharemarket by market capitalisation (their share price multiplied by the number of shares issued).

The All Ordinaries Index is known as an 'umbrella index'. It has six benchmarking indices beneath it that measure the performance of sub groups of shares with certain characteristics, for example industrial companies or smaller companies.

**PERPETUAL'S BENCHMARK INDICES**

| PERPETUAL FUND | BENCHMARK |
|---|---|
| Perpetual Australian Share Fund | S&P/ASX 300 Accumulation Index |
| Perpetual Industrial Share Fund | S&P/ASX 300 Industrials Accumulation Index |
| Perpetual Smaller Companies Fund | S&P/ASX Small Ordinaries Accumulation Index |
| Perpetual Concentrated Equity Fund | S&P/ASX 300 Accumulation Index |
| Perpetual SHARE-PLUS Long-Short Fund | S&P/ASX 300 Accumulation Index |
| Perpetual Ethical SRI Fund | S&P/ASX 300 Accumulation Index |

# PERPETUAL INVESTMENTS

Leading the way

## TRUSTED FOR OVER 125 YEARS

At Perpetual we've been helping Australians protect and manage their wealth through good times and tough times since 1886. Today, we're still proudly Australian and have evolved into a leading full-service wealth manager. We combine a reputation for prudence and care with one for being forward thinking and high performing.

## INDEPENDENT MINDS, COLLECTIVE WISDOM

Since 1966, Perpetual Investments has led the way in Australian equities, developing a strong reputation for producing consistent returns.

The secret of our success has always been our people. Perpetual's principles and processes are deeply ingrained in every member of the team, and these principles are totally focused on producing the best outcomes for you.

But don't just take our word for it. Morningstar, a prominent financial research house, has awarded Perpetual and our funds numerous awards over the years. In 2013, Morningstar named Perpetual Investments the Australian Fund Manager of the Year, and we won two other categories. These awards are determined by a combination of qualitative research by Morningstar's fund analysts; risk-adjusted returns over medium- to long-term periods; and performance in the 2012 calendar year.

If you're looking for a managed fund that can offer long-term capital growth and income, or any combination of the two, you may want to talk to your financial adviser about our range of investments. You can rest assured that when you invest in any of our managed funds, you are investing in quality.

MORNINGSTAR Awards 2013

# KEY TERMS

**ASSET CLASS**
An asset class is a group of securities with similar characteristics and behaviour. Shares are one type of asset class. Other types include property, fixed income and cash.

**CAPITAL GROWTH**
Your initial investment is known as your investment capital. The rise in value of your capital over time is called capital growth. With shares, capital growth occurs when the price of the share rises higher than what you bought it for. Shares offer both capital growth and income opportunities.

**DIVERSIFICATION**
Diversification is about spreading your risk. When you invest in different asset classes, across sectors and companies within an asset class, and in different countries you are spreading your risk – poor performance in one area is likely to be balanced out by better performance in another.

**DIVIDEND**
Income received from shares is called dividends. A company chooses whether or not to pay a dividend out of its earnings and if so, how much.

**DIVIDEND IMPUTATION**
Dividend imputation / tax effective investing – you get tax benefits for dividends received from a company that has already paid tax on the earnings behind the dividends. This is so that tax is not paid twice and represents a tax saving to the investor.

**INDEX**
A share index measures the change in value of a particular group of investments over time. A Price Index measures the change of price. An Accumulation Index measures the total return of the share price movements and dividends (assumes all dividends are reinvested). Managed funds measure their performance against benchmark indices.

**INVESTMENT PORTFOLIO**
Investment portfolio – your collection of investments. A share portfolio only includes shares, whereas an investment portfolio may include shares, fixed income and other asset classes.

**MANAGED FUND**
An investment portfolio managed by a professional fund manager. You buy units in a managed fund; your money is then pooled with money from other investors and invested in asset classes by the fund manager.

**REWEIGHTING**
The total values of the different asset classes in your portfolio will change over time. In order to make sure you continue to benefit from diversification your adviser will need to periodically reweight the portfolio.

**RISK PROFILE**
Your risk profile is determined by your investment time horizon, your expectations for returns and how much risk (volatility) you can tolerate. Once you identify your risk profile you can select the type of investments that best suit you.

**SHAREMARKET**
The sharemarket is a market in which buyers and sellers come together to buy and sell shares. In Australia, the leading market for shares is the Australian Securities Exchange. It is made up of close to 2,100 companies. It is the eighth largest sharemarket in the world, and the second largest in the Asia-Pacific region behind Japan. (Source: ASX, March 2013)

1168_PIRIIS_0713

## PERPETUAL'S MANAGED FUNDS INVEST IN ALL MAJOR ASSET CLASSES – SHARES, FIXED INCOME, CASH AND PROPERTY. WE HAVE DEVELOPED A STRONG REPUTATION FOR DELIVERING CONSISTENT RESULTS OVER THE LONG TERM.

### CONTACT US

Please contact us for more information or for a product disclosure statement.


Web www.perpetual.com.au
Email investments@perpetual.com.au

Phone (for calls within Australia, during business hours, Sydney time)

Investor Services Australia 1800 022 033
Investor Services New Zealand 0800 442 261
Adviser Services Australia 1800 062 725
Adviser Services New Zealand 0800 441 656

Reply Paid 4171
Perpetual Investments
GPO Box 4171
Sydney NSW 2001
Australia

No stamp required if posted in Australia

**NEW SOUTH WALES**
Angel Place, Level 12
123 Pitt Street
Sydney NSW 2000

**AUSTRALIAN CAPITAL TERRITORY**
Level 6, 10 Rudd Street
Canberra ACT 2601

**QUEENSLAND**
Central Plaza One, Level 15
345 Queen Street
Brisbane QLD 4001

**SOUTH AUSTRALIA**
Level 11, 101 Grenfell Street
Adelaide SA 5000

**VICTORIA**
Rialto South Tower, Level 35
525 Collins Street
Melbourne VIC 3000

**WESTERN AUSTRALIA**
Exchange Plaza, Level 29
2 The Esplanade
Perth WA 6000

**MORE INFORMATION**
Contact your financial adviser or call 1800 022 033
Email investments@perpetual.com.au
www.perpetual.com.au


Perpetual