Year 10 Commerce Assessment Task 1 - 2006

INVESTING

As an alternative to the insignificant returns from the typically low interest accrual in savings accounts, there are many financial and social reasons for people to be more disposed to investing their capital in other ways despite the inherent element of risk.

Not only are saving account interest rates very low, on average 2.81% per annum for the average income earner, but equivalent to other 'risk-free' investments, they do not satisfy substantial short-term gains. By investing in the highly volatile share or property market, however, it is possible to generate an extensive positive return over only a short period of three to four years. For example, those people investing in the property market from June 1991 to June 2001 would have generated more than $30,000 from just $10,000.

Essentially, many people realise that the risk of negative returns is necessary for them to outperform inflation; risk and return always correlate. Low-growth assets, such as cash investments are relatively low-risk, their average annual return is only 5.69% per annum after inflation over the 10 year period since 1996, as opposed to high-risk share investments, yielding 12.01% per annum over the same time period.

More significantly though, is the influence of the time factor on people's decisions to accept a greater risk, as investors 'can take more risk if [they are] investing for a longer period'. The volatility of the market, especially in the short term, can be seen by asset prices fluctuating from 'negative figures to double-digit returns' about every five years. However, in the long term, the general economic cycles of booms and recessions will ensure an eventual upward trend in market prices. Having to tolerate the risk of short-term capital losses for an eventual positive return, is acceptable for many investors interested in long term gains.

Understanding the concepts of risk management is also another reason behind many people's decisions to invest their funds in risk assets. Offsetting risks by diversification and hedging, to a large extent, minimises the possibility of a large capital loss. For example, by investing in a variety of different sectors (eg. banking, media, retail and property trusts), helps to reduce industry and product risk. Assured by the greater chance of achieving high returns and the knowledge that risk is extensively minimised from having a diversified investment portfolio, investors are more willing to accept the increased risks of investing.

With the investment capacity of $100,000, I would aim to create a diversified investment portfolio that focuses mainly on growth assets, so my funds will not lose their purchasing potential. Interested in a long-term investment term of around 7 years, I would mainly invest my capital in the Australian and foreign share markets, probably covering around 70% of my investment portfolio to suit my high risk tolerance profile, To build a balanced share portfolio, I would select five to ten sectors that have the potential to do well, such as healthcare/biotechnology, tourism/leisure and banking, and selecting within each the top-performing companies; smaller companies and emerging markets are also promising. I believe investing in overseas share markets is very important, as the Australian share market

accounts for less than 2% of the total capitalisation of the world's share markets. About 15% of my investment portfolio would invest in term deposits and bonds, as part of a conservative portfolio to ensure a more dependable flow of funds. I would also consider gearing, most likely in the property market, as a viable option, because cash flow is such an important factor for wealth.

Overall, investing can be a more profitable alternative to bank savings accounts, as it has a higher possibility of generating wealth.

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