Aberdeen Standard Investments

A guide to equities

Equities

Put simply, equities are shares in a company. Owners of these shares become part owners of the company. This gives them the right to have a say in how the company is run and to receive part of the company's profits.

Investing in equities has been taking place since the 17th century in the UK and equities now form the backbone of many people's savings and pensions.

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What is an equity?

Equities represent a proportion of the ownership of a company. So when you buy shares, you become a part owner of that company – a shareholder. Equities are usually traded on a stock exchange. You can track their value on the company's website, specialist investor websites or in a variety of major national newspapers. It is possible to invest in companies of varying sizes in different industries and sectors, and geographical locations.

Why invest in equities?

Equities (or stocks and shares) are what most people think about when it comes to investing. They have the potential to generate higher returns over the long term than most other types of investment. They can therefore play an important part in your investment portfolio.

There are many reasons for investing in equities, including the following.

- The money you invest (your capital) has the potential to grow over time.
- You can receive regular payments from your investment in the form of dividends.
- Equities can help you spread risk when used as part of a diversified investment portfolio. This is because different types of investment act in different ways and can go up and down at different times.

How can you make money?

1. Capital growth

If a company's share price goes up and you sell those shares, you make money, as they're now worth more than you paid for them. A company's share price can go up for a variety of reasons, such as:

- the company's profits are higher than expected
- supply and demand: the price goes up if there are more investors wanting to buy shares in the company than there are shareholders willing to sell
- a rival company within the sector announces good results, suggesting a positive trading environment
- the company is subject to a takeover bid
- economic or political developments are viewed as a positive for it (e.g. a government announces new infrastructure projects that will benefit builders, concrete companies, engineering firms, etc.).

2. Income

Many companies (particularly those that are large and well-established) usually pay out part of their profits to investors in the form of a dividend.

In most cases, company directors choose how much to pay out each year – and they don't have to pay out at all. Indeed, some businesses might choose not to pay a dividend, preferring to use the money to help grow the business (e.g. investing in new technology or machinery, or buying another company).

In general, though, companies have a commitment to pay a dividend to shareholders and the decision not to pay one could do more harm than good. For example, it could indicate problems within the business and lead to a drop in the share price.

How can you lose money?

Historically, equities have outperformed most of the so-called safer investments, such as bonds and cash. If managed correctly, they can provide potential for growth in your investment portfolio.

However, with the potential for higher returns comes higher risk. Equities can be volatile, meaning their value can rise or fall sharply at any time. So when you sell shares, you could get back less than you invested. You could even get nothing back. If a company goes out of business, its shareholders are likely to lose all their investment. Equity investors rank towards the end of the queue to receive any payout when a company's assets are sold off.

Equities in different sectors and countries can also perform in different ways at different stages of the economic cycle. For example, when the economy is in recession, investors tend to prefer larger companies with more reliable profits. Examples include utilities, energy and healthcare firms. By contrast, those reliant on consumer spending or business investment may suffer during a recession.

There are times, however, when the general rules don't apply. During the financial crisis of 2007/08, equities fell across the board, with nearly all types of companies caught up in the sell-off. Thankfully, such events are rare.

How to invest

You can buy or sell shares directly through a stock broker, or on websites dedicated to trading investments. This will incur a cost. Investment in individual companies can be particularly risky as your investment is dependent on those companies' profits.

To help spread this risk, many people choose to invest through equity funds, managed by an investment company. That way, your money is pooled with other investors' money to buy a range of equities. By doing this you can invest in a larger number of companies with different or diverse types of business, meaning all your eggs aren't in one basket.

Equity funds have the benefit of being run by an experienced fund manager, who invests and manages the money for you. You'll pay charges for being invested in funds, although these vary depending on the type of fund you choose. There are many different types of fund, with their own levels of risk. Whichever route you choose, we'd always recommend that you speak to a financial advisor before you make an investment decision. If you don't already have a financial adviser and would like to find one in your area, take a look at www.unbiased.co.uk.

Types of funds include:

Tracker funds

Track a specific stock exchange or index, such as the MSCI World or FTSE® 100

Style-specific funds

Focus on providing investors with a particular outcome, such as paying an income

Country- or region-specific funds

Invest in companies in one country or region (e.g. the Eurozone or Asia)

Sector-specific funds

Invest in companies in a particular sector, such as the oil industry, or in companies of a specific size, such as smaller companies. The definition varies, but smaller companies are usually those valued at less than £2.5 billion

Definitions

Equity

(n) shares in a company that can be bought and sold on a stock market

Bonds

(n) debenture, a security, issued by a government or a company when borrowing money

Multi-asset

multi- combining form meaning much or many; asset *(n)* an item of monetary value
e.g. she invested in a multi-asset portfolio

Important Information

This information is to help you understand more about equities, how they work and why you might want to invest in this asset class and all the risks.

The value of investments, and the income from them, can go down as well as up and investors may get back less than the amount invested. Past performance is not a guide to future results.

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ASI_1261_Why_Invest_In_Equities_10 GB-190219-83292-1

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