INVESTOR EDUCATION

Investor Guide

ALL YOU NEED TO KNOW

(Vol: I)

1. INTRODUCTION

Everyone today appreciates the need to save whether for a house, for children's education, a wedding, or for use after retirement. All these goals can be realized through excellent financial planning. An intelligent plan entails investing your money in an appropriate combination of assets with potential to generate the income needed to achieve your goals. If you invest wisely, you can maximize the earning on your investments.

There are many investment avenues available, but a wise investor does not invest on impulse, a hot tip or follow the herd. An investor should discriminate between information, casting away irrelevant and illogical pieces of information, and checking for opportunities and facts before making an intelligent choice of investments.

2. WHAT IS THE STOCK EXCHANGE?

The stock exchange provides a market place where shares can be bought and sold.

2.1 What is the Role of the Stock Exchange?

- The stock exchange admits companies for trading at their securities.
- It provides a market for raising capital by companies.
- It provides a market place for shares of listed public companies to be bought and sold, by bringing companies and investors together at one place.
- The exchange's role is to monitor the market to ensure that it is working efficiently, fairly and transparently.

2.2 Stock Exchanges in Pakistan:

There are three stock exchanges in Pakistan:

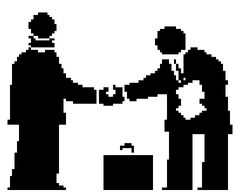
i) Karachi Stock Exchange (Guarantee) Ltd.

ii) Lahore Stock Exchange (Guarantee) Ltd.

iii) Islamabad Stock Exchange (Guarantee) Ltd.

Of these, Karachi Stock Exchange is the biggest exchange in the country.

2.3 Trading and Settlement:



The stock exchanges have introduced a computerized trading system to provide a fair, transparent, efficient and cost effective market mechanism to facilitate the investors.

The trading system comprises of four distinct segments, which are:

i) T+3 Settlement System;

ii) Provisionally Listed Counter;

iii) Spot Transactions; and

iv) Futures Contracts.

2.4 T+3 Settlement System:

In the T+3 settlement system, purchase and sale of securities is netted and the balance is settled on the third day following the day of trade.

2.5 Benefits of T+3 Settlement System:

- It reduces the time between execution and settlement of trades, which in turn reduces the market risk.
- It reduces settlement risk, as the settlement cycle is shorter.

2.6 Provisionally Listed Counter:

The shares of companies, which make a minimum public offering of Rs.100 million, are traded on this segment from the date of publication of offering documents When the company completes the process of dispatch/credit of allotted shares to subscribers, through CDC it is officially listed and placed on the T+3 counter. Trading on the provisionally listed counter then comes to an end and all the outstanding transactions are transferred to the T+3 counter with effect from the date of official listing.

2.7 Spot/T+1 Transactions:

Spot transactions imply delivery upon payment. Normally in spot transactions the trade is settled within 24 hours.

2.8 Futures Contract:

A Futures contract involves purchase and sale of a financial or tangible asset at some future date, at a price fixed today.

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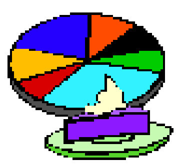


WHAT ARE SHARES?

Each share represents a small stake in the equity of a company. You can buy large or small lots to match the amount of money you want to invest. A company’s share price can rise or fall as a result of its own performance or market conditions.

Once the shares are brought and transfered in your name your name will be entered in the company’s share register, which will entitle you to receive all the benefits of share ownership including the rights to receive dividends, to vote at the company’s general meetings to receive the company’s reports.

If you decide to sell your shares you will need to deliver share certificates to the broker in time for the transaction to be completed.

With the introduction of the Central Depository System (CDS), an investor can have shares in paper form or can own shares in an electronic book- entry form at the Central Depository Company (CDC).

3.1 Why Do Companies Issue Shares?

Companies issue shares to raise money from investors. This money is used for the development and growth of businesses of companies.

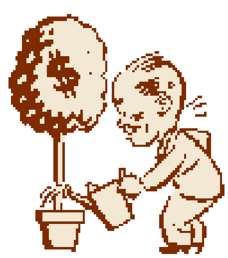
A Company can issue different types of shares such as ordinary shares, preference shares, shares without voting rights or any other shares as are permissible under the law. These give shareholders a stake in the company's equity as well as a share in its profits, in the form of dividends, and a voting right at general meetings of shareholders.

3.2 Why Do Investors Buy Shares?

Studies have shown that over a twenty-year span, investment in shares has provided greater returns than most other forms of savings. Shares can provide you with a regular stream of income through dividends as well as the potential for your investments to grow in value. If the prices of shares go up, you can sell them for more than you paid. This is called capital gain.

3.3 What are Dividends?

Dividends are returns paid to shareholders out of the profits of the company. Returns can be in the form of cash or additional shares of the company called bonus shares. Dividends are usually paid once or twice a year depending upon the company's profit distribution policy.



3.4 What is Capital Growth?

This is one of the ways in which shares differ from deposit accounts. The principal amount of money you put in a bank or any fixed income savings scheme always stays the same e.g. if you start with Rs.100,000 you will always have Rs.100,000 (other than any interest earned).changes in value according to the performance of the company. With good management, the value of your investment in shares of a company can grow over time so that your shares are worth more than you paid for them. This is capital growth.

3.5 Risks And Rewards: 

Buying shares can offer advantages over saving in deposit accounts: your investment may increase in value besides paying you dividends. You share the rewards when the company does well and the price of the shares goes up. But if the company performs badly, the share price may go down and the value of your investment will be reduced. Other factors, such as the performance of the stock market as a whole and the general economic climate, may also affect the price of your shares. Investment in shares is therefore investment in 'risk capital'. The shareholders can be rewarded for taking this risk and the potential return on your money can be higher than that on other investments. You can reduce your risks with careful planning.

4. TIPS FOR INVESTING WISELY

4.1 Know What Investment Products are Available:

The following types of securities are available on the stock market for investment:

- Ordinary shares of listed companies
- Unit trust schemes
- Mutual funds certificates
- Corporate bonds i.e., Term Finance Certificates (TFCs)
- Government securities i.e., Federal Investment Bonds(FIBs), Pakistan Investment Bond (PIBs) and Special US Dollar Bonds.

4.2 Know Your Investment Profile: 

A wise investor chooses an investment product not only according to his goals and the amount of capital available but also according to his tolerance for risk. All investments carry a certain degree of risk. You have to determine whether you are a "risk-taker" or a "risk-averse" person. Depending on the extent of risk you intend to take, you should pursue an investment strategy (aggressive, moderate or conservative) that fits your risk profile.

4.3 Do Your Homework Before You Invest: 

Don't put in your money until you have understood all relevant informationregarding the investment.

Prepare yourself for the vigorous homework of analyzing company's annual reports, accounts and other statements while keeping abreast of what's happening in the industry, country and elsewhere that may affect your investment. Consult your investment adviser/broker to get latest market information about shares you intend to buy or sell. Be skeptical of any thing picked up from rumors, particularly if you cannot rationally explain their choice.

4.4 Think Long-term: 

Bear in mind that even in the best of securities/shares, there can be short-term aberrations. It is important to have the power to hold your investments for longer periods. Studies have shown that investments properly timed and based on strong fundamentals have been very profitable for investors in the longer term.

4.5 Avoid Putting All Your Eggs In One Basket: 

The best way to minimize risk is to diversify your investments across various investment products. If equities are your sole investments, it makes sense to diversify between different companies and sectors. In this way, loss made on some investments can be absorbed by gains made in others, keeping the overall return on investments positive.

You can also diversify your investment by investing in open-end funds managed under various unit trust schemes. While investing in mutual funds check the rating of the instruments. Similarly while investing in any security please check the rating if any available.

4.6 Beware of Scams: 

Beware of promises of quick profits or sky-high returns. Remember: higher the gain on investments, higher is the risk involved. This is the fundamental risk-reward trade-off.

5.

INVESTOR PROTECTION:

You should always ensure that the stockbroker you choose is licensed by the Securities and Exchange Commission of Pakistan (SEC) to trade. Prefer stock brokerage firms with good track record. As a shrewd investor, you should know your rights and responsibilities and should beware of the rules that govern your investments as well as the legal recourse available, in case things go wrong. You can report abuse to the SEC, whose mission is to ensure the development of a fair, efficient, and transparent securities and futures market. Although its main function is regulatory in nature, the SEC has the ultimate responsibility to protect the investor through market supervision and ensuring that its laws and regulations are complied with.

Stock exchanges are the frontline regulators; they must play a proactive role. Send all your complaints in writing to the respective stock exchange(s) with full details, including the complainant's name, address and telephone number etc. In case you do not get a response to your complaint, please contact the "Complaint Cell" in the SEC.

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GLOSSARY OF STOCK MARKET TERMS

Bear – an investor who anticipates a falling market and, therefore, sells the security in the hope of buying it back at a lower price.

Blue Chip – A large well-established company with a history of profitable operation.

Bonds – Fixed-income securities, which entitle the holder to a pre-determined return during their life and repayment of principal at maturity.

Bull – An investor who anticipates a rising market and, therefore, buys the security in the hope of selling it later at a higher price.

Capital Gains Tax – Tax payable on profit arising from appreciation in value of investment, realized at the time of selling or maturity of investment.

Carry-over Trades–Equity repurchase transactions, better known, as "Badla"; these are an established form of transactions used in the stock market for temporary financing of trades by speculators and jobbers.

Dividend – That part of a company's profits which is distributed among shareholders, usually expressed in rupee per share or percentage to paid up capital.

Earnings per share (EPS) – A profitability indicator calculated by dividing the earnings available to common stockholders during a period by the average number of shares actually outstanding at the end of that period.

Equity – The owners' interest in a company's capital, usually referred to by ordinary shares.

Floatation – The occasion when a company's shares are offered on the stock market for the first time.

Fund managers – A company, which invests and manages investors' money, with the aim of maximizing capital growth.

Initial Public Offering (IPO) – The offering of equity shares of a company to the general public for the first time.

Insider trading – The purchase or sale of shares by someone who possesses 'inside' information on a company's performance which information has not been made available to the market and which might affect the share price. In Pakistan, such deals are a criminal offence.

Investment companies – A company, which issues shares and uses its capital to buy securities and shares in other companies.

Listed company – A company whose securities are admitted for listing on a stock exchange.

Long position - When an individual purchases securities of a company he is said to have a long position in the company's shares. For example an owner of shares in PTCL is said to be "long PTCL" or "has a long position in PTCL." If you are long, you would like the share price to go up.

Market capitalization – The total value of a company's equity capital at the current market price.

Nominee – A person or company holding securities on behalf of others, but who is not the owner of such securities.

Option – The right (but not the obligation) to buy or sell securities at a fixed price within a specified period.

Ordinary shares – The most common form of shares, which entitle the owners to jointly own the company. Holders may receive dividends depending on profitability of the company and recommendation of directors.

Portfolio – A collection of investments

Price/earning ratio (P/E ratio) – The P/E ratio is a measure of the level of confidence (rightly or wrongly) investors has in a company. It is calculated by dividing the current share price by the last published earnings per share.

Primary market – Where a company issues new shares, either for the first time, or at the time of issuing additional securities.

Privatization – Conversion of a state-owned company to a public limited company (plc) status.

Private company – A company that is not a public company and which is not allowed to offer its shares to the general public.

Public limited company (plc) – A company whose shares are offered to the general public and traded freely on the open market and whose share capital is not less than a statutory minimum.

Rights Issue – The issue of additional shares to existing shareholders when companies want to raise more capital.

Securities – A broad term for shares, corporate bonds or any other form of paper investment in capital market instruments.

Settlement – Once a deal has been made, the settlement process transfers stock from seller to buyer and arranges the corresponding exchange of money between buyer and seller.

Short Selling- The act of borrowing stock to sell with the expectation of price reduction with the intention of buying it back at a cheaper price.

Stockbroker – A member of the stock exchange who deals in shares for clients and advises on investment decisions.

Stock Market – The market place where shares of publicly listed companies are bought and sold.

Unit trust – An open-ended mutual fund that invests funds in securities and issues units for sale to the public. It can repurchase these units at any time.

Yield – The aggregate return earned on an investment taking into account the dividend/interest income and its present capital value.