Share Investment Fundamentals

Shares represent part-ownership in a company. The share market historically offers an opportunity for strong capital growth over the medium to long term. Combined with the potential for the capital growth, shares also provide regular dividend income stream, exposure to speciality market sectors (e.g. infrastructure and technology), taxation benefits from dividend imputation credits and more investor control over current & future tax position.

Shares can be categorised into two groups-ordinary shares and preference shares or partly-paid (contributing) shares. Ordinary shares are the most common form of security in Australia. Holders of ordinary shares are part owners of a company and may receive payments in cash known as dividends. The ordinary share holders have no preferential rights to either dividends or capital when the company they are invested in is wound up.

You can purchase the listed shares on any trading day by placing an order with a broker. You can also purchase new shares by participating in float or in an Initial Public Offering (IPO).

Shares are often very tax efficient in that the income received is in the form of dividends with imputation/franking credits attached to it. The franking credits represent the amount of tax already paid by the companies. Under the current tax system, you only pay tax once for Australian based income. If your marginal tax rate is higher than the company tax rate 30%, you are required to pay the difference to ATO. If your tax rate is lower, you will receive the difference from ATO. In addition, the capital growth from the shares is not taxable until the investment is sold.

Fully franked dividend means the company has paid tax on the entire dividend. A partially franked dividend means that tax has not been paid on a portion of the dividend and is taxable in the investor's hands.

Whilst shares have been known to outperform other asset classes such as cash, fixed interest and listed property historically (refer to the asset class return table in Investment and Risk Fundamentals), it is important to understand that the share market may be affected by factors such as general economic condition, market sentiment and the performance of the company itself. The investment returns may, therefore, fluctuate and there is also the risk of capital loss over the short term. You should take into consideration your investment time frame as well as your tolerance to risk.

Shares can be either listed or unlisted. Listed companies are required to abide by Australian Securities Exchange (ASX) listing rules in order for their company shares to be traded on the ASX.

The All Ordinaries (All Ords) measures the share prices of a basket of companies representing about 97 percent of the Australian share market by market capitalisation. All Ords Index is used to measure the performance of the share market.

Advantages and Disadvantages of Investing in Shares

The advantages of share investing include:

- Wealth Accumulation – Historically, shares provide potentially higher return on investments compared to other asset classes over medium to long term. By investing in shares you can grow your wealth at a greater rate over the long term.
- Tax Efficiency – Due to the franking credits attached to the dividend, investors can benefit from the fact that tax has already been paid on the income received by the company. Depending on your marginal tax rate, you may receive tax credits or you may not have to pay any tax on the dividend you receive. Any unused imputation credits can be used to offset tax payable on other income.
- Company Benefits – Investors are able to participate in company meetings, receive shareholder discounts (if offered) and take advantage of special share issues offered by some companies.
- Liquidity – Listed shares can be easily bought or sold on ASX.
- Dividend Reinvestment Scheme – The dividends can be reinvested to purchase additional shares without incurring brokerage & generally at a discounted price to the market value. Please note you are still required to pay tax on the income you have reinvested.
- Diversification – Spreading your investment portfolio over various asset classes means you can take advantage of investment upturns of different investments.

The disadvantages of share investing include:

- Fees – Brokerage fees and/or adviser fees are payable for the share transactions.
- Capital Gains Tax - You are liable for the capital gains tax on the profit received from the sale of the shares. Please note the assessable capital gain is reduced by 50% if you hold the shares for longer than 12 months. There is no capital gains tax if the shares were purchased prior to 20 September 1985.
- Volatility – As with all growth oriented assets, share investing involves a degree of risk. The higher the potential for return, the higher the risk that the return on the investments may fluctuate from time to time.
- Loss of capital – share prices are subject to change. You should be aware that may lose your capital if a company is wound up or even suffer a potential loss during the market downturn.
- Investment Time Frame – Due to the fluctuating nature of the investment, share investing is appropriate for investors with a minimum time frame of 7 years.
- Dividend Re-investment- Purchase of additional shares via dividend re-investment plan may cause complications in calculating capital gains tax upon the sale of shares.