Guide to asset classes

Prepared by Liberty Group Advisory Services

Helping you make an informed decision

You've heard that it's a good idea to 'diversify into different asset classes' but what are these asset classes and how do these work?

When choosing the 'mix' of assets in your portfolio, you need to understand:

- The *volatility* of the asset: how risky is it?
- The *liquidity* of the asset: how quickly can you access your money? Are there penalties or fees for 'cashing in' early?
- The *returns* of the asset: how will your investment grow and what kind returns can you expect?
- The *advantages* and *disadvantages* of the asset (some of these are listed in this document).

To help you make an informed decision about which assets to include in your portfolio and how to balance your portfolio with different assets, we have prepared this guide to different asset classes.

The table below gives an overview of each asset class: cash, bonds, property and equities. More information on each asset class can be found on the pages that follow

Cash	Bonds	Property	Equities
Interest-bearing instruments and discount instruments	Debt instruments	Physical property and listed property	Large cap and small cap shares
Suggested minimum investment period			
1 day	1 – 3 years	3 – 5 years	3 – 5 years

Speak to your financial adviser

Speak to your financial adviser before you invest in or buy a financial product. Your financial adviser will help you draw up a financial plan and guide you in choosing the products and portfolios that are right for you.

Find out more online

For information on **Liberty Life** products: www.liberty.co.za | Products.

For information on **STANLIB** products: www.stanlib.com | Investment for Individuals.

Cash

How it works	*Access to money*	*Return*
Interest-bearing instruments		
MONEY MARKET FUND		
Money is invested in money market instruments.	Depends on the instrument.	Investors have access to higher interest rates. Usually have a higher return.
CALL DEPOSIT		
Money is deposited at a bank and ‘called’ for when needed.	Interest rate fluctuates	Interest rate is usually not high although could be higher on larger amounts.
NOTICE DEPOSIT		
Money is deposited at a bank and notice must be given before withdrawing	Notice must be given to the bank before withdrawing e.g. 32 days to 1 year. Penalties apply if money is withdrawn early.	Interest rate fluctuates. Interest rate is usually higher than on call accounts as giving notice allows banks to plan their cash flows.
FIXED DEPOSIT		
Money is deposited at a bank for a pre-determined period	Notice must be given before withdrawing	Interest rate is fixed.
NEGOTIABLE CERTIFICATE OF DEPOSIT (NCD)		
A certificate is bought from the bank and can be traded (sold) to someone else	The certificate is ‘redeemed’ from the bank	The person who holds the certificate will receive interest from the bank.
Discount instruments		
TREASURY BILL		
A short-term loan certificate issued by the South African Reserve Bank (SARB) on behalf of the government.	A nominal value is paid to the investor at redemption	A nominal amount less a discount
PROMISSORY NOTE		
A loan certificate issued by a large company.	The repayment of the nominal amount is not guaranteed by a bank.	Because the only guarantee is the soundness of company, should have a higher return.

Bonds

How it works	*Access to money*	*Return*
Bonds are used to raise long-term finance for the government, semi-government organisation or corporate. They are traded on the Bond Exchange of South Africa (BESA). The bond amount and interest are ‘set’ at a certain date which is when the bond reaches maturity and can be redeemed.	The bond holder receives the ‘set’ amount and interest when the bond matures. Bonds can be traded before maturity date but only redeemed on the maturity date.	When interest rates change, the value of existing bonds also changes. Bond market volatility exists because changes in bond prices are inverse to changes in interest rates.

Bonds: some terminology

- The *coupon* is the annual interest return on a bond instrument.
- A *zero-coupon bond* is a bond that is bought at a discount so the coupon value is 'included' in the price.
- *Gilts* are bonds sold by government
- *Semi-gilts* are bonds issued by parastatals e.g. Transnet or Eskom.

Property

How it works	*Access to money*	*Return*
PHYSICAL PROPERTY		
The property is registered in the investor's name.	Rental income; capital appreciation on revaluation of the property and eventual sale.	Rental income received and increase in the value of the property.
LISTED PROPERTY		
The rights to the property are held in an investment product such as property loan stocks and property unit trusts.	Rental income in the form of interest semi-annually (like a dividend); capital appreciation is purely stock-market driven. Works the same as an equity instrument. Property JSE	Rental income received and increase in the value of the property.

Equities

How it works	*Access to money*	*Return*
Companies that are listed on the JSE Securities Exchange can raise money by issuing shares which give investors part-ownership in these companies. Shares can be bought directly or indirectly through investment vehicles such as unit trusts, life products and derivatives.	Would depend on the investment product. If shares are owned directly, income is earned from dividends and the increase in the share price.	Although equities are the most volatile asset class, they have offered the best real returns over the past 5, 10, 20 and 48 year periods. Listed property over more recent periods has marginally outperformed equities.

Equities: some terminology

Classification of shares

Shares can be bought in different sectors. The JSE defines these sectors as:

- Resources
- Basic industrials
- Financials
- Non-cyclical consumer goods
- Cyclical consumer goods
- Personal care and household products
- Cyclical services
- Non-cyclical services
- General industrials
- Information technology

Share indices

A sample of shares from each sector is taken and combined to form an index. The performance of a share can be measured against its index.

The indices on the JSE are:

Alsi 40	Top 40 shares
Fini	Financials shares
Resi	Resources shares
Indi	Industrials shares
Findi	Financials and industrials shares

Large caps and small caps

- *Large caps* are shares of the companies in the JSE top 40. These are usually large, blue chip companies which are well established and financially sound.
- *Small caps* are shares in the smallest 265 companies of the JSE and are more volatile than large caps.

How to minimise equity risk

- Stick to a long-term plan (stay invested!)
- Invest regularly.
- Invest in different sized companies and different sectors
- Invest offshore as well as domestically

Advantages and disadvantages of different asset classes

	Advantages	Disadvantages
Cash	▪ Most liquid and risk-free investment. ▪ Predictable income stream. ▪ “Short-term parking place” for excess funds while deciding where to invest for the longer term. ▪ Often seen as a safe haven during economic downturns. ▪ Return may outperform equities or bonds over short periods.	▪ No hedge against inflation. ▪ Lower risk but also generally a lower return.
Bonds	▪ Investing in bonds allows for diversification of the portfolio. ▪ Predictable income stream. ▪ Less risk and volatility than equities. ▪ Often seen as a safe haven during economic downturns.	▪ No hedge against inflation (unless the bond is linked to inflation). ▪ Lower risk but also generally a lower return than equities. ▪ Prices can be volatile.
Physical property	▪ Less volatility in capital as property is revalued every year. Not affected by market sentiment. ▪ Smoother return. ▪ More conservative investment.	▪ Longer-term commitment. ▪ Invested for the long term and can’t change exposure to different tenants.
Listed property	▪ Allows for diversification of the portfolio. ▪ Consistent cash flows. ▪ Inflation hedge over the long term. ▪ Linked to the equity market through capital growth. ▪ Linked to the bond market through income yields.	Prices can be volatile and are affected by: ▪ Negative global equity markets. ▪ Slump in global growth and impact on commodity cycle. ▪ Sudden currency change and impact on inflation and interest rates, especially bond yields.
Equities	Offer the best returns over the medium to long term.	Are volatile and require a medium- to long-term view.