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Securities Investors Association (Singapore)

Growing Money Wisely

An introductory guide to investing

Preface

During my 16 years at SIAS, I have seen many investors suffer losses. Even our esteemed Mr Warren Buffett, widely regarded as one of the most successful investors of all time, is willing to admit that even the best investors make mistakes.

Recently, in his 50th letter annual letter to the Berkshire Hathaway shareholders, Warren Buffett highlighted 2 major mistakes. Firstly, buying Berkshire and then buying National Indemnity Company under Berkshire. If he had bought the insurance business through his investment partnership hedge fund, which he still ran at the time, he and his investors would have captured all of the investment gains he created over the past 50 years. Instead, he has shared those gains with the public shareholders of Berkshire Hathaway. The mistake cost him and his partners $100 billion.

If a talented and sophisticated investor like Warren Buffett can make such mistakes, what about ordinary retail investors. The difference between Warren Buffett making such a loss from his investment decisions is that he still has billions to spare. In the case of many retail investors, when they lose their investments, there are no millions or even thousands to spare.

Over the past 16 years, SIAS has conducted over 1000 investor education programmes, touching over 120,000 retail investors and we actively champion investor rights.

On our part, SIAS will continue to engage shareholders and listed companies to raise the standard of corporate governance in Singapore and champion investor rights.

In Singapore today, over S$56 billion of Singapore citizens' monies are sitting in local banks deposits and fixed deposits earning very little interest rates; the value of which is being eroded by inflation. Singaporeans must learn to invest.

This eBook is yet one more way to educate and create more informed investors in Singapore. Produced in collaboration with SMU Sim Kee Boon Institute for Financial Economics, it helps provide you with the knowledge to invest wisely.

David Gerald
Founder, President and CEO
Securities Investors Association (Singapore)
August 2015

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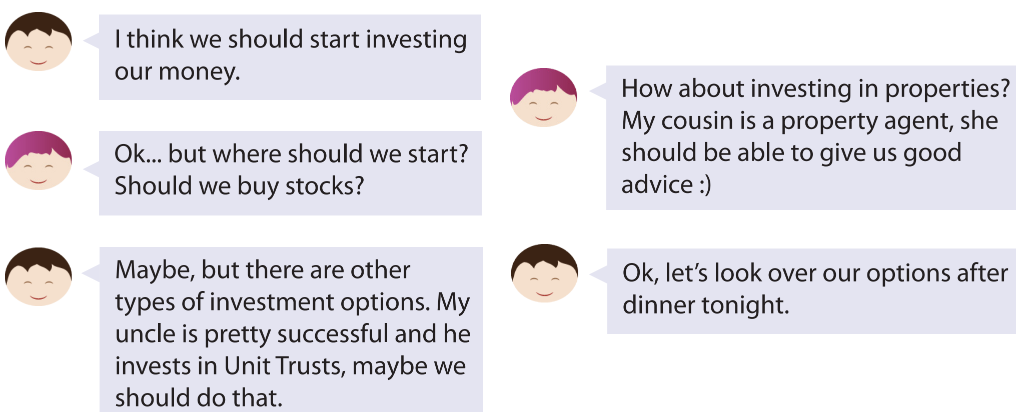
3 Dimensions of Investing

Many investors would have the following 2 questions in their minds: Should I spend more or should I save? Should I keep as deposits or should I invest? In this article, we will introduce to you fundamental concepts in investing, as well as the 3 dimensions of investing that every investor should know: "Know Yourself", "Know the products" and "Know the strategies".

Most people know that investing is the act of committing money now in the expectation of receiving more money in the future. It takes some effort to get started as there are many investment options for an investor to consider, such as real estate, bonds, stocks, etc. In helping you to select products and strategies that are suitable for your portfolio, SIAS has introduced the "3 Dimensions of Investing" to help you in your investment decisions.



Goals for investing

Most people invest in the hope of getting higher returns. However, expected returns are typically proportionate to the level of risk taken. In order to achieve higher expected returns from your investment, you have to be willing to take on additional risks.

What is risk?

Risk is the probability that the actual returns on the investment will deviate from the expected returns. The more volatile the expected returns, the higher the risk of losing your initial capital. Examples of high risk assets include junk bonds and penny stocks while low risk assets include treasury bills and fixed deposits.

There are also other risks to be considered in any investment. These include currency risk, interest risk, operational risk, political risk, social risk, weather risk and the list goes on. In summary, risk is any factor that can affect the value of your investment.

Before we look into the types of investments available in the market, we should consider our own goals for investing.

If you have decided that you are going to save some money, should you save or invest it? There are many reasons in favour of investing your money than keeping it in bank savings accounts. Firstly, the interest rate on savings accounts is very low and not expected to rise in the forseeable future. Next, inflation will reduce the purchasing power of your savings. Lastly, investing can be a supplementary source of income that will help you meet medium to long term financial goals, such as purchasing a house and retirement plans.

While investing decisions are important, many investors do not take the time to do a proper analysis of their investments on a regular basis. Most people put the blame on family and work commitments, but an adequate amount of time should also be spent on managing your money. After all, it is your hard-earned cash and poor investing choices can cause you to lose your savings instead of growing your money.

You should assume an active role where personal finances are concerned. Even if you leave your money to professional advisors and fund managers, you will need to monitor their performance regularly as the losses will ultimately be borne by you!

What are your considerations when investing?

You should ask yourself the following questions before investing:

What is your investment objective and time horizon?

If your objective is to make as much profits as possible, you have to consider investing in higher risk assets. For example, a young working adult would have a longer time horizon and prefer a more aggressive investment strategy to generate greater returns.

In contrast, a retiree living off his retirement portfolio will have a shorter time horizon, and would prefer preserving the value of his investments by investing in lower risk assets.

How much can you afford to invest?

Some asset classes, such as bonds, require a minimum investment sum before you can invest in them.

How much losses are you prepared to incur?

If you are not prepared to lose your capital, you should only take up investments which have very low risk. However, this would also imply a lower expected return on your investment.

Is the product suitable for you?

Do you understand the product? Are the timings of payments and the risks involved acceptable to you?

What are the fees and charges?

Are there any hidden fees? Do the fees and charges make the investment worthwhile? For example, unit trusts may promise high returns, but the fees they charge could wipe out the benefits of investing in them.

What is the worst case scenario?

What is the most severe loss that you expect from the investment? What is the likelihood that it will happen?

Is the product provider and financial adviser regulated by MAS?
What is their track record? Are they credible and reliable?

Are there alternative products?

Are there any other investment products in the market which will offer higher returns with similar risks?

Some important points

1. There is no "free lunch" in investing. The higher the potential returns, the higher the risk.

2. Do not take on more risk than you can tolerate.

3. Do not be attracted to an investment based solely on attractive offers of potential returns. Find out and evaluate the risks involved.

4. If you plan to invest your Central Provident Fund (CPF) savings, consider the interest you are currently earning, i.e. 2.5% per annum for Ordinary Account and 4% per annum for Special Account.

Is there a way to manage these considerations?

You can manage these consideration by using the 3 dimensions of investing. If you know yourself, you will know the investment products which are suitable for you. If you know the products well, you will know the range of products which are suitable for your risk profile. Lastly, when you know the investment strategies available, you will be able to invest in products which will allow you to generate returns.

Rumours and scams

A common mistake made by new investors is to base their investment decisions on hearsays or rumours. If you had overheard that someone made money by buying a certain stock, it does not mean that you will profit by buying it now. He may have sold his investment or bought it a lower price if he is still holding on to the stock. Some people may even be creating hype in certain assets so that they can sell it at higher prices.

Another issue about investing is the presence of scams. There is no definite way of making high profits. If there are no risks on a profitable investment, the price will be driven up by the forces of demand and supply.

One of the biggest investment scams ever was a Ponzi scheme created by Bernard Madoff, who convinced investors that he was making consistent profits. Bernard Madoff was also the non-executive chairman of NASDAQ before his scam was discovered. Hence, investors need to careful of the different investment schemes so that they do not fall prey to these schemes.

What do the 3 dimensions cover?

Know Yourself

It is important to know yourself to get a better understanding of the investing choices that are available for your risk appetite. We need to have a close look at our financial situation and personality so that we can choose the right investment vehicle.

1. Should I spend more or should I save?

2. Should I leave my money in bank deposits or should I invest?

3. How much risk can I take?

4. How much risk should I take?

5. How long should I stay invested?

Know the Products

It is important to know the products well so that you can invest a greater variety of instruments. Different products have different investing criteria and liquidity levels. In the event that you require cash immediately, liquid investments like stocks and treasury bills would be more appropriate than real estate as you can get back your money more quickly and at low costs.

1. What investments are available?

2. How safe are these investments?

3. Will I be able to get cash back when I need it?

4. How long does it take for the investment to return me the cash?

5. Is my capital guaranteed? By whom?

6. What are the penalties for early withdrawal?

7. What are the fees and charges?

8. What are the risks?

Know the Strategies

While choosing the right product is important, it is also crucial to select the right strategies. You will need to consider methods of diversification and management of your investment portfolio, which will vary over time depending on market direction. You will also need to consider entry/exit strategies and the decision to take profit or cut losses.

1. How much do I invest in each type of investments?

2. How can I protect my investments?

3. Do I invest long-term or adjust consistently in the short-term?

4. How often should I review my investments?

5. When should I take profit and cut losses?

6. How do I take advantage of the economic growth of other countries?

7. Should I invest in the local markets only or global markets?

8. Should I borrow to invest?

How can the 3 Dimensions help?

These 3 dimensions can help you to align yourself with particular investment styles and appropriate products based on your experience and risk appetite.

Let's begin with the following scenario:

Richard: I think I will invest $100,000 in the stocks of Company A. The stock price is down sharply as a result of the huge losses incurred in the past year. I believe that Company A will recover and I'll make a huge profit.

Joe: Richard is a good investor, maybe I should do the same.

The problem here could be Richard is wealthy and owns a well diversified portfolio, while Joe has only $100,000 in savings. Hence, Richard can afford to take the risk for higher returns, while Joe is not advised to follow Richard's investment decision.

> **!** Do not put all your eggs in one basket
>
> You should not place all your eggs in the same basket, especially if the investment involves high risks.

This is an extract from the book 3 Dimensions Of Successful Investing published by SIAS.

Chapter 2

The Good Old Savings Tool

From the times of the Jurassic, to the times of the World Wars up to the present (probably an exaggeration), people have been trying to come up with different ways of preserving their wealth. In those days, there was no difference between savings and investment, speculation and arbitrage. Everything was about the accumulation of assets which made sense to most people. Even before fiat currency (or paper money) was introduced, people learnt to collect rare and valuable items, such as elephant tusks or tiger skin, to exchange for other items which they require.

In the context of this book, we need to be clear of the difference between savings and investment. Simply put, your savings are stored in safe places that allow you access to your money at any time. Of course, putting your money in a biscuit tin, under the mattress, in a piggy bank or any 'secret' location would be part of your savings. But why take the risks when you can park it in a regular savings or checking account with lower possibility of loss or theft, and a chance to earn some interest as well?

However, in your investments, there is a greater possibility of losing your capital, even when they are purchased from institutions such as banks.

Mike, I saw a piggy bank on the eBay site and its soooo cute! I want to buy it

Dear, your third piggy already. Your first 2 are not full and you want to buy a third one?

Pleaseee?

How much?

Its only $50. Some more have 50% discount now because of GSS. Really a good buy.

Ok. This will be the last time I will buy for you. Make sure you keep this one fat and full.

Sure, thank you dear.

Since the purchase of the piggy bank, Jane has been saving more of her money in order to keep Mike happy. Mike comments: At least this is a good purchase after all!

Importance of savings

From a personal perspective, savings is important as it is part of the assets that we own. In addition, most people save for the proverbial 'rainy day', so that we can tap on these funds for emergency purposes quickly.

Savings is important from the economic perspective. Government investment in new MRT trains requires savings. Building of a new university requires savings. A Singapore company expanding overseas also requires savings. So where does all the money come from? In simple terms, people with excess money, such as savers, will provide funds for others who need to borrow money, such as the company which is expanding overseas. The bank will act as a middleman, linking up the supplier of money to the people who need money. Hence, with your savings, Singapore will have enough money to build newer facilities and help our companies to expand overseas.

Through the savings that you have with the banks, they will have enough capital to ensure an efficient financial system. Banks in Singapore would be able to set up more financial facilities to ensure that Singapore can remain as a global financial hub.

Cash as an Investment Class

For most investors, there is a choice between entering the markets or staying on the sidelines. During downturns, people will usually stay away from the markets and keep most of their holdings in cash.

Indeed, cash is an investment class as it allows people to deploy their assets in order to maximize returns. Hence, when the returns on risky assets are poor, people usually turn to holding cash despite the low returns. While some people believe that having a constant exposure to the market is good, it is also prudent to remember that savings can also provide returns, and during times of crisis, cash is king!

Time value of money

Whenever we are saving money in the bank account, we are putting aside money which we could spend right away, in the hope of increasing our future spending power. Therefore, we should get 'paid' for not being able to enjoy the benefits today. This payment is also known as 'interest', or the returns on our bank savings. Note that most interest rates are usually quoted on an annual basis, which is the return you get on your savings over a one year period.

In short, the time that we hold on to our money does have value in the form of interest payments. Hence, it is not advisable to hold onto large amounts of cash as it will not generate any returns for you!

Rule of 72

There are many tips and tricks in Maths, and this one will tell you how long it will take to double your money, or turn $1 into $2! Divide 72 by the annual interest rate to get the approximate number of years. For example, if annual returns are 4%, it will take roughly 18 years to double your initial capital. This is similar to the 17.67 years calculated using the exact formula. Next time, when you need to find out how long it will take to double your money, use this simple rule and calculations will definitely be much faster!

THE MAGIC OF COMPOUND INTEREST
RULE OF 72

4%		6%		8%		12%	
29	$1,000	29	$1,000	29	$1,000	29	$1,000
47	$2,000	41	$2,000	38	$2,000	35	$2,000
65	$4,000	53	$4,000	47	$4,000	41	$4,000
83	$8,000	65	$8,000	56	$8,000	47	$8,000
		77	$16,000	65	$16,000	54	$16,000
		89	$32,000	74	$32,000	60	$32,000
				83	$64,000	66	$64,000
						72	$128,000
						78	$256,000
						83	$512,000

Divide 72 by the interest rate or inflation rate to estimate
The number of years it takes for your money to "double"
For or against you.

This illustration describes the effect of compounding a $1,000 lump sum at various ages and Interest rates. It does not represent the past or future performance of any specific product.

Simple vs Compound interest

A key concept in the accumulation of money is the difference between simple and compound interest. For the simple case, interest is paid only on your initial principal amount, and not on previous interest payments. For the compound (or more difficult) case, interest is calculated based on the initial principal as well as previous interest payments. We will illustrate the difference in the example below.

Example: Mike has $100 in his savings account at Bank A, earning simple interest of 1% per year. He also has $100 in Bank B, earning compound interest of 1% per year. How much does John have in his 2 accounts at the end of 10 years?

Solution: For the simple case, use the formula Sum = Principal * (1 + Interest Rate * Number of years). Hence, Mike will have $110 = $100 * (1 + 1% * 10) at the end of 10 years. For the compound case, use the formula Sum = Principal * (1 + Interest Rate) ^ (Number of years). In this case, Mike will have $110.46 = $100 * (1 + 1%) ^10.

This example illustrates that the compound interest method will have a higher final sum than the simple interest method. This is true for all cases, with the exception of zero interest rates or a one-year holding period, when the final sum is the same.

Interesting fact: Do you know how the bank calculates interest on your savings account? Do they pay simple or compound interest?

The interest that is paid on your savings account is compounded daily and paid monthly. Suppose that the interest rate is 1% per year and your savings account has $100. This means that at the end of the first day, the bank will credit you with an interest of $1/365. On the second day, the bank pays $1/365, which is interest on the principal, as well as $1/133225, which is one day interest of the previous day's interest. This process continues, with a sum of $100.08 at the end of 1 month and $101.01 at the end of 1 year. To calculate the exact interest amounts, you can use the formula Sum = Principal * (1 + Interest Rate / 365) ^ (Number of days).

Inflation risks

Now, you may be thinking that: The bank pays me when I deposit money into the savings account, and there are little or no risks in saving more money. Well, you also need to consider the purchasing power of your money, which is affected by the inflation rate in Singapore.

Suppose that you decide to save $3 today by not having your usual plate of chicken rice at the hawker centre. Exactly one year from now, the chicken rice stall owner decides to increase the price to $3.50, or a 17% increase. The $3 that you have saved today will accumulate to $3.03 next year, based on 1% interest rate. However, as the price of the chicken rice has increased to $3.50, you would have to pay an additional $0.47 next year for the same plate of chicken rice!

Hence, the effects of inflation are equivalent to slicing off the returns on our initial principal. Inflation can also make our initial principal worth lesser in future!

However, as inflation affects the entire Singapore economy, we are unable to do much to prevent the loss of value, except to get a higher return on our initial capital.

Assume 5% inflation rate	Price Now	Price 1 year later	Price 10 years later
Coffee	$1.20	$1.26	$1.95
Chicken Rice	$3.00	$3.15	$4.89
Fish N Chips	$7.00	$7.35	$11.40

Capital Guaranteed

There are many financial products in the market, with some bearing more risks than others. At times, you will also see labels such as "Capital Guaranteed" attached to certain investment products or in newspaper articles.

"Capital Guaranteed" means the investor is guaranteed to get back his initial investment at the maturity date. A guarantor, usually a third-party financial institution, will place a guarantee on the product for a fee. However, this does not eliminate all investment risks. The investor will need to be mindful if the guarantor can repay the guaranteed amount.

On the other hand, "Capital Protected" investment, a term outlawed in Singapore in 2009, is one where the principal sum is ploughed into safe investments, such as bonds, to provide 100% principal protection upon maturity. However, there is no explicit protection in place for the investors.

Deposit institutions in Singapore

There are many financial institutions accepting deposits in Singapore. Most of you should be familiar with major banks that accept deposits over the counter, as well as finance companies which offer deposit services. The subtle difference between the two forms of institutions lies with the higher level of risks and lower financial regulation of finance companies. However, you do not need to worry about this issue as both forms of institutions are covered by the Deposit Insurance Act.

Another less well-known type of institution is the savings and thrift cooperatives. Generally, you will need to belong to particular organizations and pay a minimum fee in order to be accepted as a member of the cooperative. Some cooperatives also accept all Singaporeans as associate members. Cooperatives are financed by members' savings through subscription capital, while the capital is loaned out to its members.

Some of the benefits available to members include lower interest loans, annual dividends on deposits as well as higher interest on savings and fixed deposits. However, by saving with cooperatives, you are part-owner instead of a regular customer at a bank or finance company. Furthermore, the savings in cooperatives are not covered under the Deposit Insurance Act.

Deposit Insurance Act

The insurance was implemented in 2006, protecting small depositors of Singapore dollar deposits, as well as charities, in current, savings and fixed deposit accounts up to the limit of $20000 per member. The coverage has since been increased to $50000 per depositor and includes all non-bank depositors including companies and partnerships. CPF-related monies are also covered at the $50000 limit separately. The scheme is initiated to mitigate potential cash flow problems of depositors in the event of a bank failure in Singapore.

However, foreign currency deposits, currency linked investments, structured deposits and other investment products are excluded from the Deposit Insurance coverage.

Different forms of savings

Savings, in its simplest form, is keeping our money with the bank so that we can withdraw the money whenever we need it. However, with the growth of the financial industry, banks and finance institutions have offered a wide variety of savings products to cater to the needs of different Singaporeans. In this section, we will offer you a glimpse of the savings programs available in Singapore, which will guide you in your personal savings program.

Current and Savings Accounts

Most people have these accounts and they require no further explanation. Current accounts allow you to issue cheques but do not pay interest; savings accounts let you accumulate interest on your savings. Most accounts also come with debit cards, Internet banking, and a full range of banking services such as fund transfers and EPS share payment.

There are some savings accounts that offer you higher interest by depositing part of your monthly salary for a minimum period of 6 months. Such accounts are advisable if you wish to maintain constant savings or have no immediate use for the money.

Most of the current and savings accounts come with fees attached, so it is important to avoid charges through keeping the minimum balance or preventing overdrafts on your accounts.

Fixed Deposits

This is another common savings instrument in Singapore, paying higher interest than normal savings accounts due to the lock-up period from 3 months up to 5 years. However, if the deposit is withdrawn before the maturity date, you can suffer loss of interest payments and even a reduction of the principal sum.

You can also save in foreign currency fixed deposit accounts offering higher interest. Some of the high-yielding currencies include the Australian and New Zealand dollar, while Chinese Yuan (CNH) deposits are also available at selected banks. Do take note of the foreign currency risks which will be explained in greater detail in Chapter 14.

Precious metals

There are also savings accounts which allow you to save gold or silver through buying or selling these metals at current market prices. While you are able to trade freely, you must understand that price movements of these precious metals can be volatile. Furthermore, these accounts yield no interest or dividends for the account holder and also incur administration costs. Hence, this account might not be suitable for all savers due to higher risks.

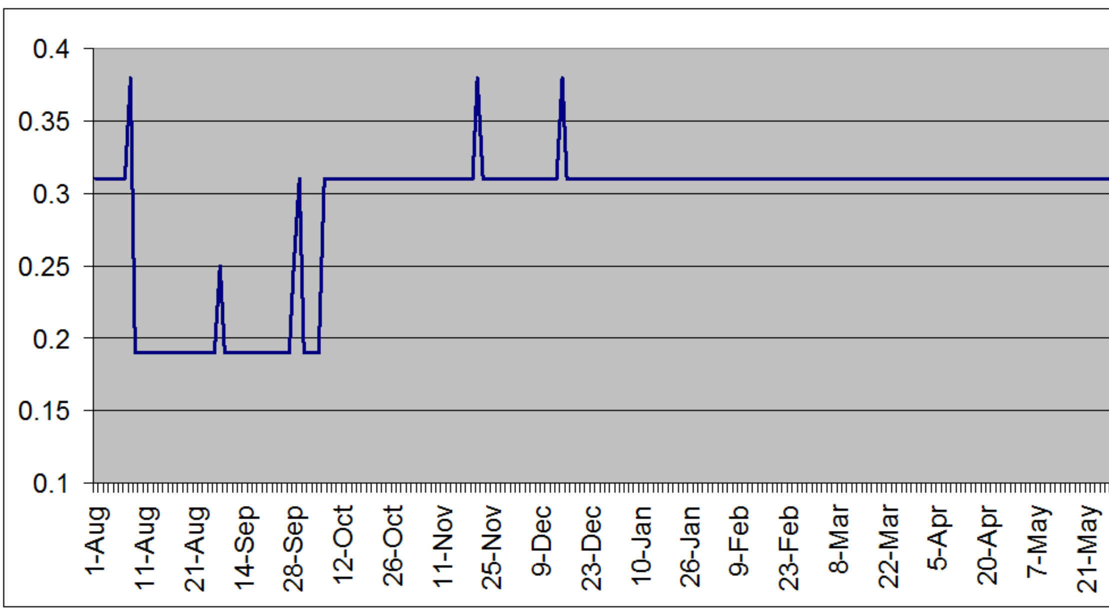
Packaged Savings

As you walk past any bank branch, you will realize that they would display fixed deposit rates that are higher than the prevailing rates in the market. These fixed deposit accounts are usually paired up with complementary products such as insurance policies or unit trusts, so that they can pay higher interest rates with the longer lock-up period or higher investment value. You need to understand the risks and obligations involved, through a detailed assessment process, before deciding to invest your money.

Why are current interest rates so low?

As you look at your savings passbook on 31 December, you will realize that the interest rates are really low: For $10000 in savings, you would have only received $5 in interest per year. Why are the rates so low? In Singapore, the key interest rate indicator SIBOR (Singapore Inter-Bank Offered Rate) is the rate that banks lend to one another, which in turn determines the rates charged on loans or paid on savings.

There are mainly 3 factors that influence this rate: US interest rates, expectations of the Singapore Dollar exchange rate and demand and supply for loans and deposits in Singapore. The first factor has been highlighted as the most important factor in influencing interest rates. With US interest rates likely to remain low in the near future, it is no wonder that Singapore's interest rates have remained at low levels.



Savings products of today

In today's complex financial landscape, there are many savings products available in the market, catering to different needs of individuals. While simple savings accounts are still available, there is a greater variety of instruments offered by banks for a complete financial solution.

1. How will our savings benefit us and the overall economy?

2. Why do banks pay us interest when we put money into savings accounts?

3. Name at least 5 types of savings accounts that are available in the Singapore banks.

4. What are the 3 key factors that affect interest rates in Singapore?

5. What is a capital-guaranteed product? Are there any risks involved in a capital-guaranteed product?

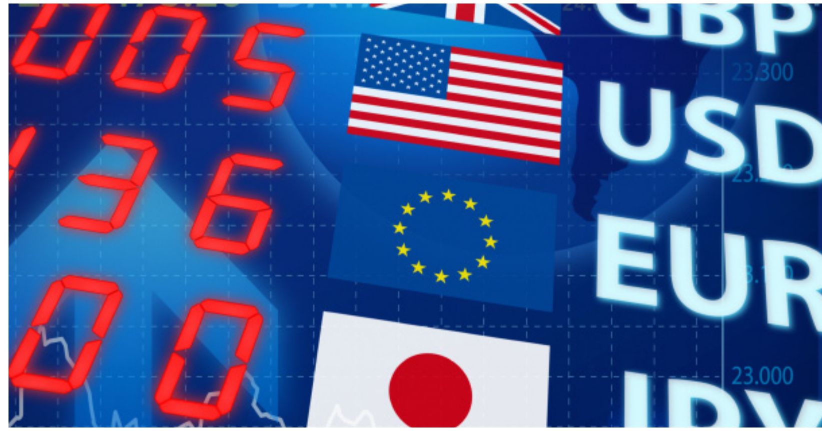
In A Nutshell

1. It is unlikely that you will lose the principal on your savings account as compared to regular investments.

2. While the bank offers interest for saving money in various savings accounts, the real return offered by these accounts can be negative, if the interest rates are lower than the inflation rate.

3. The savings in our accounts are protected, up to a maximum of $50000 per depositor, by the Deposit Insurance Act.

4. Different types of savings account today involve currency risks, asset price risks and liquidity risks and every saver should understand the risks involved and assess the suitability of the product.



Chapter 3

Other Country's Money

In ancient times, transactions of commodities or any form of business are mostly paid by the physical transportation of real gold. Yet, can you imagine the scenario of a foreigner paying gold to the cashier of the duty-free store at the airport of your country? As the result of the development of international trade and multinational organizations, a conversion system which enables international transactions to take place without the physical transportation of gold one currency is needed.

Foreign exchange is the general name of any currency other than the local currency, which is used to settle international transactions. Some currencies, including the Euro, allow for several countries to share the currency usage. Unable to cover all currencies in detail, we will mainly focus on the major currency pairs used internationally, such as the US dollars vs. the Euro and the Japanese Yen vs. the Swiss Franc in this chapter. Apart from getting to know the main members of the foreign exchange family, we are sure that you would like to know how these currencies are related to each other, in other words, what amount is one currency equal to another currency. After this chapter, you will have a better idea of how these monetary commodities are priced and circulated around the world.

Being no different from any kind of actions in our life, using or trading foreign exchange will definitely bear some risks. Due to the special characteristics of foreign exchange, we need to figure out what are the most prevalent risks that one may encounter when dealing with foreign exchange, in addition to managing them for our benefits. Hopefully, after going through this chapter together with Mike and Jane, you will be confident enough to test the water personally.

Short story about Mike and Jane

Honey moon, something just next to the wedding ceremony, is one of the most important events of life. Our newly married couple, Mike and Jane, has been planning to spend their honeymoon period to enjoy the ancient and diversified architectures in the European sites. During their preparation of this trip, money is one of the issues that they need to be concerned about. Euros are used in most of the destination countries, while others such as Great Britain are still using their own money. So where to change Singapore dollars into euros or pounds, and how many Singapore dollars are needed to exchange for one pound or euro are the main questions that Mike and Jane need to figure out. In the process of looking for the necessary answers, they found that foreign exchange is something quite interesting. Hence, they decided to look deeper into this financial area to see if they can add foreign exchange assets to their portfolios.

Here are the fundamentals which they collected in order to get to know the foreign exchange market.

Foreign Exchange

Main Currency Pairs

A currency pair is made up of two currencies, one being bought and the other sold simultaneously in the foreign exchange market. Foreign exchange pairs are written by joining the ISO currency codes (ISO 4217) with a slash, e.g. EUR/USD, USD/JPY, etc. The slash character can be omitted.

The first member of every pair is known as the base currency or transaction currency, and the second member is called the counter currency or quote currency. The International Organization for Standardization (ISO) decides which is the base currency and which is the quote within each pair. Base currency / quote currency is set by the Society for Worldwide Interbank Financial Telecommunication cooperative (SWIFT).

The most traded currency pairs in the world are called the Majors.

The Majors are:

- US Dollar / Japanese Yen (USD / JPY)
- Euro / US Dollar (EUR / USD)
- Pound Sterling / US Dollar (GBP / USD)
- US Dollar / Swiss Franc (USD / CHF)
- US Dollar / Canadian Dollar (USD / CAD)
- Australian Dollar / US Dollar (AUD / USD)

Non-major Pairs

"Minors" or "Exotic" pairs:

- USD/SEK (US Dollar / Swedish Krone)
- USD/NOK (US Dollar / Norwegian Krone)
- USD/DKK (US Dollar / Danish Krone)
- USD/HKD (US Dollar / Hong Kong Dollar)
- USD/ZAR (US Dollar / South African Rand)
- USD/THB (US Dollar / Thai Baht)
- USD/SGD (US Dollar / Singapore Dollar)
- USD/MXN (US Dollar / Mexican Peso)

Other pairs where the US Dollar is not a member currency are called "crosses". For example, GBPJPY, EURJPY, EURCAD, and AUDNZD are all considered currency crosses.

Nick Names
In daily foreign exchange market trading and news reporting, the currency pairs are often referred to by nickname. The following nicknames are common: Cable for GBP/USD, Fiber for EUR/USD, Chunnel for EUR/GBP, Loonie and The Funds for USD/CAD, Matie and Aussie for AUD/USD, Geppie for GBP/JPY, Kiwi for New Zealand Dollar NZD/USD, Barney for USD/RUB, and Betty for the EUR/RUB pairing. Nicknames vary between the trading centers in New York, London, and Tokyo.

Foreign Exchange Rate

Every purchase of one currency implies a corresponding sale of the other currency, and vice versa. This means that buying is equivalent to selling - interesting isn't it? The fact here is that you are buying and selling the exchange rate, not a single currency. Imagine the situation where currencies are traded singly and you would want to buy 100 Singapore Dollars. Do you think it would be easy to find someone offering more than 100 Dollars for the same amount? Not likely.

Don’t forget the USD!
When you think about buying or selling a cross currency pair, don't forget the US Dollar! Although not a member within the pair, it still influences the price behavior of the cross. Buying EUR/JPY is equivalent to buying the EUR/USD currency pair and simultaneously buying the USD/JPY.

An exchange rate between two currencies is the rate at which one currency can be exchanged for another. In other words, it is the value or price of one country’s currency expressed in terms of another country’s currency.

The value of a currency does not change in itself. The change is its value in relation to another currency. This is a characteristic of the free floating exchange rate system.

When looking at a chart, you can see whether the exchange rate between two currencies is rising or falling. For example, we can see from this figure that the exchange rate of EUR/USD is increasing. To express in formal financial terms, we will use EUR appreciation or USD depreciation. This simply means that for a same amount of EUR, you can buy more USD now than a few years ago.

Floating Rate vs. Fixed Rate
Fixed Exchange Rates:
A fixed, or pegged, rate is a rate the government sets and maintains as the official exchange rate. In order to maintain the local exchange rate, the central bank buys and sells its own currency on the foreign exchange market in return for the currency to which it is pegged.

Floating Exchange Rates:
Unlike the fixed rate, a floating exchange rate is determined by the private market via supply and demand. A floating rate is often termed "self-correcting," as any differences in supply and demand will automatically be corrected in the market. A floating exchange rate is changing.

When to buy
If you hear another trader saying "I'm buying the Euro", he/she is expecting that the value of the Euro will rise against the US Dollar and speculates by buying the EUR/USD exchange rate

Bid-Ask Spread

Event: IT Show
Site: Suntec City Convention Centre Level 4

Hi, Miss! How can I help you?

may I know the price of this laptop?

The latest promotion price is SG$999 and it definitely worth more than that since we …… bla bla bla……

Oh, actually I don't really need that many accessories so can I have it at let's say SG$800 if I just want the laptop?……

Here, SG$999 is the Ask price, SG$800 is the Bid price and SG$999- SG$800= SG$199 is the Bid-Ask Spread.

Pip
PIP is short for "percentage in point" and you may sometimes hear people refer to pips as points. It is the smallest unit of price for a currency. It's the last decimal point in exchange rates or currency pairs. For most currencies it is 0.0001. E.g. 100 trades at 1 pip (or 1.5 pips) = $100 ($150) in spreads.

Websites:
http://www.fxstreet.com/education/learning-center/unit-1/chapter-3/measuring-the-trade/
http://www.traineetrader.com/the-Foreign Change-market-the-exchange-rate-bid-ask-spreads/

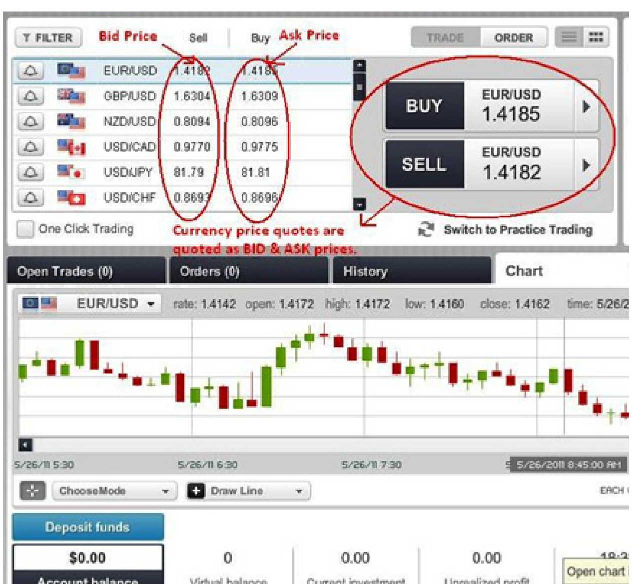
The Bid-Ask price, also known as the Bid-Offer price, is the price at which participants in a market are willing to buy or sell a good or security. To be specific, the bid price is the price at which a party is willing to purchase, while the ask (or offer) price is the price at which the other party is willing to sell the same good or security. The spread between the two prices arises when valuations differ.

That might all sound a little complicated, so let's work through an example using the USD/SGD currency pair:

Here, the USD is the base currency while the SGD is the quote currency. If the exchange rate of the USD/SGD currency pair is quoted as USD/SGD = 1.2453, this means that if Mike wants to buy 1 USD, he needs to spend 1.2453 SGD and for every 1 USD he sells he will then receive 1.2453 SGD. This is similar to currency exchange quotes at the airport when going on a holiday. The spread is quoted in Pips. So in our example, we would say the spread is 2 pips if the quotes are 1.2452/1.2454.

How are bid and ask prices read?

Let's take a look at an example from an exchange website.



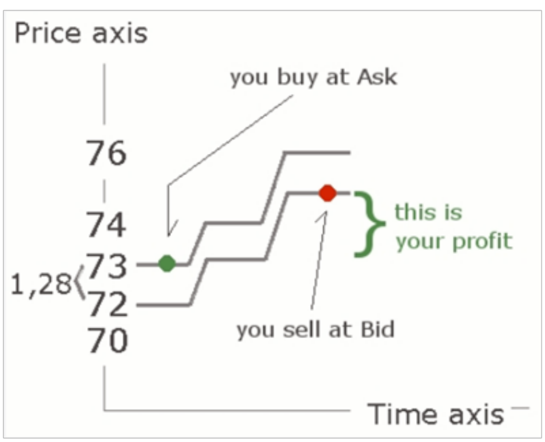
In this quote, 1.4182 is the bid price while 1.4185 is the ask price and the bid-ask spread is expressed similarly as the pair: 1.4182/ 1.4185

Why is the Ask price always more than the Bid price?

Midpoint Price
The average of the bid and ask (ask plus bid divided by two) is referred to as the midpoint price, the price at which transactions usually occurred.

You might notice that bidding price is always lower than the asking price. Ever wonder why? The bid-ask spread is how profits are made on the foreign exchange market (sell high and buy low at the same time.) This is very simple when you think about the case that the bank will always sell the currency for a higher price than it pays for it. For example, the above quotation shows that participants in a market are willing to pay 1.4182 for the EURUSD, and are willing to sell the same pair at 1.4185. This creates a 1.4182/5 spread, which is 3 basis points wide.

Calculation of the Spread



The bid-ask spread is usually calculated as: Spread= Ask Price - Bid Price; and expressed in terms of pips.

Quotation

The way that a currency pair is expressed is called quotation. Quotations can be direct quotations or indirect quotations.

Direct Quotation:

In a direct quotation, the number of local currency units is quoted, for a given quantity of foreign currency units. In Singapore, a direct quotation system is used. The quotes are in terms of how many Singapore dollars equal 1 or 100 unit(s) of foreign currency. For example: 1 USD = SGD 1.5238 (United States Dollar), 100 RMB = SGD 20

Indirect Quotation:

In an indirect quotation, the number of foreign currency units is quoted, for a unit of local currency. The United Kingdom follows an indirect quotation system. All quotes are in terms of GBP (Great Britain Pound). For example: GBP 1 = USD 1.5735, GBP 1 = SGD 3.0125

Converting direct bid-ask quotes to indirect bid-ask quotes:

Note that a direct quotation for the exchange rate between a pair of currencies will be an indirect quotation for the same pair in the other country. For example, if USD 1 = SGD 1.5238, then it is the direct quotation for USD in Singapore. In the United States, the direct quotation would be SGD 1 = USD 1/1.5238 = USD 0.6562.

Thus, if two countries follow a direct quotation system, in order to get the direct quote in the second country, use the inverse of the direct quote in the first country.

Quotation Convertion

If quotes are (A/B) and (B/C) and you want quotes for (A/C):
*Bid A/C = Bid A/B * Bid B/C*
*Ask A/C = Ask A/B * Ask B/C*

If quotes are A/B and C/B, then quotes for A/C are:
Bid A/C = Bid A/B ÷ Ask C/B
Ask A/C = Ask A/B ÷ Bid C/B

Risks

What is Exchange Risk?

Exchange risk is simple in concept: a potential gain or loss that might occur as a result of the change in an exchange rate. For example, if Mike owns a share in Apple, he will lose if the value of the USD drops. However, such risks cannot be anticipated. In most currencies, there are hedging products such as futures or forward exchange contracts which offer the ability to lock future exchange rates. So perhaps a better explanation for exchange risk is the unexpected exchange rate changes since all expected changes are priced into the rate in an efficient market.

Identify Foreign Exchange Risks

When dealing with foreign currency in a transaction, you are exposed to certain risks. For example, after you have agreed on a price for buying or selling goods priced in foreign currency, the exchange rate changes before delivery. Clearly, this can work both for and

Websites:
http://www.foreignexchangerisk.net/identifying-foreign-exchange-risks.html
http://www.foreignexchangerisk.net/managing-foreign-exchange.html

against you as exchange rates can go up and down, which is risky if the amount is large.

Below are some risks one may be exposed to when dealing with foreign exchange trading:

Frauds and Scams

Foreign exchange scams were very common, so it is important to be cautious about the broker's background and credibility before signing any documents. Bear in mind that reliable brokers usually work with big financial institutions and must be registered with the MAS.

Risk of losing in Foreign Change Exchange

The amount of money you deposit with your foreign exchange dealer, also known as 'security deposit' or 'margin', allows you to hold a position many times bigger than the value of your margin. This is commonly known as 'gearing' or 'leverage'. The greater your leverage, the higher your losses, and the losses can be greater than your initial deposit.

Risk of the market moving against you

Foreign exchange market is fairly unsteady, so changes in the foreign exchange rate between the time you enter the trade and the time you close the trade can influence your foreign exchange position and profits greatly.

No main market place

For foreign exchange, there is no main market place with buyers and sellers. You have to rely heavily on your dealer's honesty for a fair price. Your fund's safety also depends on the dealer's reputation and credibility.

Risk of the trading system breaking down

If using any electronic system for executing trades, there is always a possibility for the system to fail.

The Management of Foreign Exchange Risks

So how can participants in the foreign exchange market reduce the risks that they will face or to avoid them completely? Let us now provide some insights, which are recommendations by experts on the management of foreign exchange risks.
The identification of specific factors at risk and the influences are two main aspects to

consider when coping with risks. You can also keep up with market forecasts and news updates in risk management. Risk valuation is another important factor to consider while managing foreign exchange risks. Specifically, understanding the various risk types and their impact will be helpful as foreign exchange risks are largely due to unsteady markets and political events.

Exchange Rates do affect!
Bear in mind that exchange rates could have an effect on your business' competitiveness, even if you don't trade overseas. For example, when Country A's currency loses value against the pound, imports from Country A into the UK become cheaper, so you may have to respond through aggressive pricing strategies to fend off competitors from Country A. Similarly, if Country B's currency gains value against sterling, UK exports to that country become cheaper.

There are also other ways of managing foreign exchange risks offered by various banks:

- Forward Exchange Contracts
- Foreign Currency Options
- Flexible Forwards
- Deliverable Foreign Exchange Contract
- Non Deliverable Foreign Exchange Contract (NDF)
- Foreign Exchange Margin Trading

No Emotional Trading!
One of the most important foreign exchange tips that you can use is to never use your emotions while trading.

To sum up, managing foreign exchange risks is not an easy task. However, through effective gathering and correct analysis of different information sources, it is possible to manage and minimize foreign exchange risks.

Foreign exchange market

The foreign exchange market is the single largest financial market in the world. Major centers of foreign exchange are: London, New York & Tokyo.

1. If the quote for Euro in Singapore dollars is EUR 1 = SGD 2.2475 in Singapore, what is the direct quote for SGD in Germany?

2. Suppose that a dealer provides the following quote in the U.S. for EUR/USD:
Bid Ask Prices 0.8038 /0.8041
How many Euros can you get for each USD?

3. List at least 5 main currency pairs.

4. How to read the bid-ask price in the following chart?

5. Suppose that you are going to be involved in some international trade. Among all the risks that you might face, how will you evaluate the foreign exchange risks?

6. What are the key questions to understand before getting started with foreign exchange trading?

7. Using the chart below, explain what could be the underlying reasons that drive the change of the exchange rate.

1. What is foreign exchange, what are the main currency pairs on the foreign exchange market and how are they priced in relevance to each other?

2. Like the commodity market, currency pairs are also traded on a foreign exchange market. What are the formal names of the prices of the given currency pairs by potential traders on a foreign exchange market? How are the prices expressed? What essential information can you get from these expressions?

3. How are profits obtained from foreign exchange trading?

4. How do you define and calculate the bid-ask spread in foreign exchange markets? In practice, how is the spread expressed?

5. Explain the meaning of quotation. What are the main types of quotations and how are they related?

6. It is important to take risks into consideration when implementing trading strategies. What are the common risks that participants are most likely to come across in a foreign exchange market? In what way can traders manage such risks?

In A Nutshell

1. Foreign exchange is the general name of any currency other than the local currency. Two currencies form a currency pair. The major pairs are:

- US Dollar / Japanese Yen (USD / JPY)
- Euro / US Dollar (EUR / USD)
- Pound Sterling / US Dollar (GBP / USD)
- US Dollar / Swiss Franc (USD / CHF)
- US Dollar / Canadian Dollar (USD / CAD)
- Australian Dollar / US Dollar (AUD / USD)

2. The price of one country's currency expressed in another country's currency is called the exchange rate.

3. The Bid-Ask price, also known as the Bid-Offer price, is the price at which participants in a foreign exchange market are willing to buy or sell a currency pair. To be specific, the bid price is the price at which a party is willing to purchase, while the ask (or offer) price is the price at which another party is willing to sell.

4. The bid-ask spread is the difference between the bid price and the offer price and it is the primary source of foreign exchange trading profits. The bid-ask spread is quoted similar to currency pairs, with two numbers and a slash between them.

5. The way that a currency pair is expressed is called quotation. Quotations can be direct quotation or indirect quotation. In order to get the indirect quote, use the inverse of the direct quote.

6. Exchange risks refer to the potential gains or losses that might occur as a result of the unanticipated changes in the exchange rate.

7. Keeping up with the market forecasts and news plays an important role in risk management.

Chapter 4

Choosing the right professional

By now, you should have a better understanding of the basic operations of a unit trust, as well as the benefits and disadvantages of investing in unit trusts.

Currently, more than $5.2 billion have been invested in unit trusts through the CPF Investment Scheme. With many jumping on the bandwagon seeking higher returns, it is essential to select the right funds so that they complement our current portfolio.

Jane, have you invested in unit trusts before?

No, but I heard that they are good investments. Just let the managers invest and you can wait to collect your money!

Really? Which fund should I buy?

I am not sure. I read in the Business Times that there are more than 4000 funds to choose from! Probably you can ask your adviser?

Ok that sounds like a good idea.

Knowing yourself

Before delving into the specifics of selecting a unit trust, we will provide a brief recap of Chapter 2.

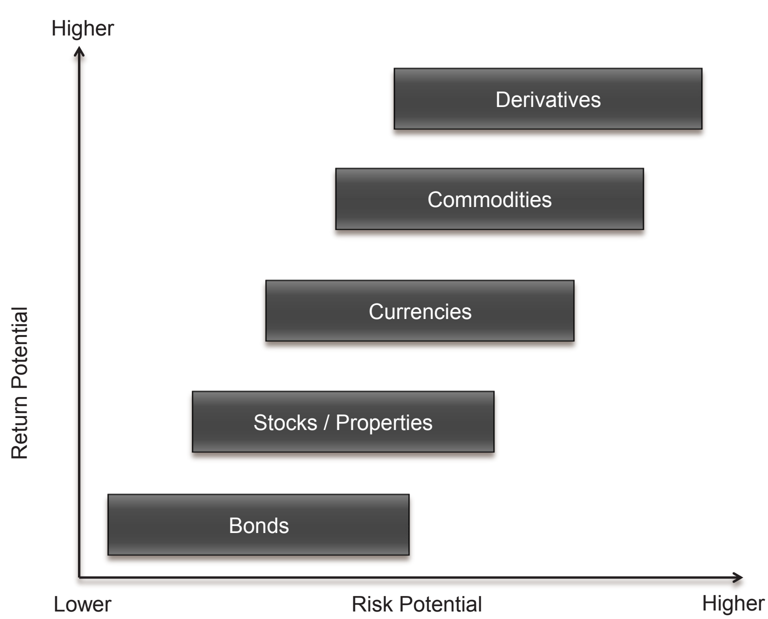
As explained earlier, you should invest in investment products that are suitable for your risk profile and investment horizon. Unit trusts differ in their investment objectives, strategies, risks and costs. Hence, you should also consider your investment needs before selecting a particular fund that matches your objectives and risk profile.

Risk profile

Your risk profile is determined by the amount of risk you are willing to take on, given your current living standards. It is different for various investors, based on age, financial situation and investment objectives.

Different unit trusts have different levels of risk, ranging from least risky (1) to most risky (10). Based on your completed risk profile, your investment adviser will decide on the suitable type of unit trusts for your portfolio.

Risk Positioning of Various Asset Classes



Investment Objective

Certain unit trusts focus on particular asset classes, geographical regions or industry sectors. You should ensure that the fund's investment objective is aligned to your financial goals before making further assessments of the suitability of investment.

Investment Strategy

Unit trusts with the same investment objective may use different investment strategies to achieve the same goal. For example, both Fund A and Fund B may have the same objective of achieving positive inflation-adjusted returns to their investors. However, Fund A may select companies that offer good value in the long term, while Fund B may choose firms that have high growth potential. Hence, you should make sure that the fund's investment strategies are in line with your personal risk profile.

Foreign Exchange Risks

Unit trusts that are quoted in foreign currency, such as the US dollar, or invest in foreign assets will be exposed to foreign exchange risks. Depending on the direction of foreign exchange rate movements, you may be subject to foreign exchange gains and losses when investing in these funds.

Investment Horizon

Your investment horizon is the time from the initial purchase of units till your expected sale. A younger investor would typically have a longer time horizon than an older investor. It is a critical factor in determining the types of investment that are suitable for your portfolio. As highlighted earlier, investments that offer higher potential returns also involve greater risk of price fluctuations and require a longer investment horizon.

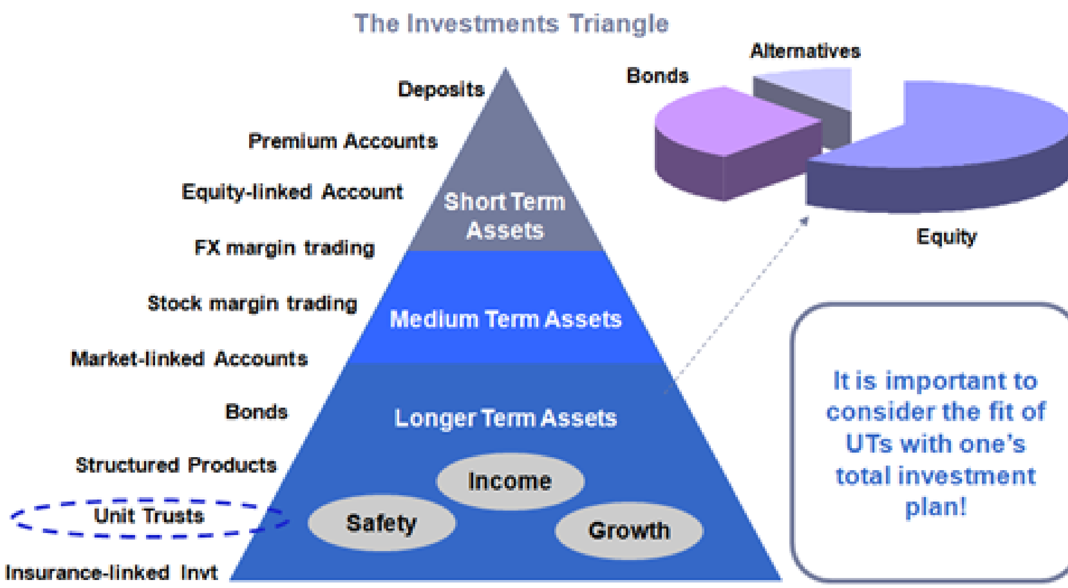
Fund Manager

When investing in unit trusts, you must also pay attention to the fund managers that are investing the portfolio. You should be comfortable that the firm and its staff have the necessary resources, experience and skills to manage your investment.

Current investment portfolio

For investors who already own certain assets, such as real estate or equities, you may want to consider if a unit trust would fit into your overall portfolio. For example, if you have a number of Singapore equities on hand, you can consider avoiding unit trusts that invest into Singapore equity counters to enable greater diversification for your portfolio.

Where can unit trusts fit into our portfolio?
Unit trusts are primarily long-term assets that complement other short to medium-term asset classes. As with any other investment decisions, we need to make sure that the investments complement each other and they are not overly focused or diversified among asset classes.



Fund evaluation and performance

Following are some of the questions that you can ask to evaluate specific funds.

Track Record

Has the fund or fund manager been presented awards for fund management expertise recently?

Has the historical performance of the fund outperformed the relevant benchmarks / in line with your return requirements?

Investment Team

Who are the people in charge of making investment decisions for the fund?
What is the structure of the management team?
How often do the management communicate with fund holders?

Independent ratings

Are the ratings suitable for your risk profile?

Fund objectives

Is the fund focused on capital growth or capital preservation?
Does it match up to your risk profile?

Portfolio allocation

Does the fund employ a top-down approach to investing? (i.e. considering the macroeconomic factors)
Or does it follow the bottom-up approach? (i.e. focused analysis into a particular company)

Investment strategy

Does the fund employ growth or value-style investing?
Does the fund aim to beat a particular benchmark or it is an absolute return fund?

Investment process and style

What types of securities does the fund invest in? Large-cap or small-cap securities?
Does the fund invest across a wide range of asset classes or is the portfolio concentrated in a few assets?

Risk management

What is the maximum allocation to a particular investment?
Does the fund need to be fully invested at any point in time?
Are there any redemption limits and restrictions placed on fund holders?

Analysis tools

Some of the unit trust portals provide many analysis tools for you to make your investment decision. There are many screening criteria which you can use to select the funds.

We will provide a short discussion of the various criteria. Firstly, asset management groups are the fund management companies that offer funds. Next, CPF funding available means you can use your excess CPF savings to fund the purchase of units, and these funds have been selected based on particular risk criteria.

Risk ratings from 0 (lowest risk) to 10 (highest risk) determines the amount of risk you are willing to take in your investment. Some sites also use the CPF risk classification to screen out funds based on their risk levels. You should select funds based on your risk profile. Investment categories include key instruments that the fund invest into, such as equities, fixed income, money markets instruments etc. Specialist sectors focuses on particular areas that you might be interested in, such as high-yield or inflation-linked instruments.

Geographical sectors allow you to select the exposure to different countries and regions, such as Asia-Pacific or Emerging Markets. You can also select funds based on currency denomination, such as the Singapore Dollar or US Dollar.

The funds can also be screened based on the annual management and trustee fees that are required to be paid. Some sites will also allow you to screen by the minimum investment amounts.

You can also rank the funds based on historical returns, from a 1-week return up to 10-year returns. This is the return you would expect from the fund based on the investment horizon selected.

Finally, some screening filters also provide risk-adjusted returns, or the Sharpe ratio. This measures the expected excess returns per unit of deviation, and a higher Sharpe ratio would mean higher returns for the same amount of risk taken.

Prospectus document

Every unit trust sold to the public must be accompanied by a legal document called a prospectus. You should obtain the prospectus from your fund manager or financial adviser. Important information includes the fund's investment objective, strategy, risks, fees, historical performance and other important information. You should seek clarification from your fund manager or financial adviser if you are unclear about the information in the prospectus.

Key items to look out for:

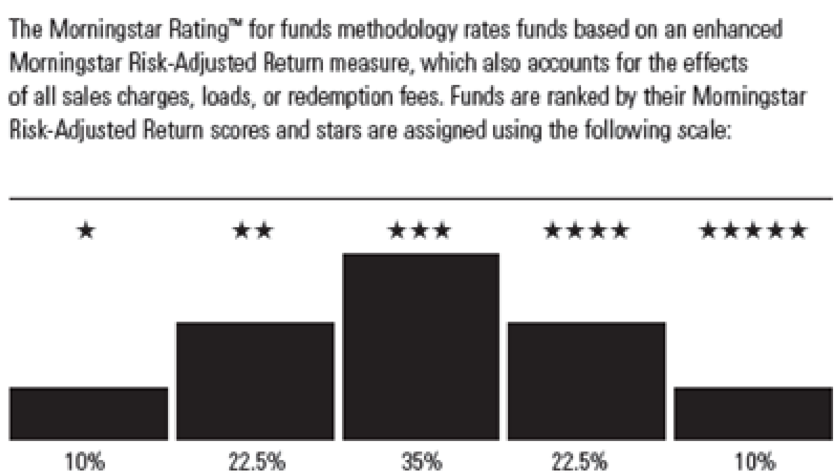
Investment objective, focus and approach

These information should be right at the top of the prospectus. You should understand them in detail, and whether it matches your investment goal.

For example, if you are a conservative investor who wants a stable return to your money without excess volatility, you can consider fund managers with 'value' approach to investing. However, if you are a 'growth' investor who is willing to take risks for higher returns, you are more likely to put money with a 'growth' fund manager.

Fund ratings

Some of the online portals such as Morningstar and Fundsupermart use qualitative factors to assess a fund's historical performance. For example, Morningstar uses a 5-star rating, with 5 stars being top-performing funds. The star ratings can be used as a guide for investors to narrow the fund group down to a more manageable list that requires additional research.



Source: Morning Star

Risks

Find out the risks of investing in the unit trust and check if they match your risk profile. For example, the unit trust may be investing in company securities in countries where the economic and political conditions may be unstable. For investments in emerging markets, the purchase or sale may also be conducted at unfavourable prices. Exchange rate fluctuations may also cause the value of your investment to be affected.

Past performance

Although past returns are not indicative of future performance, it is useful to compare the fund's performance to its benchmark and other funds with similar investment objectives. For example, in a bullish market, did the fund outperform the market? Similarly, in a bearish market, did the fund fall less sharply?

However, it is hard to ignore consistently good performance over various time periods, such as from six months to three years.

Fees and charges

Always check out the costs associated with the investment and compare them to similar funds. If two funds are similar in focus, costs may be the differentiating factor as they can cause a significant drag on performance. Remember the two main types of charges, which are the fees paid by you and fees paid by the fund.

Subscription, redemption and switching units
Actual procedures for subscribing to the unit trust, redeeming the investment and switching to another unit trust are described in the prospectus. Read them in detail and seek clarifications from your advisers if you are unsure.

Fund manager

For actively managed funds, it is important to determine select the right fund manager. What is his style and philosophy? How long has he been in charge of the fund? This information can be obtained from fund manager interviews, which are available at selected unit trust portals.
Another factor to look out for is the stability of the management team and the strategy it carries out over time. For example, if a fund is initially looking for dividend stocks but switched to looking for growth stocks, then the management could be deviating from the initial mandate.

Size of fund

Fund sizes vary from few million to more than $50 billion. When investing, you may avoid funds that are smaller than $20 million as this could mean that the manager may not be paying attention to the fund, and shut down more easily than bigger funds.

However, funds that are too large are also less able to outperform the market as they are less nimble than smaller funds.

Unit trust factsheets

Right at the top would be the fund objective, which states the investment strategy, asset class and geographical region of the fund.

In the key information section, look out for inclusion in the CPF scheme, minimum investment size, total fund size, as well as a summary of fees applicable for purchasing the fund.
In a relative performance fund, you can look at the charts to show the performance of the fund against the benchmark. This information is also summarised in table form.

The top 10 holdings of the funds are also usually highlighted, as well as the percentage to the total fund size. This allows you to identify if the diversification strategy and asset selection process is comfortable for you. Sector allocations are also mentioned for equity funds, which allow you to find out which are the sectors that the fund is most heavily exposed to.

The price range over the previous 12 months is also stated to give an indication of the NAV volatility. Important risk statistics such as the standard deviation and Sharpe ratio are provided to allow the investor to have a better understanding of overall fund performance.

Fees and charges

There are also certain ratios which you will need to keep a lookout for. First is the Management Expense Ratio, which is the ratio of sum of fees and recovered expenses to the NAV of the fund calculated daily. This includes management fees, trustee fees and expenses incurred for fund administration.

Another ratio is the Portfolio Turnover Ratio, which informs an investor about securities movements in the fund. A ratio of 100% per year means that the fund’s portfolio has been turned over once for that particular year.

Right to cancel?

If you have already invested into a particular unit trust and find that it is not suitable for you, you have the right to cancel the agreement of purchase within 7 calendar days from the date of agreement to get your money back, including the sales charges. There will not be any penalty for cancelling your purchase but you can end up with a capital loss if the unit trust has fallen in market value after you purchased it.

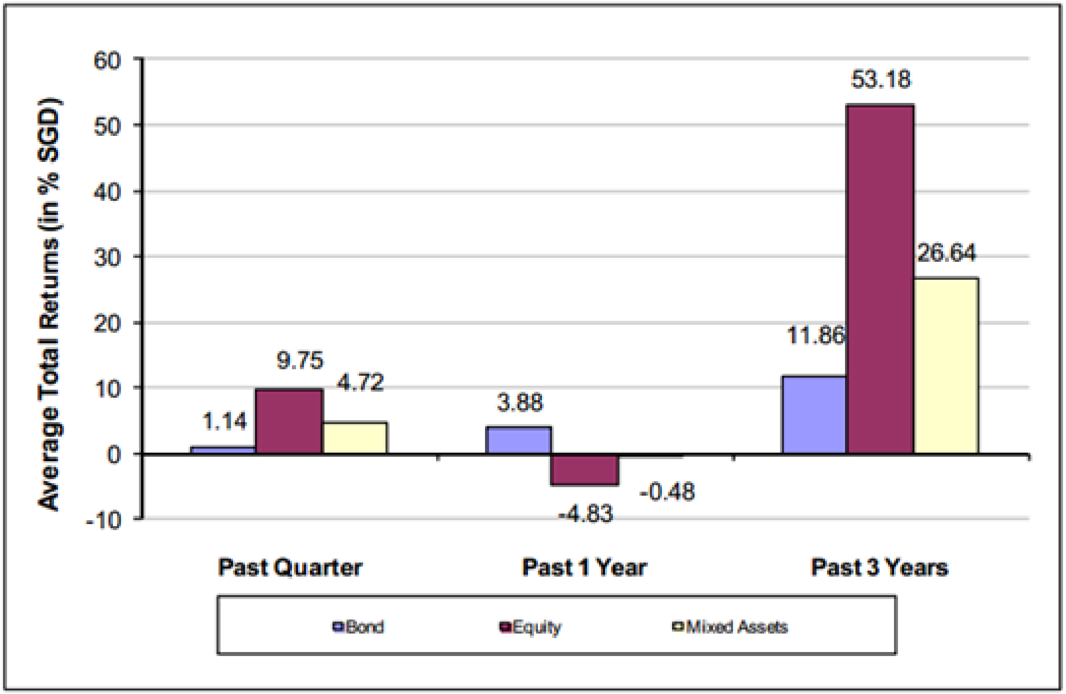
The cancellation period only applies to funds that are under the authorized scheme, not the recognized or restricted scheme, as well as funds that are listed on the SGX. However, the right to cancel is not applicable for additional investments in unit trusts that you already own.

Other information sources

Some of the unit trust portals online also provide free research reports and quarterly updates about the Singapore unit trust industry, which provides you more analysis and information about unit trusts.

These reports will provide you with indications of the performance and trends within the industry, as well as across different time and asset classes.

Figure 4 Average Performance of CPFIS-Included Unit Trusts at End-Q1-2012 by Asset Class (% in SGD)



Source: Lipper, a Thomson Reuters company

Role of Financial Advisers

When purchasing a unit trust, you will need to seek the opinion of your financial adviser. Based on his assessment of your risk profile and personality, a recommendation is made. During the recommendation process, your financial adviser is required to disclose to you the following key features:

Nature and aim of product

Whether the product is meant for protection, savings or investment

Benefits of the product

Information on amount and timing for payments of benefits and whether benefits are guaranteed or non-guaranteed

Risks of the product

Explanation of risks stated in the prospectus or profile statement

Details of the fund manager

Business address and permitted activities of product provider, and relationship between the product provider and the FA

Fees and charges to be borne by you

Details of the amount and nature of fees and charges to be paid, and the frequency of payment

Share of fees and commissions due to the financial adviser

Warnings, exclusions and disclaimers

Information on the procedures, charges and restrictions for withdrawal, surrender or claim of the product

Reports you are entitled to receive

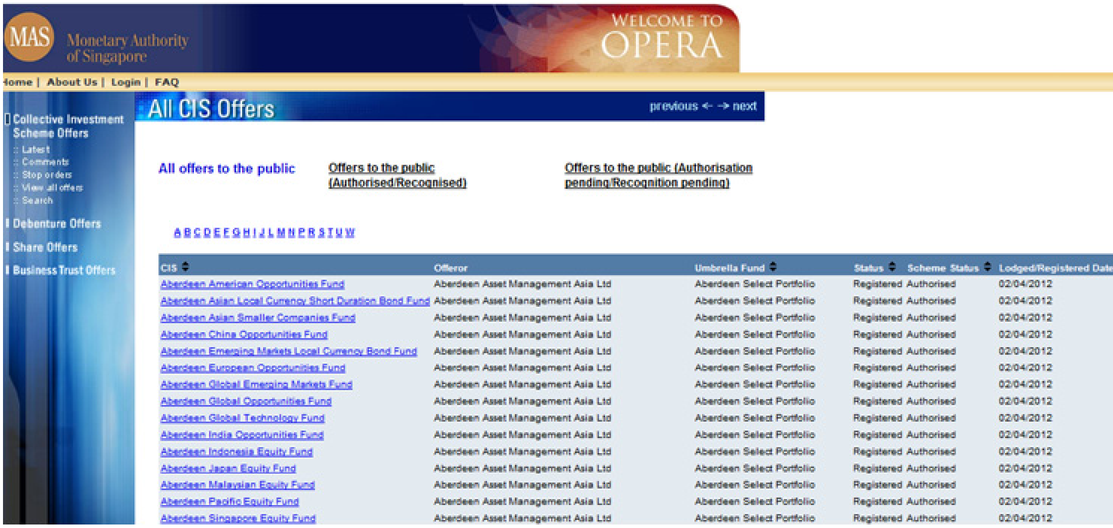
Details of how often you expect to receive reports on the unit trust and where can you get the reports

Financial advisers and their representatives should also have reasonable basis for their recommendations, taking into account your investment objectives, financial situation, risk tolerance, investment experience and personal needs when recommending the product.

Approved unit trusts

In Singapore, all unit trusts must be registered under the Collective Investment Scheme (CIS). There is a list of unit trusts approved for sale to the public on the Monetary Authority of Singapore (MAS) website at: http://www.mas.gov.sg/legislation_guidelines/securities_futures/sub_legislation/List_of_authorised_CIS.html.

The prospectus of individual unit trusts can also be found on the OPERA website of the MAS: http://masnet.mas.gov.sg/opera/sdrprosp.nsf/LeftFrame?OpenFrameset&LayerVal=C&Frame=RightPane&SRC=/opera/sdrprosp.nsf/vewPublicAllLiveCIS?OpenView



CIS	Offeror	Umbrella Fund	Status	Scheme Status	Lodged/Registered Date
Aberdeen American Opportunities Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Asian Local Currency Short Duration Bond Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Asian Smaller Companies Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen China Opportunities Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Emerging Markets Local Currency Bond Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen European Opportunities Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Global Emerging Markets Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Global Opportunities Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Global Technology Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen India Opportunities Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Indonesia Equity Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Japan Equity Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Malaysian Equity Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Pacific Equity Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012
Aberdeen Singapore Equity Fund	Aberdeen Asset Management Asia Ltd	Aberdeen Select Portfolio	Registered	Authorised	02/04/2012

MAS sets rules on fund managers to ensure that investments are sufficiently liquid and diversified. However, the approval by MAS does not guarantee the quality and profitability of the fund. Investors should always assess the merits and risks of the unit trust before investing.

Capital Protected vs Capital Guaranteed

Capital protected funds are protected using a portfolio of bonds chosen by the fund manager. However, they do not guarantee the full repayment of capital.

Capital guaranteed funds have an explicit legal guarantee to protect your funds if you hold the investment till maturity. You will be paid a guaranteed amount if the bond issuers default. However, there are still risks that the guarantor itself can default. The guarantees also do not cover sales charges.

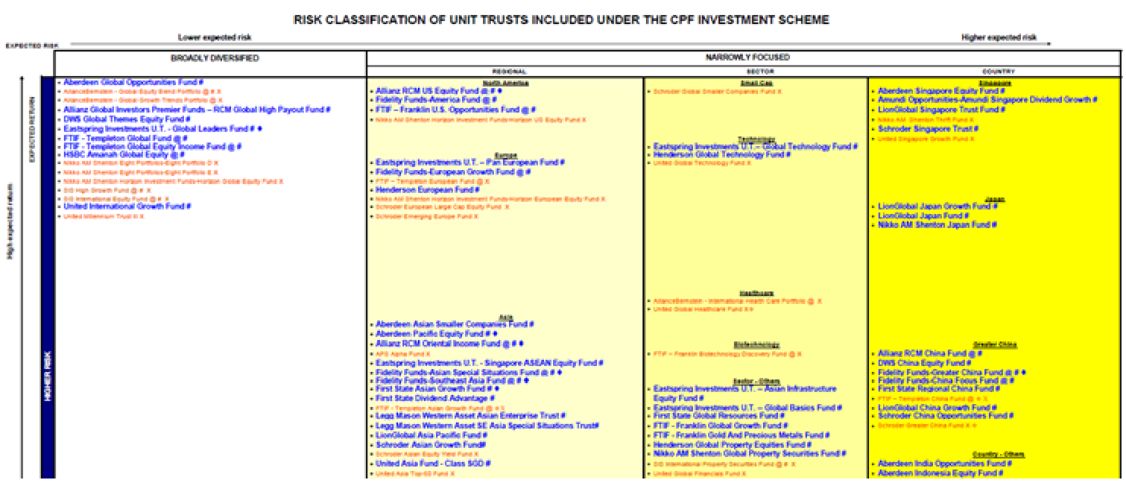
CPF Investment Scheme

For Singaporeans who have CPF savings in excess of $20000 in the Ordinary account and $40000 in the Special account, you can choose to invest them in higher-yielding assets to enhance your retirement funds. Investments in all unit trusts are possible in the Ordinary account, while only selected unit trusts are applicable for the Special account.

The main risks are grouped into equity and focus risks. Equity risk is further grouped into lower, low to medium, medium to high and higher risk. Higher risk funds usually perform better than lower risk funds over extended periods of time, but are also affected by greater volatility.

Focus risk, on the other hand, depends on the percentage of investment in a particular region or sector. Broadly diversified unit trusts invest in many regions, countries and sectors while narrowly focused unit trusts invest in a specific region or sector.

CPF has also grouped together a non-exhaustive list of funds into various categories, based on the expected risk levels, expected returns, broadly diversified / narrowly focused funds by region, sector and country. Do refer to CPF returns.pdf for more details of the risk model.



Source: CPF

Reviewing your unit trust investment

Annual reports, accounts and auditor reports will be prepared and sent to investors within 3 months of the unit trust's financial year-end. Semi-annual accounts and reports will similarly be sent to investors within two months of the financial half-year end. It is a good practice to look through these reports in deciding if you are satisfied with the fund manager's performance.

However, in reviewing your investments, it is important to remember that every time you replace a unit trust, you will incur additional costs. Furthermore, it is difficult to time the market for the most appropriate time to purchase the units.

Most fund managers may also publish monthly or quarterly updates of the unit trust's performance. This information can be found in the financial section of local newspapers, reports from fund managers, fund factsheets, websites of fund managers or advisers, and the fund information service at www.fundsingapore.com.

1. How can unit trusts fit into our overall investment portfolio?

2. What are some of the factors to consider in evaluating fund performance?

3. What are some of the available tools to evaluate a particular unit trust?

4. What are the key information presented in unit trust prospectus and factsheet that you need to know?

5. What is the role of your financial adviser in making your investment decision?

6. How can we obtain information on the unit trusts that are available for CPF investments?

In A Nutshell

1. Do not choose a unit trust because it aims to deliver a high return. Higher returns are accompanied by higher risks.

2. Before investing in unit trusts, develop a financial plan and be clear about your investment objectives, time horizon and risk profile.

3. Do sufficient research to choose the right fund manager. Check that the fund manager has the resources, expertise and skills to manage the unit trust.

4. Check that you are buying an approved unit trust managed by an authorized fund manager.

5. Read the prospectus clearly as it contains important information about the unit trust.

6. Check what fees and charges you have to pay when buying, selling or switching unit trusts, as these will affect your returns.

7. Monitor your investment regularly. Read financial statements and annual reports to check how your unit trust is performing.

Chapter 5

Hedge Funds

What are Hedge Funds?

You might have heard about George Soros and his famous Quantum Fund, the very fund that 'broke' the Bank of England in 1992, forcing it to devalue the British Pound.

Hedge funds are loosely regulated investment companies that seek to generate absolute returns uncorrelated with any market benchmark or index.

Hedge funds also utilize a wide variety of trading strategies, and may use hedging techniques to reduce or eliminate their risks.

The Monetary Authority of Singapore's (MAS) Code on Collective Investment Schemes (CIS) also has a similar definition: "In general, a hedge fund seeks to deliver an "absolute" return independent of the directional move of equity, fixed income or cash markets. In considering whether a fund constitutes a hedge fund, the MAS will consider whether the fund:

• engages in strategies that use leverage, short selling, arbitrage, derivatives, and

• involves investment in non-mainstream asset classes i.e. investments other than listed equities, bonds and cash."

While the Quantum Fund no longer exists, hedge funds continue to gain popularity among institutional investors and high net worth individuals. The global hedge funds industry is valued in excess of $1.7 trillion, and is expected to grow further.

Key Characteristics of Hedge Funds

Hedge funds are a distinct class of funds, possessing distinct characteristics that differ from the traditional unit trusts and ETFs.

While these characteristics allow hedge funds to strive for lucrative returns, they will also introduce a different set of risk exposure that the investor has to contend with.
Finally, hedge funds sold in Singapore require a minimum investment of $100000 or more!

Hedge Funds Regulations

Compared to the traditional unit trusts and ETFs, hedge funds are loosely regulated. They are required to disclose fewer information than unit trust companies.

Furthermore, while mutual fund companies publish quarterly statements, hedge funds have been reluctant to disclose trade information. Some funds might, at best, disclose such information to a small group of major investors.

However, regulation of the hedge fund industry is changing rapidly. In many economies, there has been increasing pressure by regulators, auditors and hedge fund exchanges on increasing fund disclosures and monitoring trading activities.

Use of Leverage

Leverage is a technique commonly used by hedge funds, and the understanding of this concept is crucial to investing in these funds. While most traditional unit trusts will utilize debt to provide for short-term liquidity and withdrawals, hedge funds use leverage in practically all investment aspects to get superior returns.

Fee Structure

Hedge funds typically charge two types of fees. They are the base fee, and the incentive (performance) fees.

Base fees typically stands at around 1-2% of the total assets managed annually, regardless of the fund’s performance.

Incentive fees, or performance fees, is paid to the fund manager based the performance of the fund. Some incentive fees may be up to 20% of total profits.

Some fee structures allow for incentive fees to be charged regardless of total returns, while other structures will charge fees if returns exceed a given target.

Limited Liability Feature

Onshore hedge funds are set up on the basis of a limited partnership, a limited liability corporation, or an offshore corporation, and protect investors from liability.

This means that the maximum amount that any investor can lose is the initial investment. This feature is also common in most unit trusts.

Lockup Commitments

Many hedge funds charge high load fees (fees that the investor will incur when selling back his share to the fund manager) to encourage investors to hold on to their shares for an extended period. This is to ensure that the fund does not liquidate positions all at once, which will affect overall returns.

Investment Requirements

The minimum subscription rate for single hedge funds is S$100,000 per investor, and S$20,000 per investor for Fund of Funds. There are no required minimum subscription amounts for capital-protected or capital- guaranteed hedge funds, although such funds are rare.

Hedge Funds Investment in Singapore

While hedge fund characteristics listed above are general information that investors should be aware about, hedge fund regulation and investment procedures in Singapore vary slightly from the characteristics listed above.

Onshore hedge funds are funds constituted in Singapore and are subject to the local regulatory regime. These funds can be set up as a corporation (for closed-end funds, funds that can be traded on an exchange), as a unit trust (for open-end funds, funds that can be bought redeemed directly from the fund manager), or as a Limited Liability Partnership (LLP).

Offshore funds are those constituted in foreign jurisdictions and are subject to their regulatory regimes. Such funds are allowed to disclose limited information to investors.

Regulations and Licensing Requirements

Smaller hedge funds with asset-under-management (AUM) of S$250 million or less, or serving 30 qualified investors of less, are exempted from licensing requirements in Singapore.

These hedge funds can only market a fund managed by themselves, and not third party funds. In addition, while no capital requirements are needed for such funds, these funds are still required to adopt requirements on market conduct and practices, similar to licensed funds.

All other fund managers and distributors (unless exempted under other specific conditions) will need to hold either a Capital Markets Services license, regulated under the Securities and Futures Act (SFA), or a Capital Markets License, regulated under the Financial Advisors Act (FAA).

Hedge Fund Classifications

Hedge funds are commonly categorized according to the strategies they adopt. With thousands of hedge funds available, classifying individual funds into 10 or 20 distinct groups is a challenge. Some categories might overlap; some funds may fit into several categories, while others may not fit into any category!

Nonetheless, the classification of hedge funds is an important consideration in helping investors to select meaningful benchmarks and appropriate fund management styles.

To select meaningful benchmarks, use a top-down approach by reviewing aggregate performance data, sector selection and fund selection. In selecting an appropriate fund management style, you can consider the strategies adopted.

Some investors might invest in a single strategy fund, after identifying that the investment style adopted is a valuable addition to his existing portfolio. Other investors might choose to pursue a multi-strategy fund, believing that these funds resemble a Fund of Funds that benefits from diversification.

Hedge Fund Strategies – How Hedge Funds Make Their Money

Despite the general lack of transparency surrounding hedge funds, most fund managers adopt strategies common in traditional fund management.

Equity Hedge Funds

Long-based hedge funds hold long positions and maintain small portfolio of stocks with limited leverage. Market neutral funds use a range of strategies such as arbitrage trading between futures and equities. Events driven funds include strategies such as merger arbitrage, Regulation D funds, spin-offs, and bankruptcy and reorganization funds. Finally, sector funds adopt long positions in volatile sectors to profit from large price movements.

Fixed Income Hedge Funds

These are funds that invest in bonds and other fixed income assets. Fixed income arbitrage uses long-short positions with derivatives and utilizes higher leverage as compared to other strategies. Collateralized Debt Obligations and Mortgage Backed Securities funds provide lower volatility returns for investors.

Credit, bankruptcy and distress funds invest in debt instruments of companies, adopting hedging strategies such as long-short combinations. Finally, emerging market funds are issued by countries without developed capital markets, with minimal hedging in these portfolios.

Other Hedge Fund Strategies

Other fund strategies include global macro fund, which relies on macroeconomic forecasts to make investment decisions. Currency funds use hedging or arbitrage strategies to carry out their trades.

Fund of Funds Investing

Fund of Funds are funds that invest in other hedge funds. It is open to individuals and institutional investors. Fund of funds charge additional management fees on top of the fees charged by the individual hedge funds.

Furthermore, fund of funds may not deliver superior returns over time, as compared to a sophisticated investor who selects hedge funds with superior returns.

Despite the disadvantages listed above, fund of funds provides numerous benefits to institutional and individual investors, especially people who manage smaller portfolios and are less sophisticated:

• Smaller minimum investment for fund of funds

• Risk reduction through diverse holdings of individual hedge funds

• Some fund of funds might negotiate lower performance fees with individual funds, lowering total fees paid by investors

• Fund of funds may have access to more information, which might translate to better analysis of investment decisions and improve the risk-reward ratio

• Fund of funds provide an avenue for investors with relatively limited capital to invest in hedge funds

• Because of prior agreements made by the fund of funds for preferential access, new investors can gain access to more funds

Potential Benefits of Investing in Hedge Funds

Due to the wide variety of investment strategies and wide universe of instruments and markets that hedge fund managers can invest in, hedge funds have the potential to generate returns independent of market performance.

The three potential benefits are:

Performance Consistency

Hedge funds face fewer restrictions on financial instruments and markets that they are permitted to invest in. This allows for strategic flexibility, allowing potential profits in both rising and falling markets.

Such advantage also create potential for performance consistency, as compared to traditional funds that rely on assets price appreciation. However, note that the performance consistency can vary among hedge funds.

Lower Correlation

The flexibility from adopting a wide range of strategies would create risk-return characteristics that are different as compared to traditional investments.

For example, an equity hedge fund can generate returns that have little or no correlation to the overall market returns. This allows investors to diversify and build robust investment portfolios.

Risk Protection

Due to various hedging strategies available to hedge funds, they can protect against downside risk by selling their investments or can even profit from bear markets through short selling.

Risks Exposure in Hedge Fund Investments

Risk of Magnified Losses

The use of leverage in hedge funds allows potential losses to be magnified, increasing the chance that investors will lose a significant portion of his initial capital.

Short Covering

Funds that adopt short selling as a strategy are exposed to the risk of covering their short positions at a higher price that it was initially sold.

Liquidity Risk

Hedge funds face the risk of illiquidity, if it invests in inactive markets with low trading volumes, or there are no buyers / sellers for the hedge fund investment.

Settlement Risk

Settlement risk occurs if the counterparty fails to deliver the assets on settlement day, as promised in the contract.

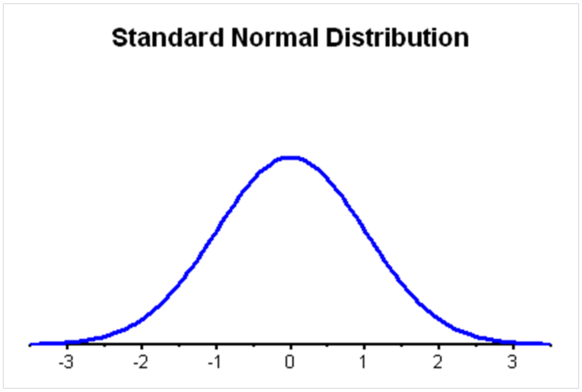
Counterparty Credit Risk

Most hedge funds are transacted via a broker-dealer relationship, thereby exposing the fund to counterparty credit risks when the counterparty fails to fulfill his obligations.

The Fat Tails of Negative Returns

In addition, it is good to note that returns on hedge funds are usually not normally distributed, but have 'fat tails' on both ends. This implies that extreme returns are more likely to occur.

The increased "tail risk" makes performance ratios, such as the Sharpe ratio, inappropriate to guide investors.



Survivorship Bias

Due to the lack of reporting standards, hedge fund databases face the effect of survivorship bias. This occurs in markets of poor hedge fund disclosure regimes and the lack of transparency.

Therefore, hedge fund databases will likely overstate performance and understate the risk of hedge funds. This also makes it more difficult to compare hedge fund performance with other investment alternatives.

Are Hedge Funds Suitable For You?

Dear, I have read so much about hedge funds from this book, and learned much from it. I feel confident to invest in hedge funds now! I want to benefit from the potentially huge returns and be rich! Then we will retire next year!

Mike spoke with utmost confidence, feeling upbeat about the future. However, Jane wasn't assured.

Darling, are you sure? Do you have at least $200 000 or more? Both of us have only just graduated and started working.

No worries! I will find a way to borrow money from my family and relatives! I will sell off my motorbike, and with our savings, we can raise that minimum amount!

But it is very risky to put all our fortune into a single asset, isn't it? We need to diversify. And, what if we decide to buy a house or car in future, and cannot cash out easily?

Mike: .... (Silence)

Let's continue to read the book...

Jane is right! Apart from investing an entire portfolio into a single hedge fund, which is a no-no for a young couple, hedge funds are complex in nature and a potential investor will have to go through the checklist below to determine if he is ready for this investment:

- Do you understand the risk-return characteristics of the fund?

- What is the leverage of your fund? Leveraging will amplify the variability of outcomes as explained above

- Most hedge funds restrict redemptions, making investments illiquid. What are the loading fees and restrictions imposed by the fund manager?

- How liquid do you need your portfolio to be? Will hedge funds be a suitable addition to your portfolio?

• What is the fee structure and how is the fund manager paid? Asymmetric fee structures can induce the fund manager to adopt high risk investment behaviors

• How much of your capital are you willing to lose for the high potential returns?

1. How do hedge funds differ from traditional unit trusts?

2. What is leverage all about? How does it affect risks and rewards of investors?

3. What is the minimum subscription rate for Single Hedge Funds, Fund of Funds, and Capital Guaranteed or Capital Protected Hedge Funds?

4. Can you name and explain at least 3 strategies hedge funds are using?

5. What are some of the points that you will need to consider when deciding to invest in hedge funds?

In A Nutshell

1. Hedge funds can provide attractive returns and significant losses to your portfolio.

2. Understand your risk tolerance level and how hedge funds might fit into your portfolio before making any investments.

3. For starters, consider fund of funds or capital guaranteed hedge funds.

However, as with all investment analysis, the key to investing successfully in hedge funds is a proper and adequate understanding of the rewards and risks involved. In other words, do your homework!

Chapter 6

Property

We often hear people comment that Singaporeans are asset rich and cash poor. Indeed, this is true, partly due to the sky high property prices here. Owning a home is the biggest financial commitment for most Singaporeans.

This chapter will equip you with the basic information and tools you will need to assess your ability to afford the piece of real estate to add to your financial portfolio.

My parents and family members are advising us against buying a piece of property, and telling us to get the most affordable unit.

Yah, they tell me that the market is high now and it is better to wait for the prices to correct. Is it good advice?

Maybe we should save enough money and wait until we can afford a flat. Hopefully, the market will also cool down soon.

A Decent Proposal?

Panel 1: "Darling, shall we go ballot for a flat?"

Panel 2: (Looks away sheepishly) "Ok"

Panel 3: Solemnization Ceremony

There are no statistics to prove the extent of the phenomenon, but urban legend has it that in Singapore, quite a number of marriage proposals are initiated by the boyfriend asking his prospective mate if she is willing to co-ballot for a HDB flat. This uniquely Singapore phenomenon is a result of the government's housing policy that favors married couples.

Useful Websites for latest transactions

To the common layman who is fluent in stock investing, data on real estate prices may appear to be very mysterious. For one, transactional data are difficult to obtain as opposed to ubiquitous stock quotes. Unlike stocks which are standardized units (one lot of shares in Genting is virtually indistinguishable from another lot of Genting shares), no two pieces of real estate are exactly identical. Valuation experts, whose professional services are required in pricing real estate, serve as a bridge in reducing price friction between the buyers and sellers.

Feng Shui: It's not whether you believe in it

What factors into the price of a piece of property? Some would say location near international schools, and proximity to a vibrant town center. What about Feng Shui?

No two properties are identical, even for two units with same blueprint side-by-side. For example, it is common knowledge to Chinese locals that a T-junction house is considered bad Feng Shui, because "Chi" coming directly from the road rushes towards the house. Incredibly, it turns out that even if you don't believe in Feng Shui, you may need to factor that in when deciding on a value for a property.

After all, prices are about demand and supply. The T-junction house typically faces a lower demand and would fetch a lower price in the market. On the other hand, many local Chinese are willing to pay a premium for houses with auspicious unit numbers.

In fact, property is one of the most illiquid assets for most people. The Singapore Government is a proactive monitoring agent in the local property market. Over the past few years, the government has stepped up efforts to balance the playing field for consumers, through the provision of up-to-date information to home buyers. This means that if you are a home buyer and you do not access the treasure trove of data freely available online, you are putting yourself at a disadvantage.

Realis Database

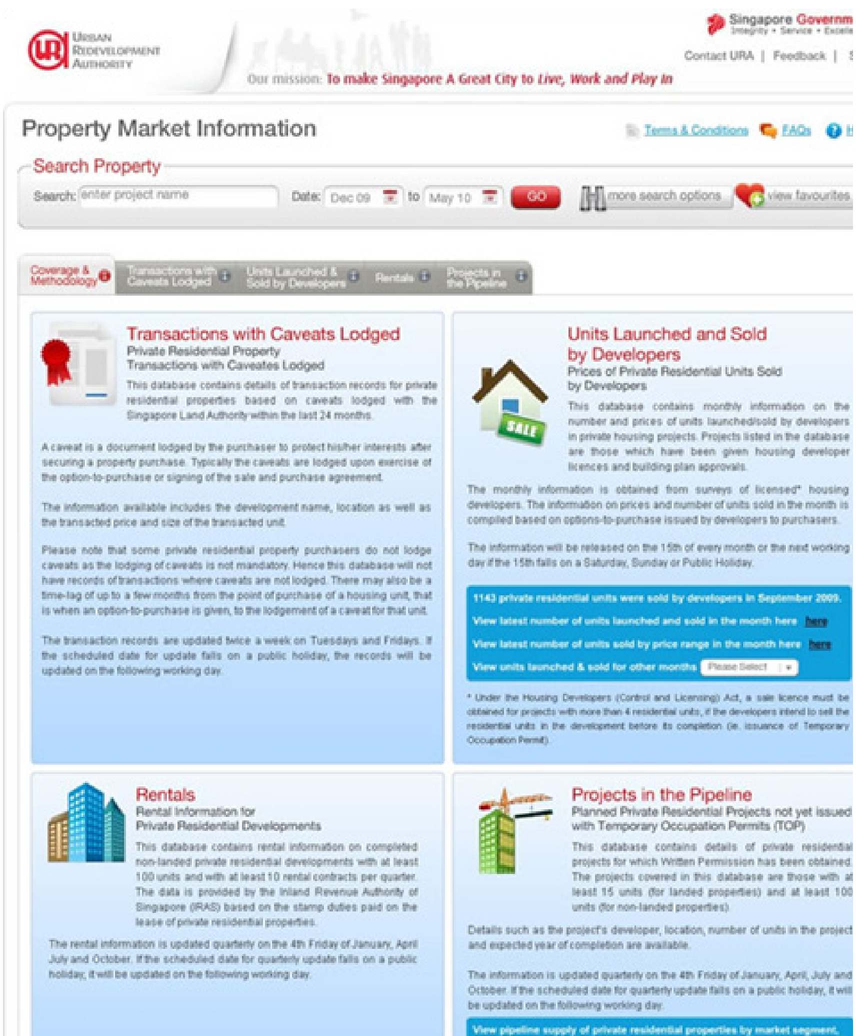
Website: http://www.ura.gov.sg/realis/

The most authoritative database by far is the Realis database maintained by the Urban Redevelopment Authority (URA). The database provides access to comprehensive information on the Singapore property market. It contains a wide range of statistics on the private residential, commercial and industrial sectors, as well as details about individual projects. You can use REALIS to obtain data such as prices of transacted sales, vacancy rates, available and occupied floor space, rental property indices and rental per square meter.

The subscription fee is $1800 for 1 year of access. If the price is too steep for you, not to worry, you can opt for the less comprehensive but more affordable sources listed below. Alternatively, you can access the Realis database from any of the branches of the National Library as they subscribe to the Realis database and provide the access to library users.

Property Market Information

Website: http://www.ura.gov.sg/propertyinfo/



Since 1996, the URA has been delivering comprehensive and timely property market information to the public via the Property Market Information eServices on the URA website. By providing more detailed information that allows for better comparison across different private housing projects and units, the eServices enable home-buyers to make more informed decisions,

The Property Market Information eServices is refreshingly easy to use. The interface allows users to access different sets of information, such as property prices and rentals, for a particular housing project or location with a single search.

Detailed transactional information, such as the land tenure, 2-digit postal district, floor level range of non-landed private residential properties are provided. URA also makes available detailed information on the pipeline supply of private residential units and the number of unsold units in new private housing projects. In addition, there is a feature for plotting graphs with the property data. Data matching your search up to 24 months ago will be displayed. You will also be able to compare property market information across different databases and time periods.

Best of all, this service is provided free of charge!

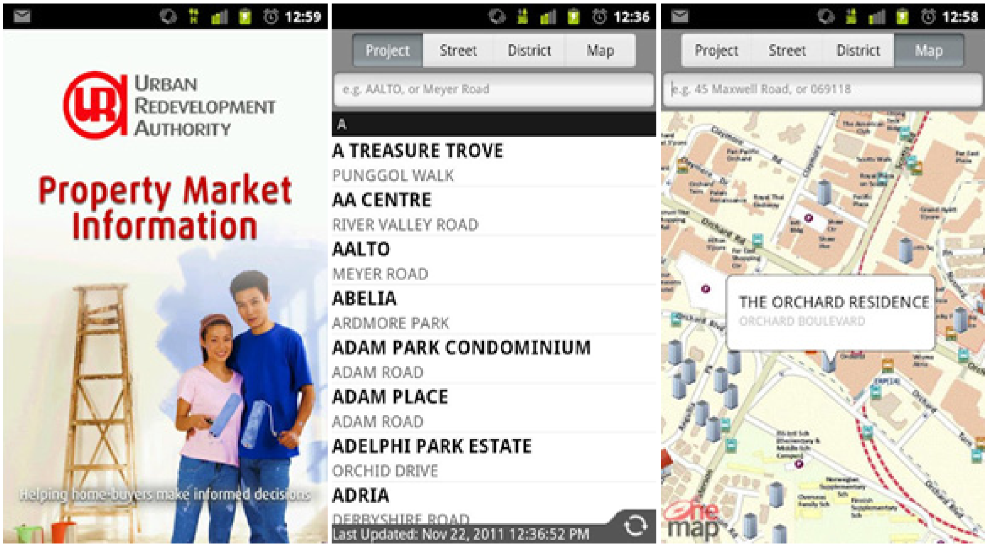
The 4 databases in the enhanced property market information portal provide information services on:

1) Private Residential Property Transactions with Caveat Lodged;

2) Prices of Units Sold in Private Residential Properties;

3) Rental Information for Private Residential Developments; and

4) Private Residential Projects in the Pipeline.



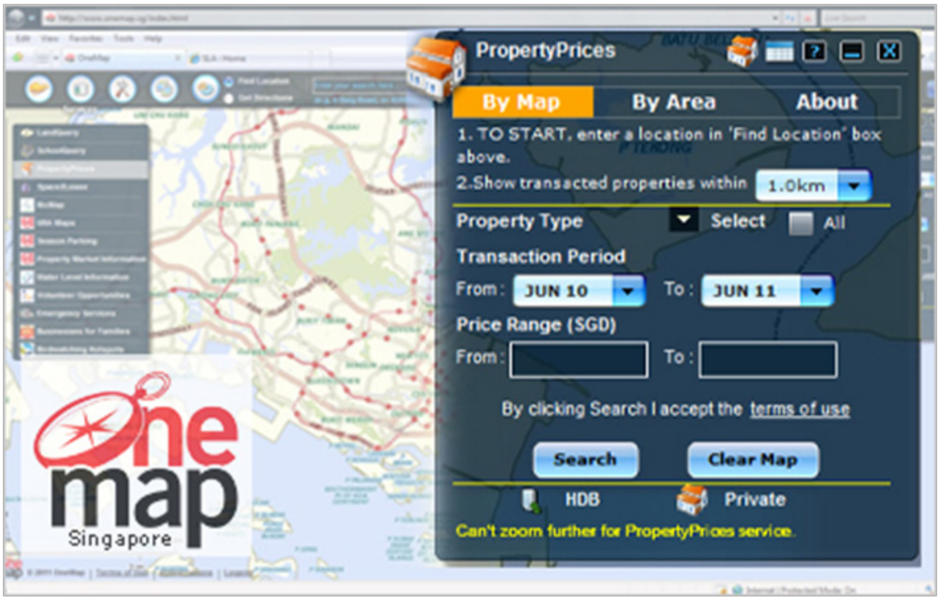
Recently, the URA developed iPhone and Android standalone apps for Property Market Information. Home-buyers now have easier access to property market information on the go from their iPhones, iPads and Android devices.

The new and free "Property Market Information, Singapore" application is developed by the as part of its continual efforts to enhance the transparency of the property market. This new service empowers home-buyers with accurate and comprehensive information on private housing projects and encourages them to look at all available market information before making a purchase decision.

At the same time, the URA has also enhanced its Property Market Information eServices on the URA website to provide more information and greater convenience to users.

The "Property Market Information, Singapore" application allows members of the public easy access to transaction prices and rentals for different private housing projects on a map-base. For example, users can see the prices of all private residential units transacted in a particular area or within a certain radius of a showflat on a map.

Onemap:



One of the hidden gems of property market information is OneMap. OneMap is an internet mapping service by the Singapore Land Authority, similar to streetdirectory.com, gothere.sg and google maps. What distinguishes the OneMap offering is the integrated map platform which enables the public to access government agencies' location-based services and information.

PropertyPrices is a new service on OneMap that shows the transacted prices of both private housing and Housing and Development Board (HDB) resale flats over the past year on a map. This also shows the size of the unit, tenure type (freehold or leasehold) and transaction date.

This "mashup" web application beautifully combines property transaction data from the URA and HDB on a common map platform provided by the SLA. Using this application, you can easily search property addresses and inspect detailed

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Definition -- Mashup Application

A mashup is a web page or application that uses and combines data, presentation or functionality from two or more sources to create new services. The term implies easy, fast integration, frequently using open methods and data sources to produce enriched results that were not necessarily the original reason for producing the raw source data.

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data such as land lot number, calculate approximate land sizes. You can also search for schools near a building or find buildings near a school within a 2km radius. You can locate nearby amenities (such as wireless hotspots, heritage areas, child care services), and search for bus numbers for bus stops. All said, for home-buyers this is an excellent tool leveraging on the latest cutting edge technologies.

Types of Properties for investing

There are many different types of properties available for investing, each with unique characteristics.

Foreign Properties

It is usually recommended that you conduct in depth research into the laws of the country before you commit to procurement of the property. Each country regulates their own internal property markets differently and foreign owners are likely to face additional restrictions compared to the locals. An example of such restrictions is the ruling that properties can only be resold to locals and not foreigners, which would depress the resale value of your property. It is imperative that you conduct your research to uncover the rules that would impact you as a foreign investor so as to mitigate your risks.

Local HDB flats

Nearly nine in ten Singaporeans live in Housing Development Board (HDB) flats. The subsidized housing is available to Singapore citizens who fulfill certain criteria such as a maximum combined family income. Singapore Permanent Residents are eligible to purchase resale HDB flats in the open market.

Originally conceived to fulfill basic housing requirements to the local population, the HDB of today have evolved to churn out respectable apartments to house the modern family unit. These range from 3-room flats at about 750 sq ft to executive flats at about 1600 sq ft.

HDB flats are considerably cheaper than private housing. Also, the HDB flats are typically located in self-contained towns comprising a town centre, shops, markets, a library, playgrounds, even cinemas, malls and other recreational facilities and amenities. These towns they are located in are normally well-served by public transportation. On the flip side, these flats are usually more basic in their physical makeup and furnishings. Because the stated purpose of the HDB flat is not for investment purposes but to house the population, the Government monitors the market for HDB flats very closely and is known to step in with new regulations now and then to discourage and clamp down on speculative investment behavior.

Local Private Condominiums

Private condominiums tend to be luxurious with additional facilities like a covered parking, 24-hour security, clubhouse, swimming pool, tennis and squash courts, gymnasium, playground, barbecue pits, beautiful landscaped gardens, putting greens, indoor badminton courts, and even spas. Condominiums tend to be a popular form of accommodation for many expatriates who can choose from cozy studio apartments to spacious penthouses.

Local Landed Property

Even in land-scarce Singapore, there is a huge range of landed properties. The most prestigious kind is the Good Class Bungalows which have a minimum size of 15,000 sq ft and are located only in 39 gazetted zones in Singapore. These are followed by normal Bungalows which have a minimum size of 4,000 sq ft and minimum frontage of 10 meters. The more common forms of landed properties are the semi-detached houses, and terrace houses.

Bungalows enjoy the luxury of being an independent building on a plot of land that runs round it. Semi-detached houses on the other hand, are a pair of houses that share one common wall. Terrace units are a row of houses that have common walls with those in the middle known as intermediate terraces, and those at the end known as corner terraces. Corner terraces have land surrounding three-quarters of the building while intermediate terraces only have land in the front and at the back of them.

A relatively new type of housing is the cluster landed houses, which is a hybrid between the condominium and the landed property. This type of property normally comes with a relatively smaller footprint, and shares common facilities and common areas not unlike a condominium.

Affordability Checklist

Consider if you have resources to afford the home you have in mind by assessing the following criteria:

Down payment: You have enough funds in Cash and your CPF Ordinary Account to fund the down payment.

Debt Service Ratio: Your monthly loan installments should not exceed your maximum monthly loan affordability (as computed in worksheet xxx).

CPF Withdrawal Limit: The CPF online calculator shows that you will reach the CPF Withdrawal Limit.

Your Financial Portfolio: You have sufficient funds to address your other financial needs such as insurance, investments, children's education, and retirement. You are aware of the tradeoffs you are making.

For a more detailed affordability guide, you can refer to the "MoneySENSE Worksheet on Buying a Home & Taking a Home Loan" available on the MoneySENSE website (www.moneysense.gov.sg).

Risks of Property investing

Property investing is definitely not an endeavor for the investors who are unwilling to do their homework. If you understand the range of risks that your property investments face, you will be better poised to handle the risks when they surface compared to others who did not make provision for the same risks.

Liquidity Risk

Unlike shares traded on the stock market, you cannot sell your property easily. The illiquid nature of real estate assets requires you to view this class of investments as one with a certain "lock-in" period.

If an emergency occurs and you are forced to sell a property quickly within a relatively short time-span, it would be difficult to find buyers, and even if you find buyers, it would be difficult to negotiate a good price.

Complete Interest Alignment?

Even though real estate agents do an excellent job in filling the liquidity gap, you need to understand that the structure of the commissions system encourages agents to help you sell your property fast, but not necessarily at the best price!

In their book Freakonomics, authors Steven Levitt and Stephen Dubner explained that when agents are selling their own property, they hold out for the best offer. However, when they are selling properties they do not own, agents would tend to encourage the sellers to take the first decent offer that comes along.

Interest Rate Risk

Interest rates could rise, and this would affect you the most if you took up a floating rate mortgage loan, which is becoming very popular in Singapore nowadays because of the perceived discount relative to the fixed rate loan.

Viewed from another perspective, you can view the extra dollars you pay for a fixed rate loan as an insurance premium that protects you against interest rate rising in the economic environment today of historically low interest rates.

Leverage Risk

Leverage refers to the ratio of the Loan amount to the Valuation of the property. If you take on a higher leverage, then you will have higher monthly payments. If you were to lose your source of income due to sickness or loss of job, or if your properties experience higher-than-expected vacancy, you could find yourself unable to maintain those higher mortgage payments that seemed fine at the beginning.

To mitigate this risk, you need to have a plan in mind that details how you would respond to contingencies. In case of sickness, say the detection of first stage colon cancer, would you be able to continue paying the mortgage on top of the treatment costs? If you figure you will always have enough cash on hand for such situations, then one reasonable option is to self-insure. Otherwise, you may need to consider whether to “outsource” this risk by purchasing proper insurance.

Tenant Risk

For investment properties, the property could be untenanted for a period of time, especially during soft rental markets. Even during recessionary periods, properties with good locations should still be able to attract rental demand, but the lower rentals will mean you have to "top-up" more to meet the monthly installment payments to the bank. It cannot be overemphasized that any property that is left untenanted for a long period of time will place a huge mortgage burden on the owner-investor.

On the other hand, you could get bad tenants who can create all sorts of problems. Renting is not as straight forward as collecting dividends on shares. For example, under the Immigration Act, homeowners who wish to rent their premises out to foreigners are required to exercise due diligence in checking the status of their prospective tenants to ensure that they are in Singapore legitimately. If you fail to ensure the papers are in order, you may be called up by the Police for a "kopi" session to discuss why you did not exercise due diligence as required by law! (Under the Immigration Act, if the homeowner is found guilty of the offence, he shall be sentenced to an imprisonment of not less than 6 months and not more than 2 years and shall also be liable to a fine not exceeding S$6,000.)

House prices could remain static, or even fall.

One main culprit of the US subprime crisis in year 2008 is the assumption that house prices will never fall which formed the basis of many valuation tools used by the financial industry in valuation of property. We all know that the premise that "House prices will always rise" is ridiculous, but we are saying this with perfect 6/6 hindsight, but let us not forget that during the property boom period almost everyone was blind to this fact.

Therefore, it is important that the property investor adopt a conservative approach when buying properties, taking into consideration that the market might decline and rental income may also decrease.

Benefits of Property Investment

Having understood the risks of property investing, let us consider the benefits of this class of investments.

Price Appreciation

The promise of excess return is of the main drivers of investor behavior in their decision to invest. While we always keep at the back of our minds that house prices could fall, there are reasons to believe that prices would rise in the long term.

For one, real estate is a physical asset. This is unlike many other financial products which are paper assets which do not give the same kind of tactile assurance to the owners. Then consider the costs of raw materials used in the construction, which is ever-increasing. The cost of labor has also been rising. Last but not least, the value of land the property sits on will increase over time, especially if the government build towns infrastructure and transportation networks around the property. This is particularly so for Singapore - the little red dot – where there is a limited supply of land, with a growing affluent population.

If you followed the argument in the above paragraph, you will appreciate that a sizable component of the price of a piece of property is inflation driven. Loosely speaking, if the cost of labor goes up, property values will increase; if the cost of construction goes up, properties will become more expensive. This is why properties are sometimes known as a physical asset with "inflation-hedging" properties. In other words, properties would preserve their value in spite of inflation.

When is the best time to buy property? That is the million-dollar question. For couples whose first property is a HDB unit and who intend to live in the flat, the answer is pretty straight-forward – the sooner the better. For the investment property however, timing is crucial. Generally, one should be extra cautious when the property market index is trending at historical highs.

Leverage Benefit

Leverage was listed above as a risk and is included here as a benefit. Indeed, leverage is the proverbial double-edged sword. We have explored how high leverage can lead to tight or even negative cash flow situations during hard times. On the flip side, leverage can magnify gains of the property investment.

For simple illustration, consider a 20% initial down-payment on a property that costs $300,000. Over 3 years the property value rose to $330,000, a 10% gain. Is 10% your overall return from the investment? No! To understand why, you could view this simplistically as an investment of $60,000 (20% of $300,000) that generated a return of $30,000, a 50% gain! Of course, we are neglecting the monthly repayments which would increase the cost of your initial outlay, but the basic concept is clear - leverage allows you to magnify your returns.

Expenses, like mortgage interest, are tax deductible.

In general, mortgage interest paid on the loan or mortgage taken to purchase properties in Singapore is tax deductible. This applies not just to mortgage interest, but to other property related expenses like property tax, premiums for fire insurance, repairs done to restore the property to its original state, cost of maintaining the property (such as painting, pest control, and monthly maintenance charges to management corporations), and even costs of Furniture and Fittings!

What does tax-deductibility of mortgage interest mean for the property investor? If you think about it, it implies that whenever you are taking a loan to buy properties, the government, by charging you a lower tax bill because you claimed for mortgage interest tax-deductions, is providing an indirect subsidy on the interest of your loan! This policy may be a reflection of the government's broader thinking to encourage greater home ownership.

Rental Income

Rental income is to properties as dividends are to stocks. For the most savvy property investors, it is not unheard of that some were able to generate enough rental income to more than cover the costs of the monthly mortgage payments. This is what is termed positive cashflow, and it is the desired outcome for many property investors, because it means the assets is self-sustaining and generating positive net income. Nonetheless, it does not mean that property investments with negative cashflow are bad.

Diversification Benefit

Real Estate is an asset in your portfolio that will provide diversification benefit, according to modern portfolio theory. To reap the most of diversification benefit, you need to be aware of the proportion of your entire wealth that you have invested in real-estate in relation to other assets, to make sure real estate does not overwhelm the portfolio. This will then ensure that you get the portfolio with superior returns given a certain amount of variance risk that you decide to take.

Dimensions of Diversification

It is worth emphasizing that when evaluating diversification, there are at least two dimensions along which one can diversify. The first is within a class of product. For example, if you did a Financial Needs Analysis and chose an optimum portfolio of 80% equity and 20% bonds weighting, and bought unit trusts in those proportions, you have diversified within your unit trust portfolio.

The second way to diversify is within your entire financial portfolio. That is, on top of your unit trust holdings, you will need to include all other financial assets you own, such as the stocks you bought at their Initial Public Offering, fixed deposits you placed with banks, et cetera. You will also need to consider the full value of your investment properties, and, some would argue, the cash value of your whole life insurance plan.

Enforced Savings

For people who are unable to save, paying off a mortgage is an enforced savings mechanism that will ensure that the owner sets aside a portion of his income towards assets accumulation rather than fritter it away. This is also an often cited argument given for most whole life insurance plans.

It is very easy to brush off the seriously and significance of this benefit. Do not underestimate the power of compounding coupled with a forced savings mechanism!

1. Which website provides the most comprehensive information on detailed property transaction information?

2. Which website provides the most useful geo-location functionality in latest real estate transactions?

3. What type of property is the Cluster Housing project considered to be?

4. Why is leverage considered both an advantage and a risk in property investing?
5. Why do some people say one of the greatest unsung benefits of real estate investing is the tax-deductibility of loan interest?

In A Nutshell

1. The most useful websites for the latest transactions are the Realis database, the Property Market Information website and smartphone apps, and OneMap.

2. The major types of properties that can be invested are foreign properties, local HDB flats, local private condominiums, and local private landed properties.

3. Property investing risks include liquidity risk, interest rate risk, leverage risk, tenant risk, and price risk.

4. Property investing benefits include price appreciation, profit magnification via leveraging, tax-deductible expenses, rental income, diversification, and enforced savings.

Chapter 7

For The Rich Life

For most investors, common investment classes include stocks and bonds. However, there are alternative investment assets which can provide greater diversification to your portfolio.

Look at the famous painting, Garçon à la pipe (A Boy With A Pipe), created by Picasso in 1905. A century later, it is the most expensive painting in the world, with a value of $104.1 million! Imagine if you have invested in this painting much earlier…

Art pieces by famous artists are commonly bought and sold in international auction houses Christie's and Sotheby's.

Storing Fine Art in Singapore

In 2012, Christie's International announced the building of a new storage facility for fine-art collectors in Changi Airport. The facility, to be managed by Christie's Fine Art Storage Services (CFASS), is an independent subsidiary of Christie's Group and a testament to the growing demand for fine art collection in Asia.

Alternative Investments

Alternative investments represent a group of asset classes that are beyond traditional definitions of securities and derivatives. They include art collection, wine collection, venture capital, private equity, closely held companies, and even stamp and coin collecting!

Each of these alternative investments has its own set of risk and reward characteristics that requires specialized valuation techniques. Furthermore, many of these investments are not liquid in nature.

Wine Investment

To invest in a wine collection, the investor will need to look out of three major factors:

1. Choosing the type of wine most suitable for aging

2. Adopting proper wine storage methods

3. Knowing when is the best time to "cash out" and sell the wine

Choosing the type of wine most suitable for aging

Not all wines are meant for aging. Wines without a strong "structure" and "character" will not age well and appreciate in value when stored in an enclosed bottle.

For example, aging cannot turn a silky-bodied Pinot Noir into a full-bodied, intense Cabernet Sauvignon. Aging the wrong type of wine is similar to watering a good bottle of wine with water.

On the other hand, wines with "personality" and "complexity" are more suited for collection.

Complexity of a wine is created by several factors: well-merged flavors, intensity, richness and depth of the combination of flavors, aroma characteristics, focus, harmony and overall balance, and the finesse (the elegance and fineness of the wine).

Character refers to the distinctive traits, distinctive tastes, or other key attributes that distinguish the wine. Personality refers to the character or style of the wine. Structure of a wine consists of its fruitiness, acidity, alcohol and tannin of the wine.

continue...

Body of the wine refers to how the feeling in your mouth when drinking the wine. Wines can be broadly described as full-bodied, medium-bodies or light-bodied.

Full-bodied wines create the fullness of taste in the mouth. Similarly, light-bodied wines refer to wines that taste relatively lighter.

Balance refers to the harmony of the various elements and tastes of the wine. When a wine is described as well balanced, the elements of the wine are in perfect harmony.

As you can see, understanding wine investments is a highly complex process. Understanding these definitions is necessary for investors to value wines.

We have provided a table showing wine investments from different countries of origin.

Country of Origin	Investment and Keep these Wines	Wines not meant to be aged
Australia	(Premium) Shiraz, Penfolds Grange	(Basic) Shiraz
France	Medoc, Graves, St Emilion, Pomerol, Pommard	Beaujolais, Alsace Pinot Noir & young Cotes du Rhone / Loire Valley / Burgundy
Italy	Barolo, Barbaresco, Super Tuscans, Brunello di Montalcino	Bardolino, Chianti, Valpolicella
Spain	Ribera del Duero, Priorato, Rioja Gran Reserva	Young Rioja, La Mancha
USA	(Premium) California Cabernet Sauvignon	Zinfandel

Adopting proper wine storage methods

One of the key considerations in wine investment is storage facilities. Some wine producers will provide cellars to store wines, while you can also store them at home as well. The logistics and storage costs should be considered as part of the investment capital in wine.

Proper storage makes or breaks the quality of the wine, and the investor will need to pay particular attention to the temperature, light and humidity, especially in Singapore. If you are seriously considering wine investment, it pays to invest in proper refrigeration or a wine cellar.

Knowing when and how to sell wines

Knowing the best time to sell the wines will ensure that you can maximize your gains!

Trivia Question

Given a wine suitable for aging, the longer it ages, the better it will taste, and the higher a value it will fetch. True, or false?

Answer: False! Wines have its respective ideal maturity age, and its value will decline after that threshold.

Wines have an ideal maturity age, and it is usually not wise to keep wine beyond the threshold. The ideal maturity age is influenced by its vintage and region of origin.

Fine Art

Fine art collection is one of the fastest growing forms of investments among investors. For art lovers, this can be pleasurable as well as profit making!

Fine art can be broadly categorized into two major forms, namely Visual Arts and Performing Arts. Visual Arts include paintings, sculptures, calligraphy, collages, architecture, film, photography, printmaking and conceptual art pieces while Performing Arts include music, dance and theatre.

Art Classifications

Art pieces can be classified according to various categories. Understanding how they are classified will aid the investor in identifying art trends.

By Artists

The Old Masters category includes artists such as Rembrandt and Rubens, while the Modern Artists category features big names such as Cezanne and Picasso, Warhol and Miro. Works by some current artists, such as Andy Warhol, can face significant price volatility in the short term.

By Style, Genre or Period

Some common styles/genres/periods include renaissance, romantics, 19th century, Impressionist, Expressionist, Minimalist, Modern, Contemporary, Naturalistic, Figurative or Abstract.

The markets for Impressionist and Contemporary art are collectively more volatile versus other styles, but might also offer better rewards at the same time.

Emerging Market Art

This category includes Chinese art pieces such as Chinese ceramics, contemporary artwork by Chinese artists, Latin American Art, Russian paintings, Pakistani and Indian art, and even artwork from the Middle East and Muslim countries, such as Iran and Iraq.

Emerging Artists

Works by emerging artists allow new investors an easier entry into the art market, as the art pieces usually cost a fraction of an Old Masters' artwork. However, there is greater risk as the artists have not proven themselves yet.

What affects the Price of Art?

The valuation of art pieces can never be an exact science. Similar to other asset classes, supply and demand of the artwork can influence its prices.

Other factors include the authenticity of work, aesthetic values, condition of piece, rarity of work, size of work, artist, subject matter, price realizations of similar works, generational tastes and preferences and speculation.

Tracking Art Prices

Art Indexes

Just like famous equity indexes such as the Dow Jones Index, there are also art indexes known as Art Market Research Indexes (AMR). Many of these indexes are currently used by leading art and financial institutions worldwide.
Art indexes allow for an easy way to track art prices for investors in the art market.

Art Auctions

Apart from tracking art indexes, art investors also tracks the prices at art auctions, where prices are disclosed publicly and transparency is maintained.

Advantages of Fine Art Investments

• Art has risk-return characteristics that are not correlated with traditional asset classes like stocks and bonds

• Art has been a reliable asset that stores wealth in the long run and a good hedge against inflation.

• Art has been shown to hold on to its value regardless of economic boom or bust.

• The aesthetic appeal of art will ensure that you will have visual pleasures that will brighten up your humble abode every day.

• Fine art performance over the long run has beaten the Standard & Poor's 500 by 16.6% to 15.1%!

Disadvantages of Art Investments

• As art is not transacted through an organized exchange, it is a less liquid asset and would not be suitable for someone who requires high liquidity.

• Art pieces are usually transacted through dealers, and the dealer might not fulfill the delivery of the art work which you had paid for.

• Art forgery is a common phenomenon in markets and specialists are hired to ascertain the authenticity. Always stick to credible auction houses and dealers.

• Some emerging art markets have only a few market participants, increasing the search and transaction costs.

• Art can require high storage and maintenance cost to preserve its value, eroding potential profits.

How to Invest in Art

Buying Art Works

The most common way to invest in art is to buy the work itself. Investors and collectors pound the pavements of art galleries, exhibitions, auction shows and dealer showrooms just to find suitable art pieces.

For example, the European Fine Arts and Antiques Fair (TEFAF) is an event held in Netherlands annually involving hundreds of dealers, thousands of collectors and millions of dollars of transactions. You can buy anything from rare art pieces by Old Master, to modern names like Warhol and Miro, even Egyptian statues!

Art Funds

Another less common way to invest in art is to purchase an art fund. These are funds that buy into art pieces, with the intention to sell them 5 to 10 years later. Some funds allow investors to borrow art pieces for personal use.

Pitfalls

As the art world is not as regulated as organized exchanges, the investor needs to conduct due diligence carefully.

• Look out for forgeries and fake signatures. Seek the help of a specialist if needed.

• Look out for posters being sold as original prints. What is similar might not be the same.

• Seek out the title from antique dealers before making the purchase. Some dealers do not have a clear title on what they are selling.

• Prices in auctions might be inflated by insiders. Do not try to chase a price beyond your budget.

• Prices might be inflated by current hype and excitement. This is similar to buyers buying on greed, pushing up prices.

• Watch out for "burned" artworks. These are art works that fails to sell at previous auctions and fairs, and are considered by the art community as "burned".

Private Equity

Private equity also deals with transaction of stocks or equity in companies, except that transactions are conducted privately through negotiations between parties.

Advantages of Private Equity to the Investor

• Lower Reporting Costs – Private equity firms are subjected to less stringent reporting requirements than publicly-traded equities.

• Longer Term Orientation – Due to less stringent reporting requirements, there is less public pressure for short term results.

• Potential for greater earnings – Investors in private equity can cash out of initial investments through the selling of equity or go public via the IPO process.

Disadvantages of Private Equity to the Investor

• Illiquidity – Private equity is an illiquid market due to the lack of public trading platforms available for shares to be traded.

• High Transaction and Search Costs – Because of the lack of a public exchange, share prices have to be negotiated between the firm and the investor directly

• Limited Disclosure Requirements – Private equity firms do not have the incentive to disclose information to investors.

Types of Private Equity

Private Investments in Public Equity (PIPE)

Firms that require capital urgently can raise capital by selling private equity to investors. These stocks are often sold at a discount to market prices.

Firms that raise capital through PIPE may be in a distress situation, in urgent need to repay their debt obligations or fund their growth opportunities.

Leveraged Buyouts (LBO)

Investors purchase the firm's equity using debt financing. Using debt as leverage, these firms will utilize operating cash flows to service their issued debt, or sell off assets to reduce their debt obligations.

Current managers in the firm can also buy out the firm in a process known as Management Buyout.

Venture Capital

Venture capital investing refers to the provision of capital to firms at their early or growth stages to fund their expansion plans.

With various initiatives launched by the Singapore government to encourage entrepreneurship and innovation, venture capital and start-up investing are investment platforms that we can look closely into.

Venture Capital

Venture capital investments are privately traded equity investments in a high-risk and high-potential business venture. These funding can occur at various stages of the business' growth, such as its seed stage, early stage and later stages.

Industries popular to venture capital funding includes the biotechnology and information technology sectors, as they are ever-changing and innovation-driven.

Stages of Venture Capital Investing

Seed Stage

This is the earliest stage of growth and investment. They are used to fund research and development programs on new product ideas.

Early Stage

Start-up Financing are funds used to complete product development and fund initial marketing efforts. First-stage financing are funds used for commercial production and sales of the product.

Later Stage

At this stage, the firm is still privately held, despite producing commercial goods and ongoing marketing efforts. Second-stage financing uses funds for production and marketing efforts, but the firm has not generated income.

Next, third-stage financing uses funds for a major expansion of the company. When taking the company public, the firm may also use mezzanine or bridge financing.

Risks of Venture Capital Investing

A prudent investor needs to be familiar with the risk involved in venture capital investments.

• Venture capital investments are illiquid in nature, making it unsuitable for investors who have high liquidity requirements.

• It takes time for a developing venture to be profitable, and market conditions might take a while to be conducive for a public offering.

• Information is limited on many fronts, especially on previous risk and return characteristics, competitors, latest developments, and cash flow and earnings estimates.

• As each investment is unique and information is scarce, there are problems in making reasonable comparison to other similar assets for valuation purposes.

• Entrepreneurs with good ideas might not necessarily make good managers.

• Incentives must be rewarded to managers on the firm's performances, and not on any other criteria.

• Entrance and exit strategies are heavily dependent on market conditions.

Private Companies

Business Structures of Private Companies

Private companies can come in several forms, most notably sole proprietorships, partnerships, limited liability partnerships or private limited companies.

The choice of structure will determine the investors' taxes and liabilities, roles and responsibilities, legal restrictions and ultimately, the risk exposure and value of their investments.

Legal Considerations

Some business structures, such as limited liability partnerships, have a limited liability feature. This means that the maximum risk of an investor is the initial capital invested.

Other business structures, such as private limited companies, are registered as a separate legal entity from their shareholders. This means that the company can sue and can be sued in its own name when litigation arises, separate from its shareholders.

Valuation Techniques of Private Companies

Due to a lack of open market transactions, cash flow valuations are usually used. For example, the investor can forecast future cash flows of the company using past cash flows as a guide.

Other suitable techniques include the cost approach, comparables approach, income approach and the public companies approach.

Further Premiums and Discounts

Apart from adjustments made for the lack of liquidity and marketability of private firms, the controlling investor can also influence further discounts or premiums for the controlling stake.

For example, if the shares held by the investor represent minority interests, a discount has to be applied to the base value derived. Similarly, you should add a premium to the base value if the block of shares represents a majority interest in the company.

For example, when you use the shares of comparable publicly traded companies to formulate the base value, apply liquidity and marketability discounts to get a better estimate of the value of the private company.

1. Which types of wine are most suitable for aging?

2. What are some of the pitfalls when investing in art?

3. What are the three types of private equity?

4. Can you name the various stages of venture capital investing?

5. Can you explain the techniques used to determine the values of private companies?

Wow! It seems like we have learnt a lot from this chapter! Alternative investments were something that I wasn't familiar with, and I always wondered if art and wine investing can really make money.

Definitely, and I also got to learn about the distinct characteristics that these assets have as compared to common stocks that we are more familiar with.

This means that we will have to learn more about these assets individually. Knowledge is power!

And don't forget to learn more about art so that we can choose some great paintings for our house in future, honey!

In A Nutshell

Mike and Jane are right. While this chapter seeks to equip you with the important tools and knowledge you need to kick start your venture into alternative investments, and make your first step a successful one, alternative investments as an asset class has unique risk-return profiles that may or may not be suitable for every investor.

Hence, thorough research is necessary and prudence is encouraged in order to make effective investment decisions.

Perhaps one day, you will chance upon a million dollar painting in your collection. Who knows?