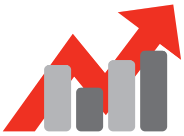
Investing in the stock market

Basic things you need to know

How do rate hikes affect the stock market?



Changes in interest rates do not directly affect the stock market itself, but they affect investors' psychology. When there is a rate hike, both businesses and consumers may cut back on spending; this may make people think that earnings will fall and stock prices will drop. Meanwhile, some sectors (e.g. the financial industry) do benefit from interest rate hikes. Banks, brokerages, mortgage companies and insurance companies' earnings often increase as interest rates move higher, because they can charge more for lending.

When is a good time to invest in stocks?

It may seem tempting to trade around the market volatility to try to capture gains during 'up' periods whilst avoiding losses during downturns. However, this imposes an additional set of costs and, while theoretically attractive, it is a difficult strategy to implement in reality. Instead of timing the market, careful use of a diversified portfolio can help smooth out volatility and avoid panic selling when the market is at its extremes. As a general rule of thumb, it is better to stay invested for a longer period of time. This is because stock markets are more volatile in the short run, but they have historically produced positive returns over the long term.

How to evaluate attractiveness of a stock market?

A variety of measures could be used to tell the value of a stock or market, including the price-to-book (P/B) ratio, the price-to-earnings (P/E) ratio, the price to earnings growth (PEG) ratio, and the dividend yield, etc. Having said that, there is no absolute measurement of whether a market is under- or over-valued and investors may need to consider a lot of other factors including the economic environment, among others.

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What are the different styles when it comes to stock investing?

The major investment styles can be broken down into three main aspects: active versus passive management, growth versus value investing, and small cap versus large cap companies. Investors who want to have professionals select their holdings will be interested in active management. Growth investors seek companies that offer strong earnings growth while value investors seek stocks that appear to be undervalued by the marketplace. Investors who prefer stability in the portfolio would choose large cap, while those aim for higher potential return may pick mid-cap and small-cap strategies. Other than these, commonly used investment styles also include high-dividend strategies and low-volatility strategies.

Comparison of Equity vs Mutual Funds

Mutual funds are managed by professionals and invest in a basket stocks. The key difference between individual stocks and actively managed equity funds are listed in the following table:

Individual stocks	Active equity funds
• Managed by investors themselves Investors enjoy greater control	• Managed by professionals Convenience and professional management
• Investors usually hold a smaller number of stocks	• Equity funds invest in a basket of stocks Diversification
• Higher minimum investment amount to build a diversified portfolio	• Lower minimum investment amount (less than HKD10,000 usually), monthly investment plan available Lower minimum investment amount
• Individual stocks could be traded anytime during a trading day, investors know immediately the pricing of the trade Intraday pricing	• Mutual funds are often traded daily and on a forward pricing basis; when investors place an order to buy a fund, they do not know the fund's price for that particular day
• Stock investors may not have easy access to overseas markets	• Equity funds provide access to different regions/markets to capture opportunities across the globe International exposure
• Investment decision made based on profile of individual companies	• Choices of different investment styles or strategies Strategic investments
• Stock investments involve mainly brokerage fee and custody fee, etc. No management fee, etc.	• Mutual funds charge subscription fee, annual management fee and sometimes performance fee, etc. Investors also need to bear other costs of mutual funds, such as trustee and custodian fees, transaction costs, etc.

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