WHAT IS the benefit of investing in shares?

Australian and international shares (and managed share funds) are expected to generate higher returns than cash and fixed interest investments over the long term. The return from shares may comprise a growing income stream (dividends) as well as capital growth.

How do shares generate a growing income stream – and capital growth?

Over time, shares (and managed share funds) may generate a growing dividend stream for investors. As you can see in Chart 1*, the annual income generated by a $100,000 investment in shares since 2000 (with income not re-invested) started off low, but then gradually built up. In fact, last year's income was $7,545, or 7.5% on the initial $100,000 investment.

The reason for the increasing dividends from shares is that businesses do not distribute all of their profits to shareholders. They retain some of their profit each year and use it to invest in the business – to help it grow.

If this is done well, it means they'll have more profit the next year – from which they can afford to pay shareholders a higher dividend than they did the previous year. Plus, they will again retain some profit for reinvestment. So, the next year their profits will hopefully be higher again, allowing the company to distribute an even higher dividend while still retaining more profit for reinvestment. And even more the next year. And so on.

Of course, the more the value of the company grows as a result of the reinvestment of the retained profits, the more the market will recognise this, and people will pay more to buy their shares. Hence the capital growth.

Compare the income stream from shares to a well-known income producing investment – the term deposit. As shown in Chart 1, a $100,000 investment in term deposits since 2000 did well initially, while interest rates were still high, off the back of the record high interest rates of the 1990's, but then income dropped away to just $101 (0.101%) in 2021, when interest rates were at record lows. Compare that to the $4,620 income from shares during the 2021 year (see chart 1).

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In fact, since 2000, the $100,000 investment in term deposits generated a total income of just $90,528, compared to $267,673 from shares. Add to that the $122,981 in capital growth from shares (as at 31 December 2024) and you have a total return of $267,673 from shares, compared to $90,525 from term deposits, as shown in Table 1.

Table 1:
Shares ahead by $177,145 since 2000*

1 Jan 00 – 31 Dec 24	Shares	Term Deposit
Total Income	$144,692	$90,528
Growth	$122,981	NIL
Total	$267,673	$90,528

What is the risk of investing in shares?

All shares and managed share funds experience volatility. Their values all go up and down – on a daily basis. That's because shares are easily traded on the stock exchange. You can buy and sell shares almost whenever you want. The trade-off for that liquidity and convenience is a bumpy share price.

Investments with a higher level of risk, such as shares, can have vastly different returns over short periods (e.g., one year) when compared with relatively low risk investments like cash and fixed interest. However, in general, with shares (and managed share funds) you'll notice that over time their prices go up more than they go down. And historically the magnitude of the price rises has generally been greater than the price falls, as shown in Chart 2 of annual share market returns.

As a result, over time shares may be expected to generate solid capital growth. In fact, the longer you hold your shares or managed share funds the less likely you will have a negative return, as you can see in Chart 3.

How to manage investment risk?

Investment risk can be managed using four prudent principles of investing:

1. Only investment in well researched, high-quality investments. Don't make investment decisions in response to short-term events. Investors who redeem their investments after a fall in value turn a notional loss into a permanent loss. This may be a poor decision, because well researched, high-quality investments should recover from falls in value over the long term.

2. Construct a properly diversified portfolio aimed at reducing the impact that poor returns in one asset class, sector or single product will have on your total investment portfolio.

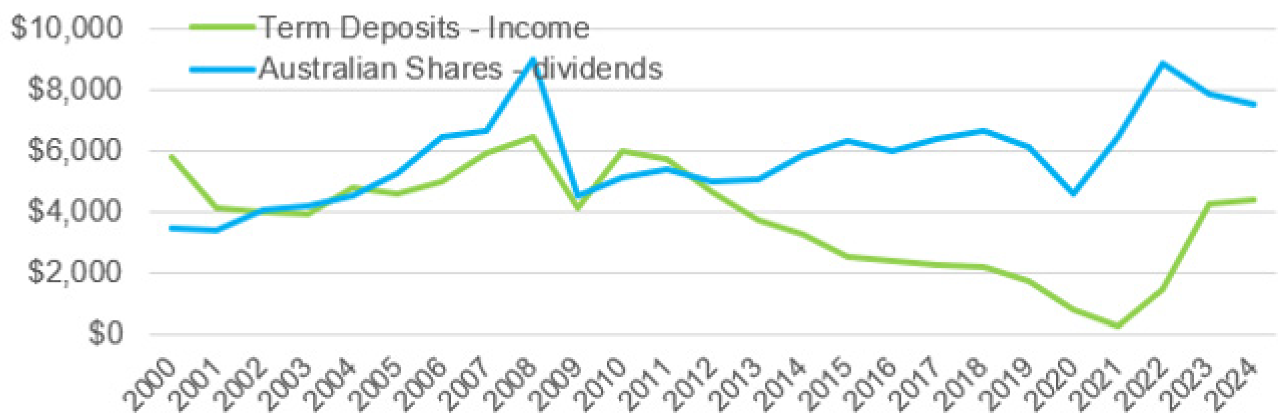
3. Invest with the time horizon in mind. Generally, the higher the level of volatility of an investment, the greater is the recommended investment time horizon.

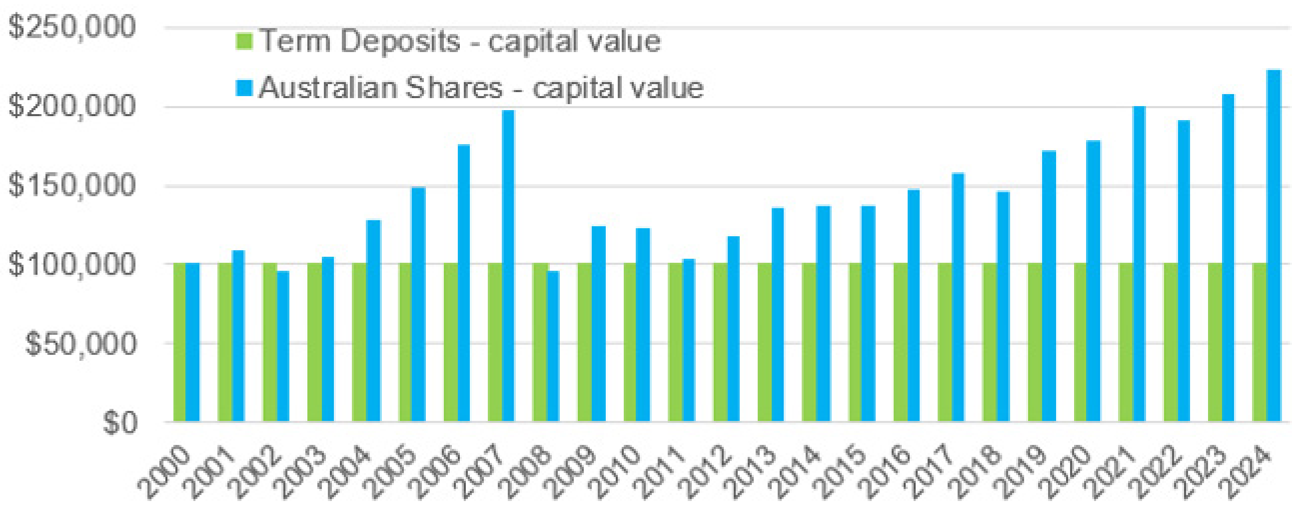
4. Regularly review your investments to ensure they continue to meet your objectives.

WHAT IS

the benefit of investing in shares?

Chart 1: 1 January 2000 to 31 December 2024 (100,000 invested)





WHAT IS
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Chart 2:

Shares go up more than down over the long-term as shown by the 1 Year Average Annual Returns of the S&P/ASX 300 Total Return Index

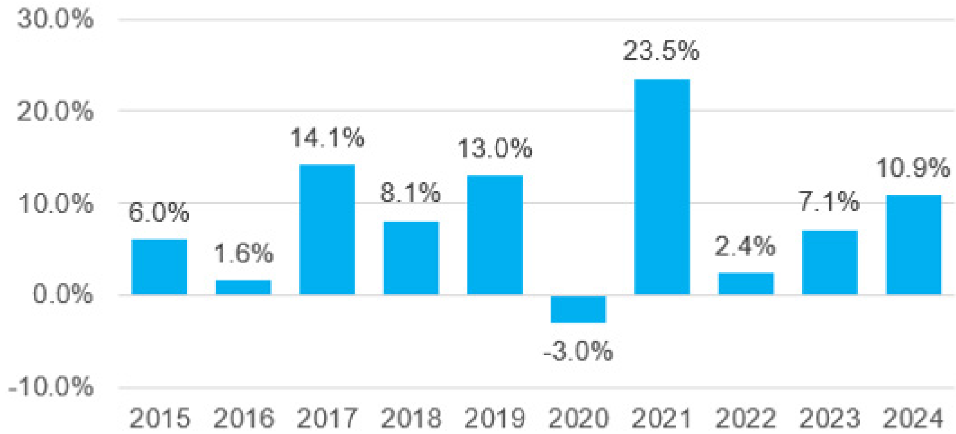

Chart 3:

Shares perform consistently over the longer term as shown by the 10 Year Rolling Average Returns of the S&P/ASX 300

This graph is for illustrative purposes only. Past performance is not an indicator of future performance.