INVESTOR EDUCATION CENTRE
投資者教育中心

Invest like Warren Buffett

14 November 2013

“ To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insight, or inside information. What’s needed is a <u>sound intellectual framework</u> for making decisions and the ability to <u>keep emotions from corroding that framework</u>.”

Contents

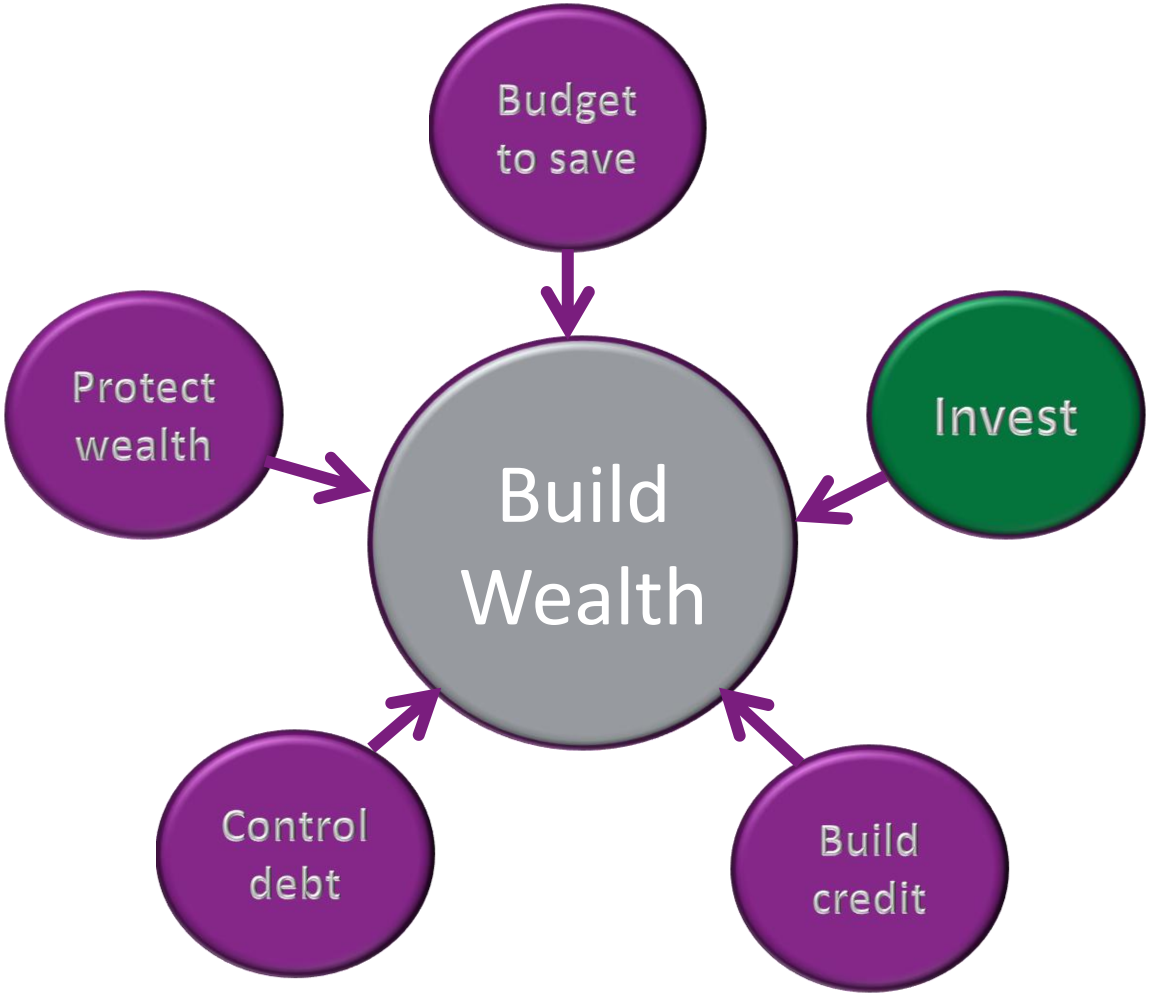
Why invest?

Know yourself first

What does wealth mean to you?

What you own − What you owe = Wealth

How to build wealth?



What is investing?

- Making your money work for you
- Growing your money over a period of time is a prerequisite of building wealth to help achieve financial goals
- Aiming at earn a return greater than the rate of inflation

What are your financial goals?

- **Short term (1 to 3 years)**
- **Medium term (3 to 7 years)**
- **Long term (7+ years)**

1-3 years	Holiday in Europe
3-7 years	Wedding / Down payment for a flat
10 years	Children’s education
45 years	Retirement

Setting SMART goals

Specific. Do you know exactly what you want to accomplish with all the details?

I need a holiday in Europe.

Measurable. Can you quantify your progress so you can track it? How will you know when you reach your goal?

I need $30,000 for the holiday.

Attainable. Is your goal a challenge but still possible to achieve?

I will put aside $2,500 a month for the holiday.

Realistic. Is your goal realistic and within your reach? Are you willing to commit to your goal?

I can save $2,500 a month by working part-time.

Time-bound. Does your goal have a deadline?

I will save $ 30,000 in a year.

Are you ready to invest?

1. Is your debt (student loans, credit card debt, mortgage, etc.) under control?
2. Do you have enough cash for emergencies?
3. Do you have adequate insurance protection?
4. Do you understand how to invest?

Do it like a pro

Investing principles

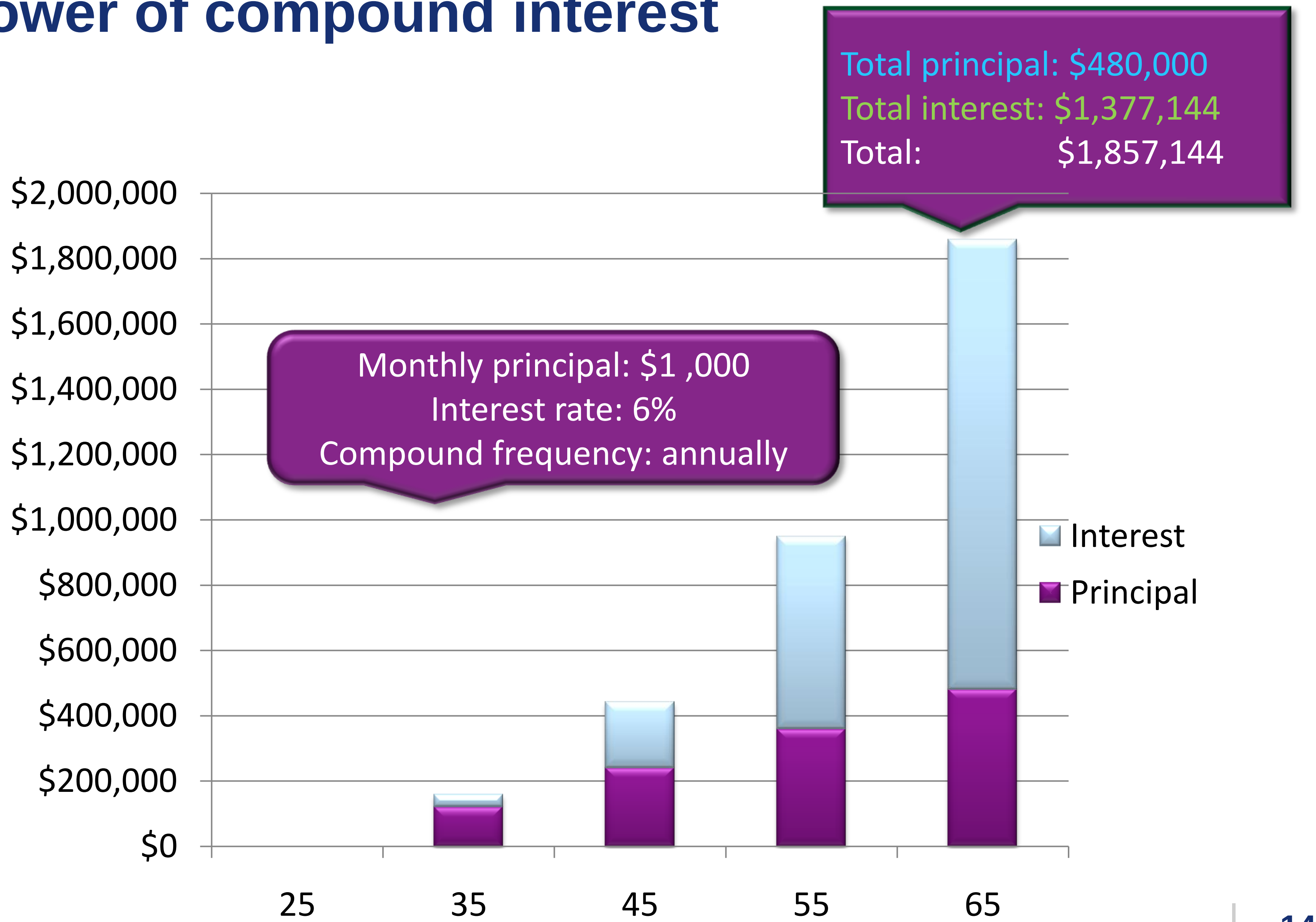
Investment principles

1. The power of compounding
2. Risk and return
3. Time and risk
4. Dollar cost averaging
5. Diversification
6. Asset allocation
7. Rebalancing

“Someone's sitting in the shade today because someone planted a tree a long time ago.”

Quoted in Andrew Kilpatrick, Of Permanent Value:
The Story of Warren Buffett

Power of compound interest

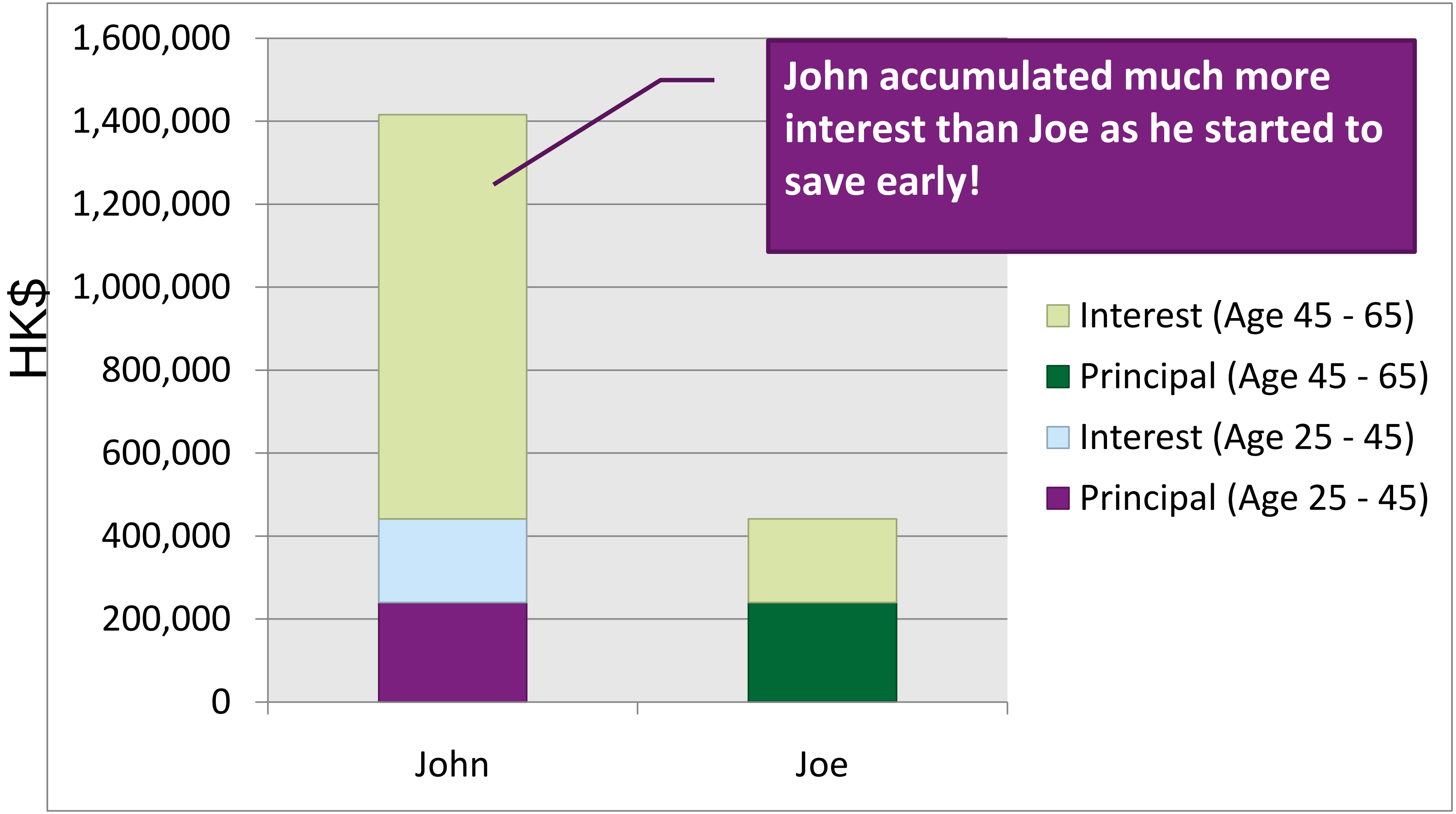


Power of compound interest

	Interest rate (compound annually)	Age 25-45	Age 45-65	Principal + interest at age 65
John	6%	• $1,000/ month •$240,000 in total	$0	$1,415,716
Joe	6%	$0	• $1,000/ month •$240,000 in total	$441,427

Start early!

Power of compound interest



Start early!

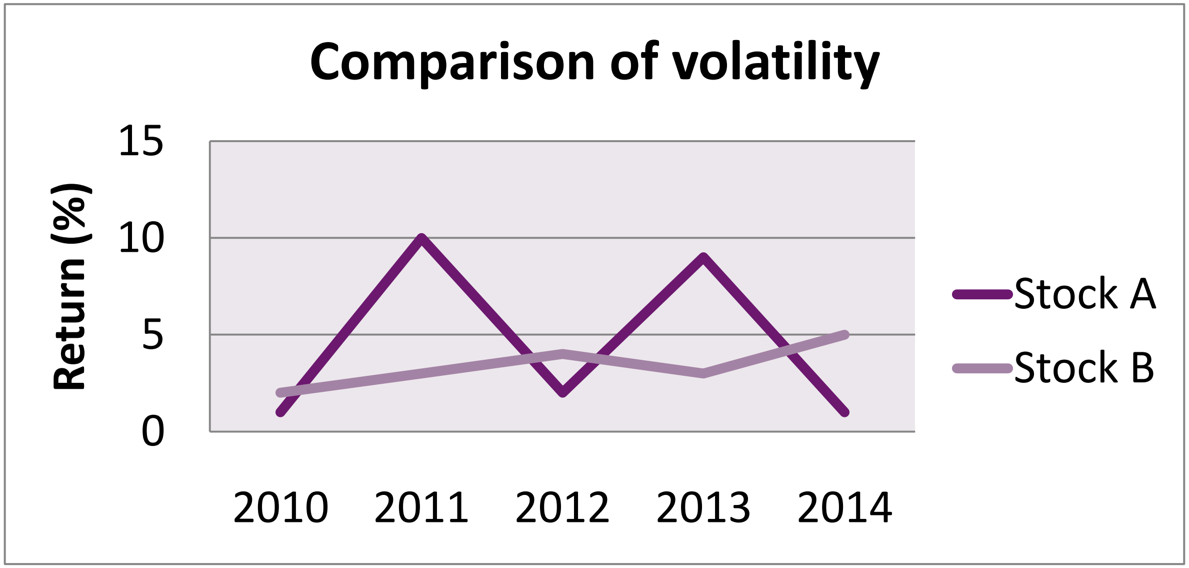
“Risk comes from not knowing what you are doing.”

Warren Buffett

Risk and return

What is risk?

- The chance that you may get lower return than expected, zero return or even negative return, i.e. loss
- Risk is also about volatility. The possibility that your investment will fluctuate (go up or down).



- Different investment products have different degrees of risk.

Risk and return

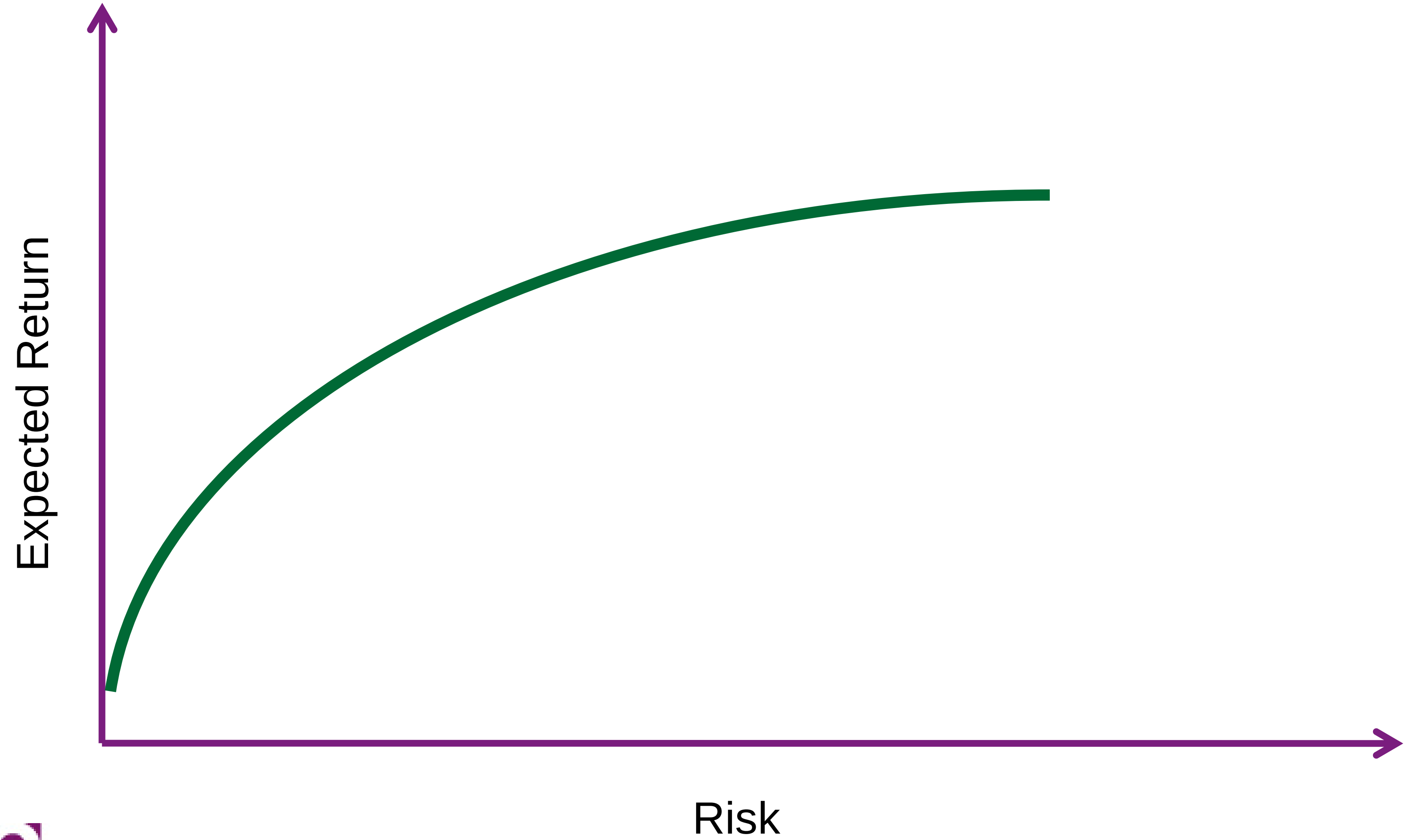
<u>What is return?</u>

During the holding period

An interest or dividend payment + The value of the investment appreciates (or depreciates) = Total return for the holding period

Income + Capital gain (loss) = Total return for the holding period

Risk and return



Risk and return – a balancing act

<u>Risk tolerance</u>

- **Subjective**
- **Psychological factor/ no right or wrong**

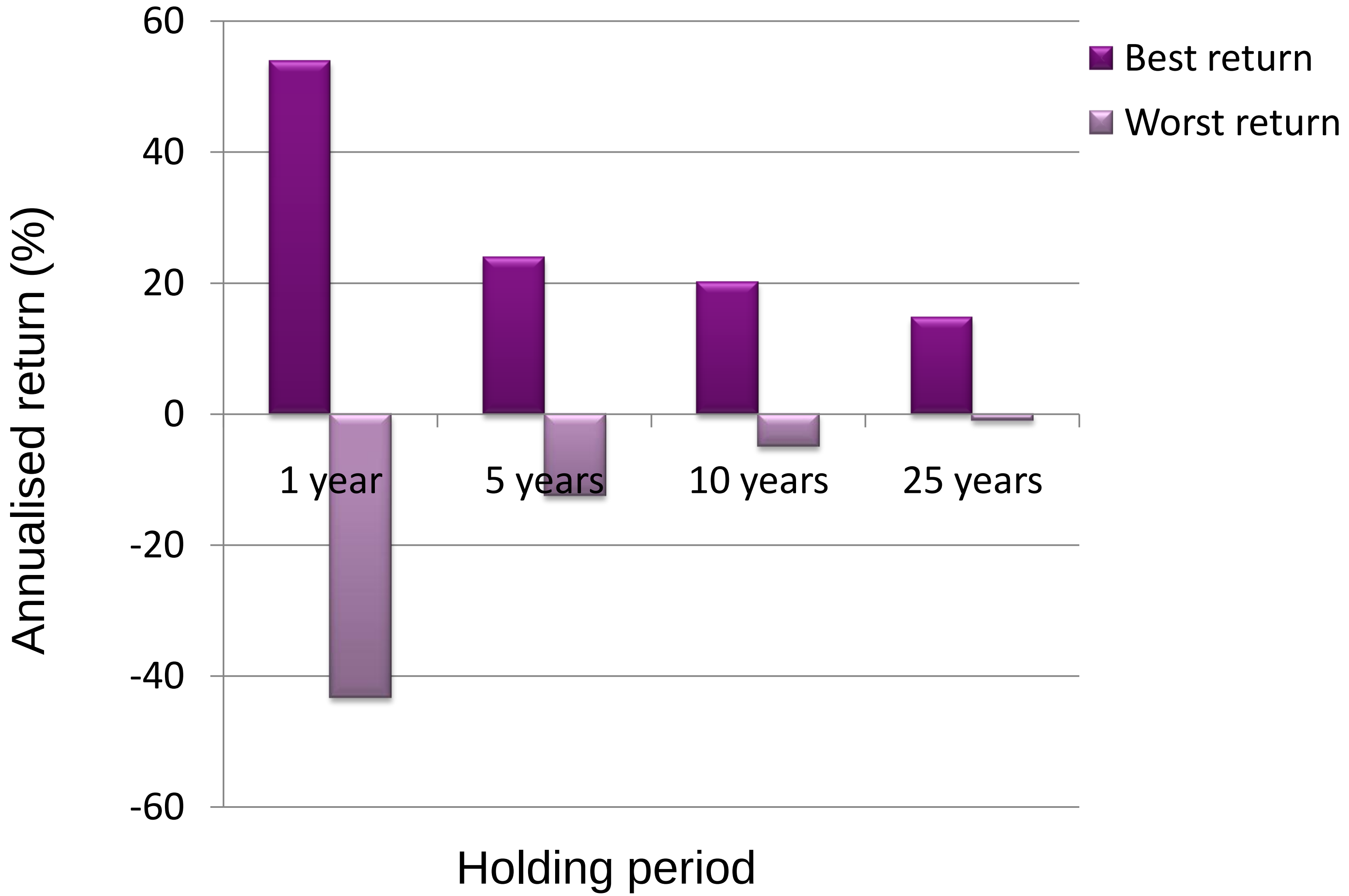
<u>Risk capacity</u>

- **Factors**
  - Financial goals
  - Time horizon (age)
  - Liquidity needs
  - Financial resources
  - Number of dependents

“Our favourite holding period is forever.”

Letter to Berkshire Hathaway shareholders, 1988 Warren Buffett

Risk and time – look at long term



" We have no idea and never have whether the market is going to go up, down, or sideways in the near or intermediate future."

Warren Buffett – Berkshire Hathaway Annual Report 1988

Dollar cost averaging – best time to invest

Month	Amount invested	Price per share	Number of shares
January	$500	$10	50
February	$500	$5	100
March	$500	$4	125
April	$500	$5	100
May	$500	S10	50
June	$500	$12.5	40
	Total: $3,000	**/**	**Total: 465 units**

Average cost per share: $6.45

Diversification

Why

- Each type of investment tends to respond differently to economic and other events
- This means that it is unusual (though not impossible) for all the asset classes (eg. stock, bond, currency, precious metal, etc.) to perform badly at the same time

Diversification – spread your risk

Benefits

- A major method of limiting risk is to spread the investment over a range of different investment asset classes. 'Don't put all your eggs in the one basket'
- Spread your investments to avoid risk

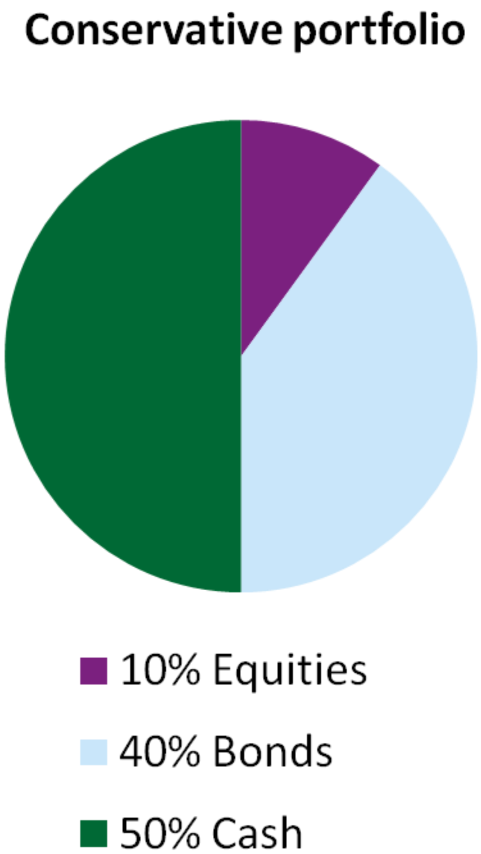
How

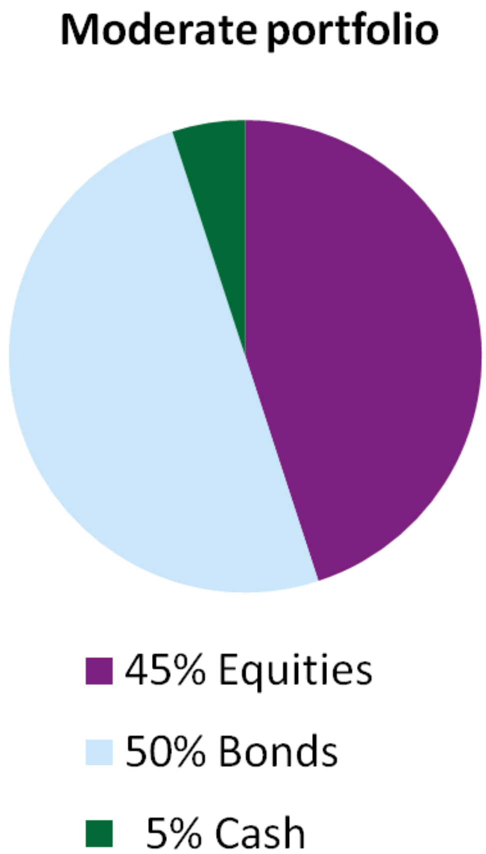
- Invest in different types of investments (asset class)
- Invest in different companies/industries/countries within a type of investment

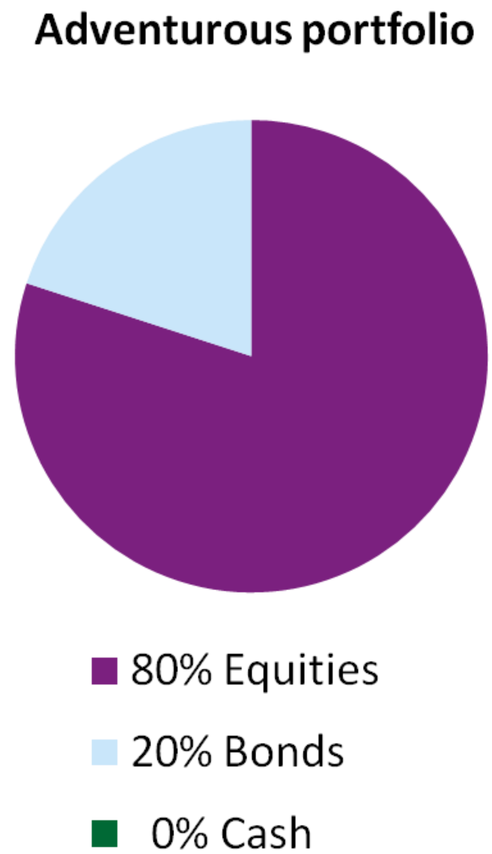
Asset allocation

- Asset allocation: the process of deciding what share of your investable should be invested in what asset class (type of investment) such as cash, bonds, and shares etc.
- What really make a significant difference to a portfolio (collection of investment)'s returns and risks is not which shares or bonds were chosen but how much was invested in each asset class
- Asset allocation decision is the main deciding factor for a portfolio's returns and risks

Asset allocation (hypothetical portfolios)







For illustration purposes only. They are not a replacement for financial advice.

Asset allocation – get it right

If you have just started your first job

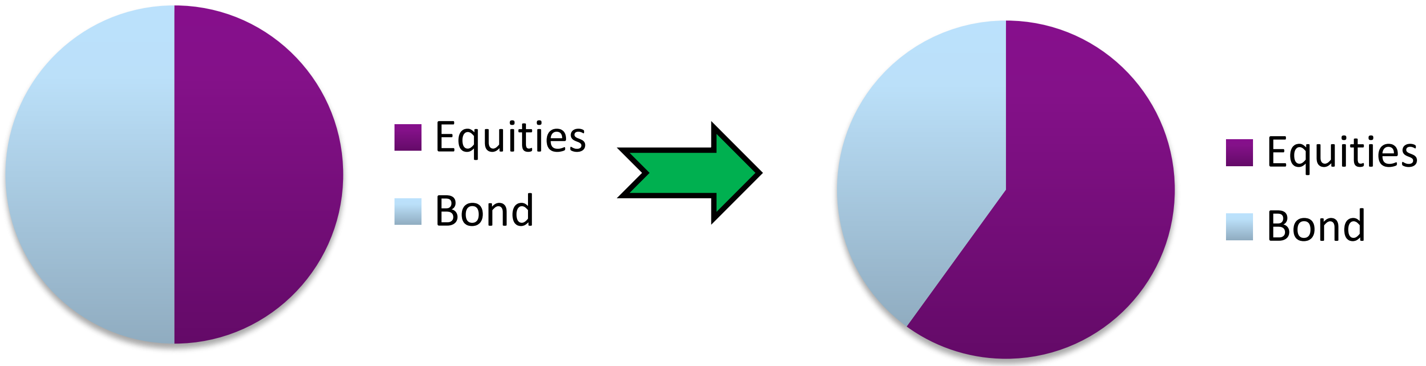
If you are married and have children

As you approach retirement

Review and possibly change your asset mix over time

Rebalancing – keep it updated

- Market fluctuations can affect your mix of assets and change the risk/return profile of your portfolio



- Adjusting your portfolio back in line with your investment objective
- Ensure that your portfolio does not become overly invested in a particular type of investment, and thus change its risk profile so that it's out of line with yours.

Asset classes

Know what you are investing in

Savings and investment products

- **Deposits**
  - The money an investor transfers into a bank's savings or checking accounts
  - Bank savings deposits
  - Bank time deposits
  - Foreign currency deposits

Savings and investment products

- **Bonds**
  - An investor loans money to an issuer (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate
  - **Making money from interest income** (the interest rate, or the coupon rate, the maturity of the bond, and the credit rating of the issuer)
  - **Making money from capital gains** (depending on the credit quality of the issuer, interest rates)

Savings and investment products

- **Funds**
  - A **pooling** of investors' funds or contributions invested in a portfolio of assets (commonly **stocks and/or bonds**)
  - With **different themes, different asset mixes, different risk levels**
  - **Making money** from **dividends/ interest**
  - **Making money** from securities in the portfolio increase in price (**capital gain**)
  - **Advantages**: professional management, diversification, economies of scale

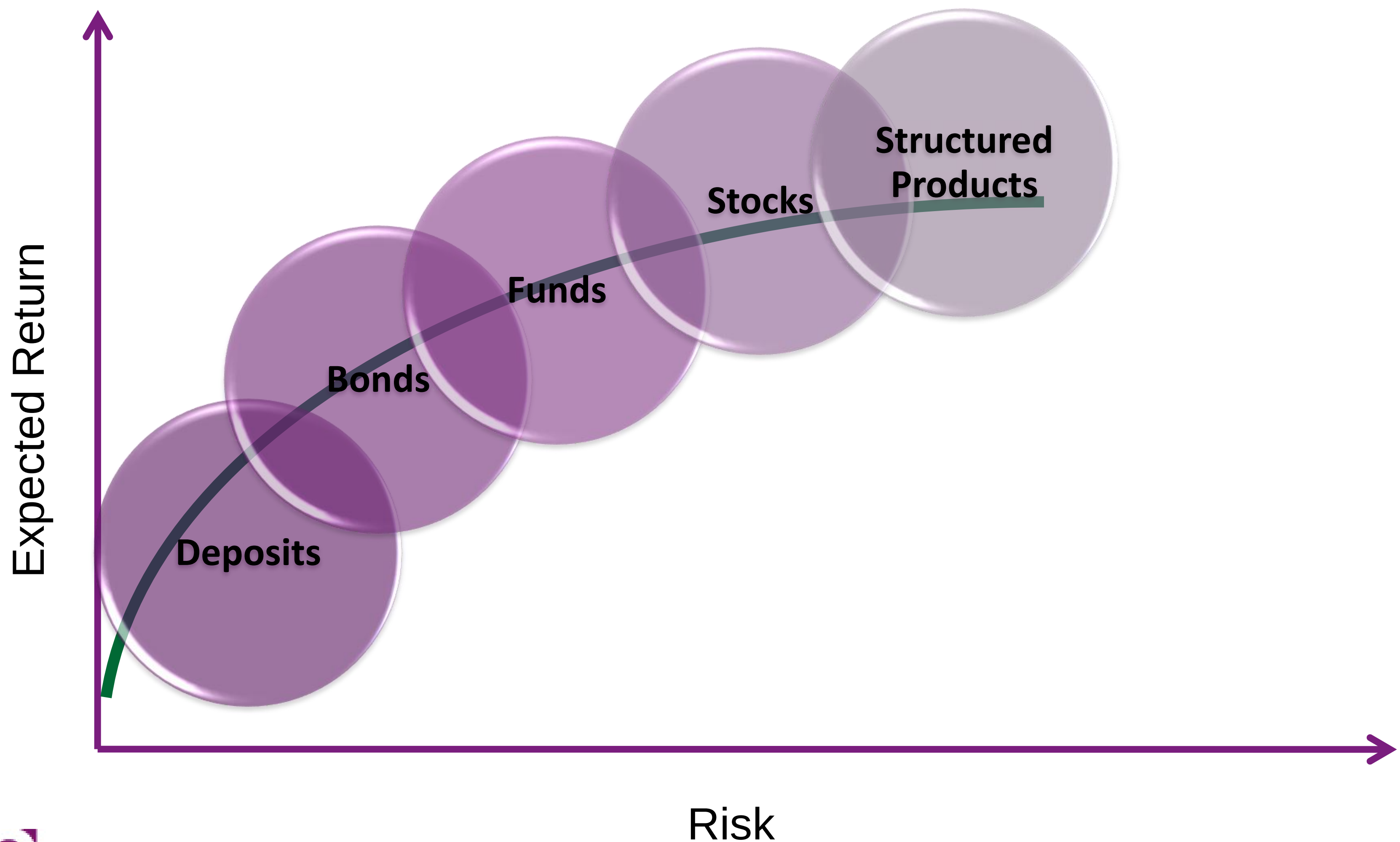
Savings and investment products

- **Stocks**
  - Stocks represent a share in the **ownership of a company**
  - **Making money from dividend**
  - **Making money from an increase in share price**

Savings and investment products

- **Structured products**
  - Comprised of one or more **underlying securities**, with a focus on one or more sectors or asset classes
  - **Leverage** magnifies the impact of both the potential positive and negative performance of an underlying asset
  - More suitable for **experienced investors** with a high risk appetite

Risk and return of different asset class



Practical investment tips

There are no quick wins in investing

“We've long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children.”

Letter to Berkshire Hathaway shareholders, 1992 Warren Buffett

1. Investment is not speculation

Investment	Speculation
Long-term commitment	Short-term holding
Investing in an asset to enjoy possible return	Buying an asset with expectation of profile on sale due to price changes
Achieve planned investment goals	Follow the trend
Relatively steady	Relatively uncertain
Evaluation through scientific analysis	No analysis, just past trend

"We don't have to be smarter than the rest. We have to be more disciplined than the rest."

Warren Buffett

2. Discipline is paramount

- Investor behaviour is a major contributor to investment performance, both positive and negative
- The media and the financial services industry tend to swamp investors with short-term distractions
- When deviating from long-term investment goals, investors can cause considerable harm to their investments returns
- However, “stop loss” is needed when the fundamentals have changed from positive to negative

3. How to keep track of your investments?

- Good record keeping
- Read websites and newspapers for economic conditions, interest rates, fundamentals, etc.
- If you have invested for the long term, don't be spooked by short-term ups and downs

4. Watch out for warning signs

- Accounting problems
- Management problems
- Over-promising and under-delivering

5. Get to know investment advisors

- **Deal with regulated persons**
- **Investment advisers who advise on securities (eg. stocks and funds) or future contracts are required to be licensed by the SFC**
- **Three principal groups of investment advisers selling or advising on financial products in Hong Kong:**
  - **Intermediaries who are licensed by the SFC**
  - **Banks**
  - **Insurance intermediaries**

6. Be mindful of fees

- Remember the compounding effect?
- Fees can eat into your return

“Investment must be rational, if you can’t understand it don’t do it.”

Warren Buffet

What have you learnt?

- If you are going to make your first investment, it is very necessary to learn thoroughly about it
- There are various investment principles (but remember they are not absolute rules)
- Investment is not speculation
- Only invest when you are well prepared

Visit the IEC website www.hkiec.hk

Questions and answers

Thank you

投資者教育中心
Investor Education Centre
http://www.hkiec.hk