

PART 1

What you need to know
about investing in shares
online

CHAPTER 1

Online share trading gives you global investing power at your fingertips

WHEN YOU INVEST IN SHARES ONLINE you become a part owner of a public company that may be located anywhere in the world. This places you in a powerful position as you are now playing a role in that company's future, despite the fact that you may be living some distance from its location. This is because as an online share investor, you now have the opportunity of trading in international markets directly from your computer, WAP mobile phone or any other Internet-enabled personal communications device anywhere, any time.

One of the many reasons why a company offers you shares is to raise cash to pay for its business operations, especially if it is a newly listed public company.

To facilitate the power of online share trading, governments around the world are working towards building cross-border trading systems and settlement systems between their stock exchanges. This ensures that you are able to buy and sell shares online in companies located overseas efficiently, legally and directly from your local stock exchange. For example, the Australian Government is working with the governments of Singapore, South Africa, China, the UK and the USA to facilitate cross-border trading, according to the Australian Stock Exchange's (ASX) Managing Director and Chief Executive Officer, Richard Humphry.

This means that any local online share investor may go to an Australian stockbroker and be able to trade shares in a company trading, for example, in Singapore and listed on the Singapore Stock Exchange and vice versa.

You can trade shares in any stock exchange in the world

A stock exchange is the forum where the trading of shares takes place in a process similar to that of an auction for a house, except that it happens behind a computer screen via the Stock Exchange Automated Trading System (SEATS). Share buyers, during the trading hours of the stock exchange, make bids online for shares, and sellers sell online for the best price. In Australia, the ASX's electronic trading hours are between 10.00 am and 4.00 pm (see Table 1.1).

One of the world's largest sharemarkets in terms of value of companies traded is the New York Stock Exchange (NYSE) (see Fig.1.1). It lists more than 3000 of the most famous public companies such as General Electric, Citigroup, Pfizer, American Express, Lucent Technology and Texas Instruments.

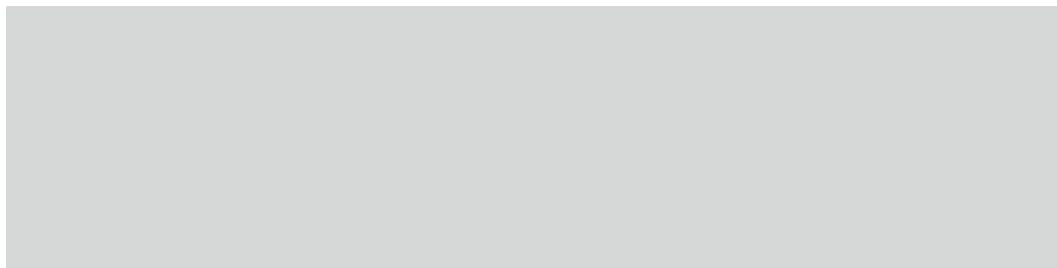


Figure 1.1. Share trading volumes of the world's largest sharemarkets during 1999

In 1999, according to Securities Industry News, the NYSE traded around 203 billion shares. By comparison, in the same year, the ASX traded 102 billion shares, ranking it the sixth largest sharemarket in the world in terms of trading volumes, just behind Milan which traded 125 billion shares and Tokyo which traded 155 billion shares. Yet, the local sharemarket made up only about 2 per cent of the total share-trading value of the world's sharemarkets.

One of the things about the Australian sharemarket that is not widely understood is that the volume of shares traded in this country is actually extraordinarily high when compared to its size. Despite this volume of trading, Australian shares do not carry the same value as international shares despite the volume of transactions being very high by comparison.

Richard Humphry, MD & CEO, Australian Stock Exchange

With the advent of the Internet, the world's stock exchanges are now available to all online share investors (see Table 1.2). This means that you can access the NYSE as easily as the ASX via any Internet-enabled communications device, subject to your online stockbroker being authorised to trade in the country of your choice (see Appendix 1). It also means that you now have the opportunity of spreading your risk by not having to rely solely on the local economy for your wealth creation. (Go to www.eojeda.com to quickly access any stock exchange in the world.)

EXAMPLE: How you can take advantage of overseas economies

The Australian dollar fell substantially in value during 2001. If you had previously invested in the US stockmarket you would have not suffered any financial loss but rather you would have made a gain on the exchange rate at that time.

It is interesting to note that the on 19 October 1987, share trading at the ASX went electronic with SEATS for the first time in its trading history. The next day it had to cope with the sharemarket crash where the main performance indicator, the All Ordinaries Index (All Ords), fell by some 25 per cent from 2065 to 1549 causing the net value of ASX listed companies to fall by \$55 billion. In spite of this, the new trading system proved to be reliable, fast and efficient, according to the ASX. Since then, the ASX has placed limits to minimise any freefalls in share prices, and should it occur again, all trading is suspended due to SEATS' fast processing, thereby avoiding huge losses in any one trading day from panic selling.

Table 1.1. A trading day in the life of a stock exchange

Time of day (Sydney times)	Market phase	Action taken
7:00 am–10:00 am	pre-opening	Online share traders and stockbrokers place orders. The orders are queued according to price-time priority.
10:00:00 am	opening for trade:	During the first 10 minutes, SEATS calculates the opening share prices for the day's trading. Shares are placed in a queue in five different groups according to the starting letter of their stock exchange codes.
10:00:00 am	share codes: A–B	
10:02:15 am	share codes: C–F	
10:04:30 am	share codes: G–M	
10:06:45 am	share codes: N–R	
10:09:00 am	share codes: S–Z	
10:00 am–4:00 pm	normal trading	Online share traders and stockbrokers enter orders and SEATS matches the buying and selling orders for share trade transactions to take place.
4:00 pm–4:05 pm	pre-open prior to closing	Trading stops and stockbrokers enter, change and cancel orders in preparation for the market closing.
4:05 pm–4:06 pm	closing single price auction	SEATS calculates the closing share prices from the day's trade.
4:05 pm–5:00 pm	closing for trade	Electronic trading ceases. Only trading between stockbrokers may continue via telephone. New orders are only entered into SEATS—they are not actioned until the next trading day.
5:00 pm–7:00 pm	after hours adjust	Stockbrokers finalise their orders by sorting through those that require amending and cancelling any that are unwanted. Telephone trading between stockbrokers may continue.
7:00 pm–7:00 am	inquiries	SEATS is available for enquiries only. No trading takes place until the following trading day.

The different kinds of stockbroking services

Stockbrokers may be divided into three categories based on the type of service they provide. Due to the fierce competition for online traders, these categories are becoming blurred as more and more stockbrokers add new multimedia online services to attract Internet users. These categories are full service stockbrokers; telephone-based non-advisory stockbrokers; and Internet-based non-advisory stockbrokers or 'discount brokers'.

Full service stockbrokers

Full service stockbrokers tend to be the most expensive given that they offer advice on buying and selling shares, make recommendations for your share portfolio and provide research on companies, industries and economic news. They may also offer other investments such as options, debentures and bonds, and assist you with your investment plans.

Telephone-service non-advisory stockbrokers

Non-advisory telephone service stockbrokers are cheaper than full service stockbrokers. This is because they only place your orders after you notify them over the phone and no other service is given. You would need to be an experienced share trader to have the confidence to use this type of service.

Internet-based 'discount' non-advisory stockbrokers

The point of contact with an online stockbroker is the stockbroker's website where orders can be placed online using the Internet (see Table 5.7, page 41).

Table 5.7. Examples of online stockbrokers in Australia and the USA

Company name	Online address
AMP	www.amp.com.au
Andrew West Stockbroking	www.andrewwest.com.au
Austock Brokers	www.austock.com.au
BankWest	www.bankwest.com.au
Charles Schwab Australia	www.schwab.com.au

Case studies

The following case studies outline how average salary earners and low-income earners can benefit from buying shares that pay dividends.

How imputation credits work for average salary earners

You are an average salary earner where your income consists of \$32 000 in salary and wages. You also receive \$3000 worth of fully franked dividends carrying imputation credits of \$1285.

The amount of tax you will pay on your total taxable income is calculated as follows:

		\$
Salary and wages		32 000
Dividends	3000	
Imputation credits	<u>1285</u>	<u>4285</u>
Taxable income		<u>36 285</u>
Tax payable on \$36 285		7265
Less		
Imputation credits		<u>1285</u>
Net tax payable		<u>5980</u>

How to receive a refund from an imputation credit as a low-income earner

You are a low-income earner; you receive \$5000 in salary and wages from a part-time job and \$3000 from fully franked dividends carrying imputation credits of \$1285. This is how you make the calculation to find out how much tax you will pay on your total taxable income. The good news is that in this case you actually receive a refund.