INVESTMENT GUIDE

MICHAEL OLAFUSI

TABLE OF CONTENTS

Purpose & Benefit of this Guide

Most of us find the finance and investment world hard to make sense of. We would rather just work hard, earn a respectable income and give someone else (or investment firm) to invest it on our behalves.

There is nothing wrong in doing that, well, on the surface. The real trouble in doing that is the underlying assumptions – that you will find a trustworthy and high-grade investment manager and that you will never fall into any financial crisis. Sincerely, I would rather cross a road with my eyes closed than take that risk. And since I do not intend to cross the road with my eyes closed, I have taken great pains to equip myself with all the finance and investment knowledge I need.

And that knowledge is what I have condensed into this Investment Guide.

You will find it useful in making sense of the investment world and, hopefully, fuel a hunger in you for more practical financial knowledge

Best of all, I have made it easy to understand. You don't need to have any special or background knowledge. All you need to understand everything in this guide is to read this in a calm place and maybe print it out, to easily mark areas that interest you.

Why You Need to Invest?

Investing is not just about wealth generation – making your money work hard for you as you did for it. Investing is also about wealth preservation – making sure that the N1 million you have now will have the same purchasing power 2 or 5 years from now.

If you put all your money in a savings account, the interest you will get on it is not going to insulate you from the damaging effect inflation will have on your life savings. As the price of things keep going up and cost of living increases, the N10 million you have in a bank will not be able buy you much in 10 years' time, the value will have been eroded by inflation. So, you really have no option than to make sound investment decisions now.

I work terribly hard every day and deny myself a lot to set aside some of my income. I will cry if I discover that the N20 million naira I have saved over my working life is just worth N5 million naira in today's value.

And that is the what inflation does to money kept in a savings account. The house you can buy with the N20 million naira today will be selling for N40 million naira in 10 years, while your savings account will be reading N20.5 million. And that's if you're lucky to find a savings account with 3.6% interest rate. Most are 2%.

Getting Started

To start you need to understand the different investment options you have. I have taken time to compile the standard financial investment options individuals have in Nigeria.

A. HIGH YIELD SAVINGS ACCOUNT

High Yield Savings Account is a special savings account that offers a higher interest rate than regular savings accounts. It might come with restrictions on number of withdrawals per month or minimum deposit to enjoy the high interest rate. Mine with Diamond bank doesn't place a withdrawal limit but doesn't provide you with an ATM card; withdrawal is over the counter.

PROS

1. A High Yield Savings Account provides the easiest and fastest access to your money among all the investment vehicles listed here. All I do to access my fund is to show up at the bank and fill a withdrawal slip. I can even use the online banking service too.

2. It provides a near risk-free return on your investment, and a predictable interest rate too.

CONS

1. It provides a very low rate of return on investment. Too low for any long-term financial goal.

2. It's return rate is way less than the inflation rate, hence your money is actually losing value (purchasing power)

RECOMMENDATION

Best used as your Emergency fund account.

B. EQUITY MUTUAL FUND

The most popular ones in Nigeria are Stanbic IBTC Nigerian Equity Fund, ARM Discovery Fund and ARM Aggressive Fund.

They pull money from different investors and invest on their behalves (mostly in Stocks).

I have one with ARM, and since April 2011, I have been transferring a portion of my salary into the fund monthly (via Direct Debit). I once opened the Stanbic IBTC NEF too, but I closed it while I was reviewing my portfolio in 2012.

Equity Mutual Funds are very easy to open, the requirements are same with opening a bank account, and the minimum opening amount ranges from N10,000 to N100,000. And you'll get an online account to monitor your investment performance.

PROS

1. Equity Mutual Funds are managed by professional investment managers. And that is a huge relief for most people who want to invest in the stock market without the fear of losing all their money.

2. They allow you to automate investments monthly or quarterly, so you'll end up cultivating a savings habit. Helped me a lot.

3. Some (like ARM) will provide you an Investment Account Officer who can provide expert financial/investment advice to you.

4. Your return on investment can be huge.

CONS

1. Most of your money is invested in stocks, you might have months or years when your investment will de-grow, even beyond your initial capital.

2. Withdrawal of money from the fund takes about 5 working days.

3. The Investment Managers make a lot off you, even when they are losing your money.

RECOMMENDATION

If you are young and serious about investing in the stock market, starting with an Equity Mutual Fund is highly recommended.

C. MONEY MARKET FUND

Money market fund is like an Equity Mutual fund in some ways. Money is pulled from several investors and invested on their behalves. The major difference is that Money Market Funds invest in short-term debt securities like CDs, Treasury Bills and commercial papers. And these have fairly predictable rates of return. Currently, the return rate of Money Market Funds in Nigeria is about 11%.

PROS

1. Money Market Funds help low net-worth individuals like me enjoy higher interest rates than possible in an equivalent fixed income account or high yield savings account.

2. It's extremely unlikely that your investment will de-grow or your initial capital be wiped out. The cases I know of are where the parent company of the fund administrators went belly up. So just stick to the very big and reputable ones and you'll be safe (almost).

3. You'll also get an Investment officer (depending on the fund administrator you choose)

CONS

1. The rate of return hardly catches up to the inflation rate. In the long run, your money might lose purchasing power.

2. Most Money Market Funds in Nigeria require 5 working days to process your request to withdraw money from your account

RECOMMENDATION

Money Market Funds are best for saving money you're not sure what do with; like sales bonus and lottery winnings (if you play lotteries).

D. BOND FUND

A bond fund is also a mutual fund, several investors' money pooled and invested in bonds.

First, I need to correct the wrong impression most Nigerians have about bonds. Bonds aren't risk free. They can be riskier that stocks.

I'll recommend you go with Stanbic IBTC Bond Fund, I believe it is the best managed. Anyways, they have got that reputation.

PROS

1. Managed by professionals.

2. If you go with Stanbic IBTC bond fund, you will greatly reduce your risk of losing money, and you will earn a good return.

3. Best suited for investors that cannot cope with the fluctuations in stocks market. Especially investors close to retirement.

CONS

1. Bond funds are run very conservatively and end up like Money Market funds with slightly higher rate of return and more withdrawal restrictions.

2. Withdrawal requires several working days to implement

RECOMMENDATION

Go for the Bonds Fund if you hate the Stock market

E. FIXED INCOME ACCOUNT

Fixed Income account is majorly for high net-worth people, and companies too. You are able to negotiate an interest rate that can be as high as FGN bond yield without the restrictions that come with bonds.

PROS

1. Great for people with lots of cash

CONS

1. Bad for people with small cash and no negotiation leverage.

RECOMMENDATION

Just got your N 65 million pension? Fixed Income all the way!

F. REAL ESTATE INVESTMENT TRUST FUND

REIT, as it is popularly known, is a mutual fund that invests in real estate. It is just becoming popular in Nigeria.

PROS

1. Gives you the opportunity to share in the Real Estate boom, especially in Lagos and Abuja with as little as N100,000.

2. Excellent for Real Estate investment freaks.

CONS

1. REIT always underperforms stocks. And you are often better off playing real estate on your own terms; you can more easily find bargains and make financial windfalls than a Real estate company.

RECOMMENDATION

Only if you are obsessed with Real Estate investment and do not have enough to enter big time.

G. RUNNING YOUR OWN STOCK BUYING ACCOUNT

This is the most lucrative investment vehicle. If you put in the hard work and learning required, it beats all the others put together (diversified portfolio). I will be talking more on this in the next sections, so I will be brief here.

PROS

1. Provides the possibility of the highest rate of return (compared with the other investment vehicles)

2. You profit directly from your hard work and knowledge. You become better and better at it unlike the other investment vehicles I listed.

3. You can even write a book based on your experience and stock investment strategy. Lots of people are making money doing this.

4. You stand a chance of becoming a celebrity like Jim Cramer. Everyone will want to listen to you, just show them the records and make some noise.

CONS

1. You can lose all. Lots of people do.

RECOMMENDATION

If you have got the heart and age on your side, then go for it!

Understanding Stocks and Bonds

There are different ways to own a company:

1. You can start one yourself

2. You can partner with a friend to start one, and

3. You can buy the stock or bonds of a company.

For most of us, buying stock or bonds are the easiest way to own a company, at least a piece of a company.

Occasionally, we see a company growing very fast. And its bankers advise it to float an IPO (Initial Public offer). They come up with a mind-numbing valuation of the company and break it down into million units of shares. They sell a part to the public, you and me. Every share of the company you buy is a portion of the company. If you are extremely rich, you can decide to buy all the company's shares and make it your family business. That's if the board of directors let you.

Buying a company's stock is owning part of the company; it's like becoming a limited partner with less legal rights.

Then when the same company sees a huge business opportunity and wants to quickly cash in on it, it may float bonds for the public to buy. Bonds are like loans, (often) from the small guy to the big guy. You, as an individual, are lending money to a multi-billion-naira company. And that's simply what buying bonds is.

Now to the less obvious.

We can break down the ownership of a publicly traded company into three different classes:

1. Bond Investors

2. Preferred Stock Investors

3. Common Stock Investors

Bond Investors are regarded as senior owners and lay a prior claim to the assets of the company before both the preferred stock and common stock investors can enforce their claims. Likewise, the preferred stock owners are superior to the common stock owners.

If, for any reason, the company has to shut down and its assets be sold off. The bond investors will first be satisfied, then preferred stocks investors and lastly, the common stock investors. In most cases like this, nothing reaches the common stock owner.

In practical terms, if you buy the bonds of a company, the only way you'll lose your investment (if you don't trade it at a discount) is if the company closes down completely or file for bankruptcy (nowadays, it's also called restructuring). But as a stock owner, once the company stops making profits for years in a row, you either jump ship or watch your investment vaporize.

On the other hand, if the company is doing extremely well and growing revenue to the sky. A bond owner will not get more than he was promised. While a stock owner will reap almost all the rewards.

And that is why bonds are viewed as conservative investments, and stocks as very risky. But the reality is that a company that is healthy enough to fulfil its bond obligations will most likely be faring very well in the stock market, while a company whose stock is getting seriously bashed might end up not meeting its bond obligations (except in some few exceptions).

In conclusion, when it comes to buying bonds, you are better off sticking to government bonds. If there is a company you believe its bonds are investment grade, you should rather consider investing in its stock (except it's overpriced). So, in reality, use the bond ratings of a company as an indicator of the company's health, to see if you can continue with your plan to buy its stock.

Understanding Shares: Common & Preference Shares

Shares are the units of a financial instrument. In our case, we'll say, shares are the units of a stock.

What is a stock?

Stock is the capital of a company raised through the issue and subscription of shares.

And you say stocks when you are talking about several companies, each having its own distinct stock.

The Nigerian Stock Exchange has a listing of over 170 stocks, or companies.

I have investments in 2 stocks – GTB and NASCON.

I have 24,680 shares of GTB stock.

I hope now you'll never be confused when you see shares, stock and stocks in any document.

Companies have two types of shares - common/ordinary shares and preference/preferred shares.

Common or ordinary shares are the shares of a company that you can easily trade on the stock exchange. They are the ones you see in Punch Newspaper's NSE stocks price and activity page. They are the ones you trade when you open a stock brokerage account.

The preference/preferred shares are not easily traded. You often buy them directly from the company's issuing house. I almost bought one in 2008, it was FirstInland Bank's preference shares. It was selling at N9.50 per share.

And it had the following specifications (which ordinary shares do not have) –

- A fixed dividend of 9.25% per annum on the offer price of N9.50

- Dividends are to be paid after tax (unlike bond interest payments)

- Dividends have preference over that to paid to ordinary shareholders. That is if there is anything left to pay them from.

- Dividends are non-cumulative. If for any reason the company could not pay this year, there is no payment carry-over. You should not expect the missing year's dividend to paid another year. It is every year to its own.

- You can convert 30% or less of the preferred shares to ordinary shares on the 30th of April of every year, for the next 7 years.

- The Issuer can call the preferred shares any time after the next 7 years. Meaning you'll be forced to sell the shares back to the company any time after the 7 years tenor of the shares.

- Common shares do not have any of such characteristics. And that is the simple difference between a common share and a preference share.

N.B.
You will often see Common Stock and Preferred Stock, but I went with Common shares and Preference shares so as not to confuse you as regards the clarification between shares, stock and stocks. In reality, shares are grouped into common shares and preference shares. The common shares are collectively known as the company's common stock, while the preference shares are known as the company's preferred stock.

How Stock Gets Its Price

As a quick recap: There are 3 ways to own a company - you start/inherit one, you buy a company's stock, or you buy a company's bond.

We've got preferred stock and common stock. It's the common stock that is being traded on the stock exchange. Hence, whenever I write stock, with no adjective, I mean common stock.

When a company wants to go public, its bankers value the company's assets (buildings, equipment, bank account, intangibles, etc.) and value it's liabilities (mostly debts). Then, they deduct the liabilities from the assets and name whatever value they get as the company's book value. Then they do some financial modelling magic to calculate the lifetime earnings of the company and then discount it to today's cash. They call that the company's valuation. It's that amount they quote to the public to buy at. They can split it to 100 million units and sell to you & me. That's what is called an IPO: **Initial Public Offer**. The good part is that they also give you a free prospectus detailing nearly everything about the company, especially the book value that shows what money the company should really be exchanging for. But these bankers are marketers at heart. They put up fancy billboards. They change our favourite tunes to advertising jingles. They almost brainwash us via radio, TV and internet adverts. And even though we can see the truth in the prospectus, we still believe the future they are painting for us and buy into the IPO.

After the IPO, the other professionals (the ones that make their living reading financial statements) come in. They focus on what we ignored, the financial numbers. They run series of calculations. They make future projections. They compare the company's numbers with that of similar companies. They come up with their own valuation of the company. And God help us if it's less than what the IPO guys gave. The same marketers that led by example, buying into the stock, will be the first to dump the stock and crash the price to what the stock market professionals think. Then after a while, the company's stock price stabilizes.

What makes a stock's price go up and down?

It is the stock market professionals, the guys who are full-time stock traders. They are like car dealers. Professional car dealers have a near perfect idea of what every car is worth. Whenever they see a car being sold for less than it's worth, they buy it instantly and move the price up to the market price. But their biggest effect lies in the fact that they are constantly scouting for such offers. They make it nearly impossible for you and me to find those cheap car offers. They are constant buying them out and moving the price to what they think, thus, setting the market price.

And that's how the professional stock traders operate. They have this idea of what a stock should be sold at, and force everyone to trade at that price.

To understand how stock price goes up and down, you will need to understand how the professionals determine a stock's price. It's part science, part greed and part fear. Though you can always get the science part right (which is why I'm here) and be able to predict its effect on stock prices, you can't always get the greed and fear part right. So, in the end, you can't always predict stock prices.

A stock price will go up if the professionals believe it's worth more than it is selling for, and it will go down if they believe it is selling for more than it is worth.

BONUS

WHY DID THE 2008 STOCK CRASH HAPPEN?

It was simply because the greed and fear part dominated.

How Do You Pick the Right Stock?

This is called **Stock Analysis**. It is some people's full-time job, and for a reason – it's a lot of work.

I can't share it here to prevent this guide from getting too long and boring. But you can read at your pace all I have explained about it on my blog, Investment Series.

The rationale behind picking the right stock is in finding a company that is doing well, has a bright future and buy it at the right price. The logic is simple; it's the execution that is very hard.

Why am I Being This Generous?

We have come to the end of the Investment Guide.

I know some people will like to know why I am giving away so much information for free. It's because I hope to meet you someday, maybe 10 years from now, and you'll say, "*Thank you Mike for that Investment Guide of yours. You gave me the much-needed push to take my financial future in my hands and make the most of it. I'm now a billionaire because of you.*"

See you at the billionaires' club,
Michael Olafusi