Chapter Four
Foreign shares

A substantial number of foreign companies are quoted on the London Stock Exchange, especially from Europe (eg Volkswagen, Bank of Ireland, Bayer and Ericsson). In addition there are US companies (eg General Electric and Abbott Laboratories), Chinese (Air China), Japanese (Honda, Kawasaki and Mitsubishi), Taiwanese (Acer), South African (SAB Miller), Chilean (Antofagasta) and Russian (Gazprom). Most of them trade in Britain as well so it is possible to get some idea of the business and see stockbroker analysis of the management and figures. Trading in these is pretty much like investing in a major UK company.

The mergers of European stock markets make it easier to get access to markets in other major countries and their shares, especially as there is a large number of rather good internet-based stockbrokers in Germany, France and Holland.

It is theoretically possible to buy overseas shares through a UK broker – in practice only some offer this service so check in advance whether the broker you want does. However, global markets and differential economic performances are producing more opportunities, and the internet and online brokers make it easy. But despite the growth of European traders most of the readily available trade in overseas shares is for US stocks. That looks to change as an ever-growing number of cut-price dealers from Germany and France set up net services in Britain.

As with all such investments, a degree of research and homework is essential. The trouble is that there are added levels of risk in overseas shares. The first is the state of the overseas economy. An investor needs to know whether interest rates are on the verge of change in that country because that might have an immediate effect on share prices, or whether the economy as a whole is about to soar away or is heading for a precipice.

Second, a wise investor gets to know something about the state of a particular sector: one needs to know which is about to be affected by a trade agreement, a reorganization, a spate of mergers and so on.

Third, it is a little harder to keep track of the companies – British newspapers tend not to write about them, stockbrokers do not analyse their figures and one cannot keep an eye on their products and services in the marketplace. There are also local peculiarities, for instance Swiss shares, which are commonly £5,000 each, with some at over £20,000 for a single share. That makes it harder for a small investor to get a range of these stocks – though to be fair there are ways of buying part of a share.

On top of that there is the exchange rate risk: a comfortable profit from trading in the shares might be completely wiped out by the relative movement of sterling. Finally, there are risks in the way the market itself operates. Regulation in major countries like Australia and the United States is pretty comparable with Britain, but 'emerging' markets can range from the haphazard to the corrupt. As part of that there may also be erratic recording of deals, ownership records may be variable, and controls wayward.

There are people who can cope with all those dangers, and have done very well from US shares, and even from investing in the budding markets of smaller countries. Mostly they know what they are getting into and know something of the circumstances to manage the risk.

For a novice to the stock markets or someone with a relatively small amount of money to play with, it is probably wiser to buy investment or unit trusts with the sort of overseas profile you fancy. There is such a variety on offer, you can decide whether to opt for Japan, the United States or Germany; for the Pacific Rim, western Europe, or developing countries; and even whether to pick specific industrial sectors within these regions. That not only hands over the decision to professionals on which are the good shares, but also spreads the risk. Another choice is to buy the shares of a UK company that does a lot of trade in the favoured area. Those choices also eliminate the foreign exchange consideration since the dealings are in sterling.

Chapter Five
How to pick a share

I started with nothing. I still have most of it.

JACKIE MASON, AMERICAN RABBI AND COMEDIAN

Anything to do with money is a matter of difficult choices. The savings and investment part also demands a line of careful decisions. First comes the grading of safety and access to spare cash. There is the current account for everyday expenses, followed by the amounts accumulating for predictable larger spending such as holidays, redecorating the home, replacing the car, the children's education, and so on. Then comes the provisions for a safe old age, life assurance, pension and rainy-day reserves. Only when these necessities have been taken care of comes the riskier area of stock market investment. It is not cash you will need to realize at short notice but will supplement income for your old age, say.

Stock market investment is for cash you can spare in the sense that if its value falls it may be disappointing and inconvenient but will not cause serious hardship. It is also for people whose nerves can stand uncertainty – for people who will not lie awake at night fretting about the fluctuations of share prices or get ulcers if the business invested in goes off the boil, or even down the pan. If you can think of it in the sense of an alternative to a flutter on the 3.30 at Sandown, or a punt at a roulette wheel, and can accept reverses with a reasonably philosophical shrug, the stock market may be for you.

That is not quite a fair picture, since if the horse you back fails to win, all your stake is gone. Money in shares has a pretty fair chance of not vanishing completely as most companies stay afloat and continue to pay dividends to provide some return on the investment. In any case, unless you were being forced to sell, a drop in share price is only a notional loss while dividends continue to arrive. On top of that, not only are the odds way ahead of other forms of gambling, but the return is better than other forms of investment. Careful research, monitoring and evaluation can reduce risks on the stock market. If the hazards could cause alarm, it does not mean the stock market is closed to you. You can still benefit from the long-term performance of shares by the reduced-risk route of pooled investment vehicles (see Chapter 3). The money is still invested in shares but the dangers of big losses are lessened by spreading the risk.

But that does not end the decision making – on the contrary, it just starts it on a new tack. To sift the right investment from the many thousands available through stock exchanges takes a series of tests and decisions. There are risk/reward calculations and approaches to decide – other people can help by spelling out the options but not take the decisions for you. For instance, some people are prepared to bet at odds of 14.5 million to one against them, which would normally seem insane, but because the cost of taking part in the National Lottery is only £2 and the winnings can run into millions, lots of people are prepared to take a punt.

That shows some of the criteria for decisions. One way of screening the thousands of potential investments is to set your own goals clearly and explicitly. It is not nearly enough to say the aim is to make money out of the stock exchange. The process involves:

- Deciding the acceptable amount of risk. Compared with the return on a safe home for the cash like gilt-edged securities or a deposit account at a building society, is the profit from shares enough to compensate for the risks? How much risk am I prepared to accept, first in general, for investing in shares at all, then in the particular sort of shares to go for – such as accepting that small and new companies are more in danger of failing but do have the potential for a larger percentage growth in both share price and dividend; some companies are seasonal or more reactive to economic fluctuations; overseas shares include an element of currency risk?
- Setting a time horizon for the investment. Whether the investment is to be short, medium or long term: volatility of share price can be disregarded for the long-term investment and so the shorter-term investments would be more stable businesses.