

understanding shares

This factsheet is designed to offer a basic understanding of the stock market.

what are shares?

By buying a share in a company you are, for better or worse, tying the fate of the investment to the performance of that company. In effect you are buying a part of that company and its future profits, or if the company doesn't perform well, a share of its losses. You will receive a share of the company's profit in the form of a dividend payment – you can also benefit from a future rise in the company's share price.

However, investments in shares (also referred to as 'equities') can go down as well as up in value.

Investing in shares may be more suited to someone willing to accept medium or high risk, as they are regarded as riskier than some other investment vehicles such as bonds.

Historically the best returns for long-term investors have been from shares, although past performance should not be assumed to be a guide to future performance.

Stock markets can be divided into two separate categories – primary and secondary. Both are equally important to companies wishing to raise capital.

the primary market

This consists of shares in two types of companies:

- those issuing shares for the first time (an Initial Public Offering or IPO)
- those who are already public and are looking to raise new funds by offering new shares.

the secondary market

Existing company shares are traded here on a daily basis. Movement in these prices indicate the relative performance of the company over time. Most investment in shares is in the secondary market.



the share price

Share prices in the secondary market reflect the supply and demand for the individual share.

If more investors wish to purchase than to sell a particular share, the share price rises. If more investors wish to sell than to purchase the particular share, the price of the share will decrease until the level becomes attractive to those looking to buy.

Many factors will influence the value investors place on a share. The dominant factors affecting the demand for shares can be broadly categorised as follows:

Macro factors

- Political events
- Legislative changes
- Unexpected events (terrorism/natural disasters)
- Interest movements
- Inflation forecasts

Micro factors

- Company profit forecasts/warnings
- Company's dividend history/policy
- Merger and acquisition activity

- Changes in management
- Activity in competition
- Valuation of shares

As well as these 'rational' factors, more emotional factors may affect a share price. For example, the development of a 'herd mentality' with investors buying a share because of a perception that lots of others are doing the same.

the golden investment rules

Investing in shares involves risk taking. There are a number of golden investment rules to help reduce an investor's overall exposure to risk:

Spread the risk – between different companies and different sectors – diversification is key!

Keep up-to-date – the financial press is a good source for checking share prices; you can see the change on the day and the high and low prices related to a period of less than

52 weeks. Of course, a wealth of information is provided on the internet – including up-to-the-minute share price information.

Stay calm – the stock market often reacts in an exaggerated manner and can move sharply from day-to-day. Generally, the aim is to 'buy low and sell high'. Sounds easy, but can be much more difficult in reality.

Reduce the losses – should you face the scenario where a share is not performing as hoped, you may wish to consider cutting your losses. It is important to predetermine when shares will be sold – the lowest price where you feel you cannot afford to lose more. This strategy should also be used to determine the highest price at which shares will be sold – it's important not to be too greedy as stock markets can be volatile, meaning strong returns can quickly disappear.

share classification

Shares are classified in accordance with the nature of the issuing company. Typically shares are classified in the following way:

Sector

Sectors relate to the key operations of the company, ie what product it sells or the service it provides, eg Pharmaceuticals, Telecommunications and Retail.

Size

Defined as small, medium and large capitalisation. For example a 'large cap' would be a large multi-national company such as Microsoft.

The characteristics of the company

Shares can be categorised in accordance with the current and future earnings or dividend characteristics of the company:

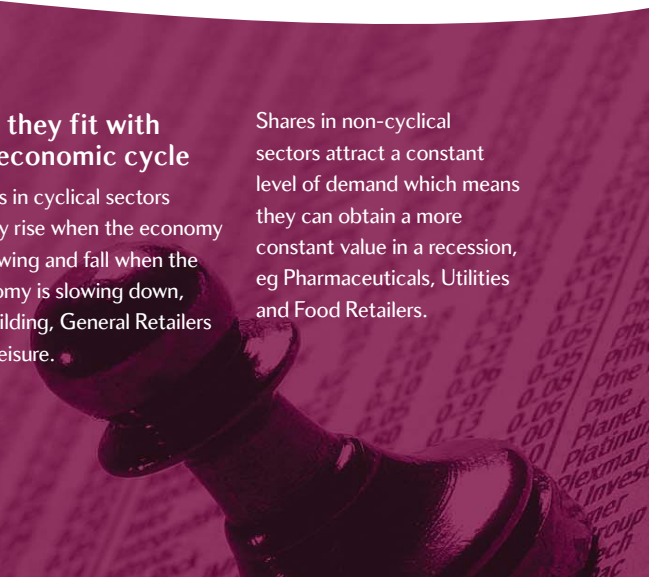
- **Growth shares** are shares in companies that have experienced sustained growth in sales and earnings, with a consensus that this is likely to continue.
- **Income shares** are shares in companies who, unlike growth shares, have dividend policies which favour paying out a large proportion of their profits to shareholders.

- **Value shares** are attractively valued relative to other shares in their sector. This means the investor believes the share price is below what the actual asset is worth, even if that asset does not seem attractive at that point in time.

how they fit with the economic cycle

Shares in cyclical sectors usually rise when the economy is growing and fall when the economy is slowing down, eg Building, General Retailers and Leisure.

Shares in non-cyclical sectors attract a constant level of demand which means they can obtain a more constant value in a recession, eg Pharmaceuticals, Utilities and Food Retailers.



and finally...

The stock market may have the potential to deliver higher returns than other investments, such as savings in a bank or bonds. However, there is significantly more risk involved, with more knowledge required to make the right decisions.

Which shares you select depends on your attitude towards risk. Nobody can predict the stock market and therefore it is wise to choose a diversified portfolio of shares in different companies across different sectors.

A convenient way to gain exposure to stocks and shares whilst diversifying risk is to invest in a fund holding a collection of shares.

A financial adviser will be able to offer further advice about investing into funds and whether they are a suitable investment for your needs.

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