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## PFP Erasmus+ Module 3: Investing

### Teacher's Guidance Notes

#### **1.1: Before you start investing in the stock market**

Investing in the stock market is a calculated risk. Your investments may go down in value as well as up!

The minimum age to open a share dealing account is 18. Your parent(s) can open an account on your behalf at a younger age and then transfer the account to your name once you are 18. You may have a child trust fund (CTF) or Junior ISA (JISA). In this case you can control the account from 18. The current JISA annual limit is £4,260. This can be split between a cash JISA and a shares JISA.

You do not need a large amount of money to start investing. The 2 most common methods of building a pot of money are: regular contributions and/or lump sums.

The rationale for investing is that it forms a part of a portfolio of assets. Typically a person's assets will consist of house equity, share investments and cash savings. Over an extended period of time the returns from investing in shares are better than cash savings and at least as good as house price appreciation (assuming share dividends are invested).

Becoming a successful shares investor takes time. A good way to learn how to manage a shares portfolio is through a shares based competition such as:

1: <http://www.studentinvestor.org/>

2: [www.shares4schools.co.uk](http://www.shares4schools.co.uk)

Or opening a practice account with a stock broker such as The Share Centre:  
[www.share.com/investment-accounts/free-practice-account](http://www.share.com/investment-accounts/free-practice-account)

#### **1.2 Introduction to investing**

An important initial decision is choosing the share dealing provider. There are many providers and they differentiate themselves in a variety of ways. These include price, customer service, fees, range of markets and trading features such as stop losses. The cheapest is not always the best and it may be worth reviewing comparison sites to see which broker has won industry awards or gets good customer feedback. Sometimes the best starting place is using your current bank/building society share dealing platform. Popular trading platforms can be found at the following link:

[www.money.co.uk/share-dealing.htm](http://www.money.co.uk/share-dealing.htm)

Well known providers includes: Barclays, Hargreaves Lansdown and The Share Centre.

Opening an account is very straightforward. It normally involves filling in some online forms and then depositing some money into the account.

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### 1.3 Types of investment

**ISA:** An ISA is an Individual Savings Account. Any money inside an ISA is free from taxation. There is an annual limit per year for the size of deposits.

*Top Tip: An ISA account should generally be your 1<sup>st</sup> choice of account. This is due to the tax advantages.*

**Shares:** Also known as stocks or equities. When you buy a share you directly own a part of the company. Your return will depend on the performance of the individual share, share price rises/falls and dividend payments.

**Funds:** The most common funds are investment trusts and unit trusts. These involve your money being pooled with other investors and the fund is managed for you. There are some differences between investment trusts and unit trusts but they generally produce similar returns.

*Extension: What is the difference between a unit trust and an investment trust?*

The major benefit of funds is that the investment is diversified across many shares and spreads risk. It also enables access to a wider range of markets such as Japan or Emerging Markets. This is often an excellent starting point for novice investors but be careful of fees.

**Exchange Traded Funds (ETF):** These are similar to funds but do not involve active management by a fund manager. They usually track a particular index or sector (such as the FTSE 100) and their major advantage is low fees.

*Extension: Research other forms of investments such as bonds and preference shares.*

### 1.4 Making a trade (step by step)

A whole industry survives on providing advice to investors about the best investments. At first it is best to keep this simple. Most brokers have their own advice sections for various types of investment (shares, funds, ETF's). The following is a link to The Share Centre's advice for individual shares:

[www.share.com/investments-and-recommendations/share-tips-and-search/recommended-shares-to-buy](http://www.share.com/investments-and-recommendations/share-tips-and-search/recommended-shares-to-buy)

A: Do your research and decide what you want to purchase.

B: Make sure the market is open. For instance the UK indexes are usually open from 8am - 4.30pm. You can leave trade instructions outside of these hours. This involves a limit buy/sell. In this case you set an order to be traded once a share/fund/ETF hits a certain buy/sell price.

C: Find the share on the dealing platform.

D: This will tell you the current share price. Notice there is a difference between the buy/sell price. This is called the 'spread'.

E: Select how many shares you wish to buy or what amount you want to invest. Enter these details and click buy. You will typically be shown the current trading price and have 10 seconds to go through with the trade at the stated price.

F: Congratulations, you are now an investor!

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### 1.5 Costs of investing

This will depend on your share dealing service provider and share dealing account option. For instance, frequent dealers may pay a monthly fee to reduce individual trade costs. Typically when you buy an investment you will face total transaction costs of approximately 1.25% of the transaction.

Costs involved are:

**Dealing costs:** This may be a fixed fee per trade or a percentage of the total transaction. A typical fee is approximately £12 per trade.

**Spread:** When you buy a share it is slightly above the sell price. This amount is very small for FTSE 100 companies but can be more for smaller companies listed on the smaller markets such as AIM (Alternative Investment Market). Allow for approximately £10 per trade.

**Stamp duty:** When you buy most investments you will need to pay stamp duty. This is currently 0.5% of the transaction total value.

**Selling:** When you sell a share you face similar costs but not the stamp duty fee.

### 1.6 Investor objectives

Investing is not the same as speculating. Investing usually involves at least a 2 year time frame. Investors can be broadly categorised into 3 categories. These are;

#### Growth

Growth investors are primarily concerned with making profit from an increase in the price of the investment they have bought.

#### Income

This type of investor is primarily concerned with the income that shares generate in the form of dividends. Dividends are a share of a company's profit that are paid out to investors. Dividends are a very important component of investor returns and are usually paid twice annually (interim and final).

*Top tip: Dividend/income compounding is a key method of accumulating wealth. This is so important it will have its own section in the notes.*

#### Balanced

A balanced investing approach involves looking for investments that have some income from dividends and some return from price appreciation.

Whilst many investors naturally incline to one of the three objectives, it is not uncommon to have a portfolio that has elements of all the stated objectives.

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### 1.7 Reading the financial pages

Different newspapers and data sources use various formats but the following is a representative example.

High	Low	Share	Price	Change	Yield (%)	P/E
500p	420p	GSK	475p	-4p	5	21
Share price max price Usually for the year	Share price min price Usually for the year	GlaxoSmithKline GSK is known as the 'ticker' symbol	The current share price	The change in the price in the last trading session	This is the total yield currently paid by the share	Price of the share divided by earnings. It is a valuation measure

### 1.8 Common errors when investing

Investing is a calculated risk and the results from investing can usually be improved by adhering to the following guidelines.

Don't overtrade. Regular trading is not investing. It also means that dealing costs become expensive

Don't own too many shares: Owning up to 10 shares/funds/ETFs is more than enough to monitor.

Do diversify. Don't put all your eggs in one basket.

Do consider buying funds/ETFs when starting to invest as this helps diversify your portfolio.

Do manage risk: Use alerts to let you know when a share price is rising/falling and consider using stop losses to minimise downside risk.

Do watch your fees. This could be dealing fees or ongoing fund/ETF fees

Don't watch your investments every day. Once a week or less is more than enough.



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### 1.9 Reducing risk when trading

Stop losses and trailing stops

Most share dealing platforms allow for automatic stop losses and trailing stops to be entered. The online platform then executes these trades automatically. A stop loss is a designated level at which your investment will be sold. Typically stop losses are set at approximately 20% below the investment purchase or current price. A trailing stop sells investments once they have fallen a certain percentage/level below the share's highest price.

Email alerts

A feature of share dealing accounts is to allow email alerts when a share hits a certain price. This can be useful to help monitor your portfolio.

Pound cost averaging

This involves 'drip feeding' ie regular payments into investments. This can be more effective than putting lump sums into investments as timing can be a critical factor using this approach.

### 1.10 Compounding

Compounding involves a focus on investments with reliable and relatively high dividend yields. Most share dealing accounts have a feature that enables dividends paid to automatically be used to purchase more shares. This enables compounding of returns.

Einstein called compounding the 'eighth wonder of the world'

The key to successful compound returns is time. The longer you give the process the higher the likely return.

*Top tip: Compounding has reliably been shown to be one of the best generators of wealth available.*

[www.thecalculatorsite.com/finance/calculators/compoundinterestcalculator.php](http://www.thecalculatorsite.com/finance/calculators/compoundinterestcalculator.php)

[www.fool.co.uk/ten-steps-to-financial-freedom/step-1-the-miracle-of-compound-returns/](http://www.fool.co.uk/ten-steps-to-financial-freedom/step-1-the-miracle-of-compound-returns/)

### 1.11 Glossary of key terms

[www.share.com/glossary](http://www.share.com/glossary)

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