IFPHK
Institute of Financial Planners of Hong Kong
香港財務策劃師學會

Professional Development Programme on

Contemporary Perspective of Personal Financial Management

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Course Content

Day Two AM Session

Part 1: Basic Concepts in Time Value of Money

Part 2: Personal Consumer Finance & Credit

Day Two PM Session

Part 1: Risks and Returns

Part 2: Lifecycle Financial Planning Approach

Risks and Returns

- Common Financial Products and their Risks and Returns
- Factors affecting the Risks and Returns

Sources: The materials discussed in this session are extracted from the websites of SFC and HKEX

Common Financial Products and their Risks & Returns

Common Financial Products and their Risks & Returns

- Equities (covered in Session 1)
- Debt Securities
- Derivatives
- Unit Trusts / Mutual Funds

Common Financial Products and their Risks & Returns

Equities

- Returns of investing in equities

  Capital Gains

  Investors make a profit when they sell the shares for a price higher than they originally paid.

  Dividends

  A portion of the company's profits declared by its board of directors.

  Sometimes paid in the form of an issue of securities instead of cash.

Common Financial Products and their Risks & Returns

Debt Securities

- Debt securities include bonds and notes which represent loans to an entity (such as a government or corporation) in which the entity promises to repay the bondholders or note-holders the total amount borrowed.
- That repayment may be made on maturity or by instalments.
- Unlike shareholders, holders of bonds and notes are not owners of an entity, but its creditors.

Common Financial Products and their Risks & Returns

Debt Securities

- In return for the loan, the entity will usually compensate the bondholders or note-holders with interest payments during the life of the bond or note.
- The interest rate on bonds and notes can be a fixed or floating rate.

Common Financial Products and their Risks & Returns

Debt Securities

- **Examples of debt securities traded on HKEx**
  1. Corporate Bonds
  2. Convertible Bonds
  3. Exchange Fund Notes (EFN)

Common Financial Products and their Risks & Returns

Debt Securities

- Benefits of investing in debt securities

  Stable and Predictable Interest Payments

  Investment in debt securities provides a return of capital on a fixed date and usually periodic interest payments that tend to be higher than the interest payments available on bank deposits.

  Flexibility and Convenience

  Debt securities listed in Hong Kong are traded on or off the Stock Exchange and investors may buy or sell them according to their financial needs.

Common Financial Products and their Risks & Returns

Derivatives

- Commonly invested derivatives in HK
  1. Warrants
  2. Futures and Options
  3. Structured Notes

Common Financial Products and their Risks & Returns

Derivatives - Warrants

- Warrants are a popular investment product in Hong Kong.
- Warrants are an instrument which gives investors the right - but not the obligation - to buy or sell the underlying asset (e.g. a stock) at a pre-set price on or before a specified date.
- Warrants can be classified into call and put.
- A bullish investor may buy a call warrant to benefit from upward share price movements, while a bearish investor may buy a put warrant to capitalise on downward share price movements.
- A risk-averse investor may buy a put warrant to hedge against the downside risk of the underlying asset he holds.

Common Financial Products and their Risks & Returns

Derivatives - Warrants

- Factors affecting the price of a warrant
  1. The underlying asset price
  2. The exercise price
  3. Time to expiry
  4. Dividends expected to be paid by the underlying asset.
  5. Interest rate
  6. Expected volatility of the underlying asset price

Common Financial Products and their Risks & Returns

Derivatives – Futures and Options

- **Futures**
- A stock futures contract represents a commitment to buy or sell a predefined amount of the underlying stock at a predetermined price on a specified future date.
- Buying a stock futures contract, you are holding a long position and have to buy the underlying stock on the final settlement date.
- However, you can choose to hold a short position by selling a stock futures contract - this means that you have to sell the underlying stock according to the contract terms.

Common Financial Products and their Risks & Returns

Derivatives – Futures and Options

- **Options**
- A contract that involves two parties, a buyer and a seller.
- An option's buyer has the right, but not the obligation, to buy according to a "call" option from, or sell according to a "put" option to the seller the specified underlying asset.
- Option contracts are for an agreed quantity of an underlying asset, price, and future period.
- If the buyer exercises his right, the option's seller has to settle according to the contract's specifications.
- An option holder is described as having a long position, while an option writer has a short position.

Common Financial Products and their Risks & Returns

Derivatives – Futures and Options

- Why do investors trade futures or options?
  - Directional trading
  - Hedging
  - Arbitrage

Common Financial Products and their Risks & Returns

Derivatives – Structured Products

- ***What are structured products?***
- Structured products are synthetic products with investment returns linked to the performance of the underlying assets.
- Equity-linked, credit-linked, or index-linked notes are among the most commonly found structured products in the retail market.
- Structured products are not necessarily capital protected and low risk.

Common Financial Products and their Risks & Returns

Unit Trusts / Mutual Funds

- A mutual fund is a collection of stocks and/or bonds or other investments.
- Each investor owns shares of the mutual fund or units of the unit trust, which represent a portion of the holdings of the fund.

Common Financial Products and their Risks & Returns

Unit Trusts / Mutual Funds

- You can make money from a mutual fund in three ways:

1. Income is earned from dividends on stocks and interest on bonds. A fund pays out nearly all of the income it receives over the year to fund owners in the form of a distribution.
2. If the fund sells securities that have increased in price, the fund has a capital gain. Most funds also pass on these gains to investors in a distribution.
3. If fund holdings increase in price but are not sold by the fund manager, the fund's shares increase in price. You can then sell your mutual fund shares for a profit.

Common Financial Products and their Risks & Returns

Unit Trusts / Mutual Funds

- Advantages of Mutual Funds:

1. Professional Management
2. Diversification
3. Economies of Scale
4. Liquidity
5. Simplicity

Common Financial Products and their Risks & Returns

Unit Trusts / Mutual Funds

- Disadvantages of Mutual Funds:

1. Professional Management
2. Ownership of underlying assets
3. Decisions on underlying assets
4. Costs
5. Dilution

Common Financial Products and their Risks & Returns

Unit Trusts / Mutual Funds

- Types of Mutual Funds

1. Equity Funds
2. Bond Funds
3. Money Market Funds
4. Balanced Funds
5. International Funds
6. Regional Funds
7. Specialty Funds
8. Index Funds
9. Guaranteed Funds
10. Hedge Funds

Risks and Returns

Factors affecting the Risks and Returns

Factors affecting the Risks and Returns

Which of the following is/are correct?

High Risk, High Return!

High Return, High Risk!

Before committing to any investment, you must make sure you understand the possible downside.

Factors affecting the Risks and Returns

Estimated Returns by Asset Classes (2000-2003)

	Stocks	Real Estate	Bonds	Cash (Time Deposits)	Equally Diversified Portfolio
2000	-9.1%	-6.0%	12%	5.4%	0.5%
2001	-23%	-6.5%	10%	4.4%	-3.8%
2002	-16%	-7.0%	9.3%	0.9%	-3.1%
2003	40%	1.6%	3.7%	0.2%	11%
Estimated Cumulative total return 2000-2003	-17%	-17%	39%	11%	4.0%

Source: SFC

Factors affecting the Risks and Returns

Remarks:

1. Estimated return to stocks is based on the HSI and the estimated dividends received.
2. Estimated return to real estate is based on the domestic residential property price index (period covered is the four years to Nov 2003 and the estimated rentals received).
3. Estimated return to bonds is based on the return to a 5-year Exchange Fund Note (including interests earned and capital gains in appreciation of bond prices).
4. Equally diversified portfolio means a portfolio holding 25% of each of stocks, real estate, bonds and cash.

Factors affecting the Risks and Returns

What are the risks one faces when investing?

1. Market risk
2. Business risk
3. Corporate misgovernance risk
4. Interest rate / Price risk
5. Reinvestment risk
6. Currency risk
7. Inflation risk
8. Liquidity risk
9. Political risk

Factors affecting the Risks and Returns

END of this Session