Understanding asset classes

Investments can be divided into income assets and growth assets. Growth assets primarily provide returns in the form of capital growth and include Australian and international shares and property investments.

Investing in growth assets such as shares and property can help protect the purchasing power of your money over time. Some shares and property investments also provide income distributions and dividends.

Income assets primarily provide returns in the form of income and include fixed interest and cash investments. Income assets tend to provide more stable, albeit lower returns over the long term.

The longer your investment time frame the higher the level of growth assets you can include

Investment markets move in cycles, reflecting the underlying strength of the economy, industry trends and investor sentiment.

Generally, the longer your investment time frame the higher the level of growth assets you can include in your portfolio.

While growth assets, like shares and property securities, tend to have more volatile returns over the shorter term—meaning they are likely to produce negative returns more often than income type investments—they have the potential to produce higher returns over longer-term time frames.

Of course, if your primary need is for income and you need quick access to your money, you may benefit from a higher exposure to income assets.

The right type of investment for you will depend on your investment objectives, time frame and tolerance for risk.

Australian shares

Investing in the share market provides a way of participating in the future profits and growth of listed businesses.

Shares are generally considered a high-risk and high-return investment and are suitable for longer-term investors.

Historically, Australian shares have provided long-term growth well above inflation. However, shorter-term returns have experienced higher volatility at times.

While shares are primarily a growth asset, they may also provide a good source of income. Most companies distribute a proportion of their profits in the form of dividends.

Dividend imputation is the main reason Australian shares are tax effective. Given companies have already paid tax at the company tax rate, investors can use franking credits to offset the amount of tax they pay on dividends and have any excess credits refunded.

International shares

Investing offshore may increase your diversification and give access to industries and companies not available in Australia. After all, Australia represents around 2% of the total world share market.

Many industries are not represented or under-represented in Australia. For example, the MSCI World Index has an allocation of more than 25% to the fast-growing information technology and healthcare sectors. By comparison, Australia has less than 8% in these sectors.

Bonds

Bonds can be issued by the federal government, state governments, semi-government authorities, banks and other corporations, both locally and overseas, to raise capital for projects.

Investments in both international and Australian bonds have two major benefits for investors. They increase diversification, which lowers risk, and they provide opportunities for enhanced returns without resorting to lower-grade, higher-risk debt.

Bonds operate like an IOU, whereby you lend your money to the issuer for a set period of time, in return for interest paid over the term of your investment. Your investment, or capital, is then paid back to you in full at the end of the investment term.

Bonds can be traded on the secondary market before their maturity. This is usually how bond funds are managed. Fund managers trade bonds with the aim of profiting from price fluctuations.

Property

While direct residential property has been the traditional form of investment for many Australians, real estate investment trusts (REITs) have also risen in favour. REITs are pooled investments with units listed on the share market, which hold a basket of properties in one or more property sectors.

Managed funds can invest in single or multiple listed property sectors. Some even include exposure to direct property and international property securities. The main benefits of managed funds are you can invest in large properties you would not be able to access directly, and hold a diversified property portfolio for a small initial outlay.

One main benefit of managed funds is the ability to invest in large properties you would not be able to access directly

Cash

Cash investments can include term deposits, money market securities and cash management trusts. Cash has the lowest risk of all asset classes.

The short-term nature of cash investments makes them less volatile than other types of asset classes. While it is unlikely that the value of your capital will fall, you do risk the possibility of your capital not keeping pace with inflation and losing value in real terms.

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