The Six Asset Classes

An Investment Article from Pinnacle

In the world of investment there is a plethora of opportunities all offered by an equally impressive list of institutions. This article aims to unbundle all that's out there and narrow it down. Because in essence - regardless of what the brochure says – you're effectively only ever investing in 6 asset classes.

Cash

Cash is a store of wealth and a medium of exchange that never increases its intrinsic value because the $100 note in your wallet will still be worth $100 in 12 months' time. However, cash in the bank does attract interest in accordance with bank interest rates, which generates the notion of increased value.

The buying power of cash is affected by inflation. That's not good for those holding big chunks of cash in the bank, because the interest rates being given by banks at present are extremely low. To illustrate this fact we took a look at rates being offered by HSBC. Here you can expect to receive 0.0010% interest on your cash. However if you are prepared to lock your money away with the bank for 12 months and have HK$1,000,000 or more, then you can get 0.2%.

6 Ways to Build Wealth

Whilst you may think these rates are woefully low, they are indicative of the current low interest rate environment. The more disturbing news is that inflation actually erodes the buying power of your money in the bank and eradicates interest rate gains. Inflation reported in June was 2.8% and the average inflation rate from October 1981 is 4.63%. In effect your cash in the bank is going backwards. So whilst holding some cash is always a wise thing for a rainy day, now's the time to be looking at moving some into other areas.

Bonds

A bond is a formal contract to repay borrowed money with interest at fixed intervals over a period of time. Thus a bond is like a loan: the issuer is the borrower, the holder is the lender, and the coupon is the interest. Bonds provide the borrower with external funds to finance long-term investments - or in the case of government bonds - to finance national projects.

The interest rate that the issuer of a bond must pay is influenced by factors such as current interest rates, the length of the term and the creditworthiness of the issuer. These factors are likely to change over time, so the market price of a bond will vary after it is issued. This in turn produces a degree of volatility in bond prices, as well as the opportunity for greater capital growth over the longer term compared to cash.

Most portfolios will have an exposure to bonds to add some degree of growth whilst protecting capital. Because governments are generally big issuers of bonds to fund national projects, closer scrutiny is now being made into governments' ability to repay their debt.

Equities

An equity investment generally refers to the buying and holding of shares on a stock market by individuals or firms in anticipation of income from dividends and capital gains, as the value of the stock should rise over time. The equities held by private individuals are often held via mutual funds or other forms of collective investment scheme, many of which have quoted prices that are listed in financial newspapers or magazines.

Mutual funds are typically managed by prominent fund management firms. Such holdings allow individual investors to obtain the diversification of the fund(s) and to obtain the skill of the professional fund managers in charge of the fund(s). An alternative, usually employed by large private investors and pension funds, is to hold shares directly, and it is now not uncommon for regular investors to invest in direct share portfolios.

With the recent massive losses on global capital markets, there is a more cautious attitude towards shares. Do the underlying earnings of these companies justify the growth in share prices? If the company goes bust and you own shares, then they are worthless. Is the fund manager who is investing the money and taking fees generating the returns that meet your expectation?

Equities are an integral part of all portfolios. As there is more risk there is more potential reward, and over time expected returns should be in excess of those generated by cash and bonds.

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Collectibles

As the name suggests, collectibles are items that can be collected and store value; whether the value is sentimental or a cash value depends on what is collected.

Your great Grandad's Hornby train collection? Or your Penny Black collection or fine wine collection?

There are also collectors' items that are rare or unique and thus generate specific interest. Often these don't stay around too long.

In the World of property a collector's item could be one for sale in a place like Belgravia, London. Not often on the market, next door neighbour of the Queen and as a result very unique.

Fine Wine Collection

Commodities

Commodities are goods for which there is demand, but which is supplied without qualitative differentiation across a market. Commodities are substances that come out of the earth and maintain roughly a universal price, such as oil, copper, wheat & gold. The price of copper is universal and fluctuates daily based on global supply and demand. One of the characteristics of a commodity is that its price is determined relative to its market as a whole.

There is another important class of commodities: energy, which includes electricity, gas, coal and oil. Electricity has the particular characteristic that it is either impossible or uneconomical to store, hence, electricity must be consumed as soon as it is produced.

Due to the diverse nature of commodities and where they are traded, this is often a complex asset class and not for the inexperienced.

Both commodities and collectibles are termed uncorrelated in that their performance is independent of the other asset classes, and this adds to their specialist nature.

Property

Property is good old fashioned bricks and mortar: the roof over your head, the holiday home, your retirement income. Whichever way you look at it, property is something that we all recognize and use on a daily basis.

According to Maslow and his hierarchy of needs, the roof over your head is one of the most basic of human requirements. However, in the world of investing and increasing wealth, many people are also holding property as an investment.

Why? For one thing, unlike a share certificate, property has real tangibility. A property won't go bust like companies can. Even if it burns down, owners have insurance in place to replace the value.

Property can generate significant wealth through capital growth and generate income through rental income or yield. This is not dissimilar to the other asset classes of bonds and equities. However, property - through increased value - allows investors to use equity to buy more property, hence compounding the value.

Property markets do fluctuate in value, so they are somewhat reflective of what capital markets do. However, the degree of drops in value when corresponding capital markets plummet is often less. This is primarily because selling a house takes longer than selling a share, so the panic selling that characterizes capital markets is often less.

With property prices having fallen, and currencies remaining weak, for many Asian investors property is tangible and still represents a great investment opportunity.