Practical Personal Financial Management
Lecture 2 – Investment and Insurance
1 Importance of Financial Management
2 Money Management
3 Financial Planning
4 Credit
5 Insurance
6 Investment
Insurance - types of risk

Case:

- Tom, salesman, no medical insurance
- Injured by accident and took 3 months for recovery
- Financial stress: loss of income & medical cost
Should I buy insurance?

- Do you have enough cash reserve?
- Does your employer provide the related insurance?
- Are you the bread winner of the family?
- Can you afford the insurance premium?
- Is your job secure?
- Does the insurance coverage period suit your need?
# Insurance - needs and types

<table>
<thead>
<tr>
<th>Insurance needs</th>
<th>Property</th>
<th>Medical</th>
<th>Liability</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coverage (examples)</td>
<td>Property, Cash</td>
<td>Critical illnesses, Surgery expenses</td>
<td>Financial support to the living of others, Debts</td>
<td>Child education, Retirement, Legacy planning</td>
</tr>
<tr>
<td>Insurance types</td>
<td>General insurance</td>
<td>General insurance</td>
<td>Life insurance*</td>
<td>Life insurance*</td>
</tr>
<tr>
<td>Insurance products (examples)</td>
<td>Personal accident insurance, Home insurance, Travel insurance</td>
<td>Hospitalization insurance, Disability insurance, Long-term care insurance</td>
<td>Whole-life insurance, Term life insurance, Participating / non-participating</td>
<td>Endowment, Investment linked assurance scheme, Annuity</td>
</tr>
</tbody>
</table>

★ Some life insurance products are participating, i.e. with non-guaranteed dividends or bonuses
### Sample of participating life insurance proposal

**Life insurance plan - Summary (Currency: HKD)**

<table>
<thead>
<tr>
<th>Policy year</th>
<th>Death Benefit</th>
<th></th>
<th></th>
<th></th>
<th>Cash Value</th>
<th></th>
<th></th>
<th></th>
<th>Accumulated premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Guaranteed</td>
<td>Non-guaranteed</td>
<td>Total</td>
<td>Guaranteed</td>
<td>Non-guaranteed</td>
<td>Total</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>1</td>
<td>100,000</td>
<td>0</td>
<td>100,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1,248</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>100,000</td>
<td>5</td>
<td>100,005</td>
<td>0</td>
<td>5</td>
<td>5</td>
<td>2,496</td>
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<tr>
<td>3</td>
<td>100,000</td>
<td>29</td>
<td>100,029</td>
<td>23</td>
<td>29</td>
<td>52</td>
<td>3,744</td>
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<td>4</td>
<td>100,000</td>
<td>86</td>
<td>100,086</td>
<td>92</td>
<td>86</td>
<td>178</td>
<td>4,992</td>
<td></td>
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<tr>
<td>5</td>
<td>100,000</td>
<td>172</td>
<td>100,172</td>
<td>210</td>
<td>172</td>
<td>382</td>
<td>6,240</td>
<td></td>
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<tr>
<td>10</td>
<td>100,000</td>
<td>1,189</td>
<td>101,189</td>
<td>3,229</td>
<td>1,189</td>
<td>4,418</td>
<td>12,480</td>
<td></td>
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<tr>
<td>15</td>
<td>100,000</td>
<td>3,695</td>
<td>103,695</td>
<td>8,082</td>
<td>3,695</td>
<td>11,777</td>
<td>18,720</td>
<td></td>
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<tr>
<td>20</td>
<td>100,000</td>
<td>8,214</td>
<td>108,214</td>
<td>14,958</td>
<td>8,214</td>
<td>23,172</td>
<td>24,960</td>
<td></td>
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<td>25</td>
<td>100,000</td>
<td>15,025</td>
<td>115,025</td>
<td>24,245</td>
<td>15,025</td>
<td>39,720</td>
<td>31,200</td>
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<td>30</td>
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<td>24,653</td>
<td>124,653</td>
<td>34,663</td>
<td>24,653</td>
<td>59,316</td>
<td>37,440</td>
<td></td>
<td></td>
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<tr>
<td>65</td>
<td>100,000</td>
<td>54,977</td>
<td>154,977</td>
<td>45,652</td>
<td>54,977</td>
<td>100,629</td>
<td>49,920</td>
<td></td>
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<tr>
<td>70</td>
<td>100,000</td>
<td>76,802</td>
<td>176,802</td>
<td>46,111</td>
<td>76,802</td>
<td>122,913</td>
<td>49,920</td>
<td></td>
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<tr>
<td>80</td>
<td>100,000</td>
<td>136,682</td>
<td>236,682</td>
<td>47,041</td>
<td>136,682</td>
<td>183,723</td>
<td>49,920</td>
<td></td>
<td></td>
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<tr>
<td>90</td>
<td>100,000</td>
<td>225,731</td>
<td>325,731</td>
<td>47,991</td>
<td>225,731</td>
<td>273,722</td>
<td>49,920</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100</td>
<td>100,000</td>
<td>356,373</td>
<td>456,373</td>
<td>100,000</td>
<td>356,373</td>
<td>456,373</td>
<td>49,920</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Dividend option: earn interests**
Case: Travel insurance
Conditions – Travel insurance A

Death or permanent total disablement caused by accident in a common carrier or private car, and the age of insured person is:

- Six months to 16 years inclusive: Cover limit $240,000
- 17 to 75 years inclusive: Cover limit $1,200,000
- 76 to 85 years inclusive: Cover limit $360,000
Conditions – Travel insurance B

Death or permanent total disablement caused by accident in a common carrier or private car, the cover limit is up to $1,500,000, but is not applicable to an insured person aged 17 or below, as well as an insured person aged 76 or above.

Which travel insurance should be bought? If in the trip, the insured people are:

- Case 1: A young couple;
- Case 2: A big family, including children and grandparents
Beware of risks

If you are the...

- Tourist bus driver
- Taxi driver
- Taxi passenger
- Pedestrian
- Their family member
Tips for buying and handling insurance

1. Calculate your insurance need (example):

Income needs
- Living cost ($0.5M)
- Outstanding debt ($0)
- Expenses for dependents ($1M)

Current assets
- Cash and deposits ($0.2M)
- Investment ($0.3M)
- Existing insurance cover ($0.5M)

= Estimated amount of insurance needed ($0.5M)
Tips for buying and handling insurance

2 Things to check for insurance intermediaries

Insurance agent as an agent of one or more insurer(s)
- Pros: provide direct follow up services
- Cons: represent no more than 4 insurance companies

Insurance broker as an agent of the policy holder
- Pros: able to quote and compare various products
- Cons: provide indirect follow up services
Tips for buying and handling insurance

② Things to check for insurance intermediaries

Customers can check registration records and licensing status

- Professional Insurance Brokers Association
  http://www2.piba.org.hk/~ima/pn01_0.php?srhtyp=T&lang=en

- The Hong Kong Confederation of Insurance Brokers

- Insurance Agents Registration Board
  http://www.hkfi.org.hk/#!/consumer-zone/agent-search
Tips for buying and handling insurance

3 Shop around and get comparisons
   • Compare the coverage to find a suitable one
   • Understand fees and charges

4 Examine the policy conditions
   • Know the exclusions (e.g. high risk sports excluded in the travel insurance)

5 Take note of the cooling-off period
   • Applicable to life insurance only
1. Importance of Financial Management
2. Money Management
3. Financial Planning
4. Credit
5. Insurance
6. Investment
Why should I invest?

- Financial position
- Risk tolerance
- Investment objective
Why should I invest?

Addition rule: income growth every year

Wealth accumulated at retirement

Multiple rule: wealth growth by investment

Current assets

Wealth at present

Now

Retirement
What does wealth mean to you?

What you own - What you owe = Wealth
How to build wealth?

- Budget to save
- Protect wealth
- Invest
- Build credit
- Control debt
Are you ready to invest?

- Is your debt under control?
- Do you have enough cash for emergencies?
- Do you have adequate insurance protection?
- Do you understand how to invest?
Five steps to investment

1. Understand yourself, e.g. funds available for investment and your risk tolerance

2. Grow your investment fund for your financial goals, set your investment objective and decide on the investment tenor

3. Manage the risks of investing

4. Select investment products suitable for your risk tolerance and diversify your Investment

5. Review your investment portfolio regularly to make sure you are still on track to achieve your investment objectives
Risk and return

What is risk?

- The chance that you may get lower return than expected, zero return or even negative return.

- Risk is also about volatility. The possibility that your investment will fluctuate (go up or down).

Comparison of volatility

Different investment products have different degrees of risk.
Risk and return

What is return?

An interest or dividend payment + The value of the investment appreciates (or depreciates) = Total return for the holding period

Example: Buy stock A at $100 and hold it for a year

Stock A dividend 5% / year + Stock A price per share $100 +10% $110 = Stock A annual return: 15%
Risk and return
What investment products should I choose?

People who can tolerate lower risks tend to employ more conservative investment strategy and select lower risk products.

People who can tolerate higher risks tend to employ more aggressive investment strategy and select higher risk products.
## Risk and return – a balancing act

<table>
<thead>
<tr>
<th>Risk tolerance</th>
<th>Low</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment horizon</td>
<td>Short</td>
<td>Long</td>
</tr>
<tr>
<td>Age</td>
<td>Old</td>
<td>Young</td>
</tr>
<tr>
<td>Demand for liquid assets</td>
<td>Strong</td>
<td>Weak</td>
</tr>
<tr>
<td>Financial resources</td>
<td>Limited</td>
<td>Abundant</td>
</tr>
<tr>
<td>Financial burden</td>
<td>Heavy</td>
<td>Light</td>
</tr>
</tbody>
</table>
Case study Video
Dollar cost averaging

<table>
<thead>
<tr>
<th>Month</th>
<th>Amount invested</th>
<th>Price per share</th>
<th>Number of shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>$500</td>
<td>$10</td>
<td>50</td>
</tr>
<tr>
<td>February</td>
<td>$500</td>
<td>$5</td>
<td>100</td>
</tr>
<tr>
<td>March</td>
<td>$500</td>
<td>$4</td>
<td>125</td>
</tr>
<tr>
<td>April</td>
<td>$500</td>
<td>$5</td>
<td>100</td>
</tr>
<tr>
<td>May</td>
<td>$500</td>
<td>$10</td>
<td>50</td>
</tr>
<tr>
<td>June</td>
<td>$500</td>
<td>$12.5</td>
<td>40</td>
</tr>
<tr>
<td>Total</td>
<td>$3,000</td>
<td>$6.45</td>
<td>465 units</td>
</tr>
</tbody>
</table>

- Stock Monthly Investment Program
- Average cost per share: $6.45
Diversification

Why diversification matters

- Each type of investment tends to respond differently to economic factors and market events
- It is unusual for all the investment products to perform badly at the same time
Diversification – spread your risk

Benefits

• Spread the investment over a range of different investment asset classes

• Don’t put all your eggs in one basket?

How - 2 levels

• Invest in different types of investments (asset class), and

• Invest in different companies / industries / countries within an asset class
Asset allocation

Conservative portfolio

Cash / Deposit

Stock / Stock fund

Bond / Bond fund

Moderate portfolio

Cash / Deposit

Stock / Stock fund

Bond / Bond fund

Aggressive portfolio

Bond / Bond fund

Stock / Stock fund

Stock / Stock fund

Remarks: The above information is for discussion and reference only and should not be treated as investment advice
Asset allocation – get it right

Review and possibly change your asset mix over time

- Your risk tolerance and risk objective may have changed
- The risk of the investment may have changed

If you have just started your first job

If you are married and have children

As you approach retirement
Market fluctuations

- Adjusting your portfolio back in line with your asset allocation
- Ensure not become overly invested in a particular type of investment

Rebalancing – keep it updated
Savings and investment products

Deposits

- Bank savings deposits
  - simple and convenient but lower interest rates

- Bank time deposits
  - high interest rates but lower liquidity

- Foreign currency deposits
  - a wider range of choice in foreign currencies but higher exchange rate risk
Savings and investment products

Bonds
• An investor loans money to an issuer that borrows the funds for a defined period of time at a fixed interest rate
• Making money from interest income
• Making money from capital gains Example

<table>
<thead>
<tr>
<th>Face value</th>
<th>Coupon rate</th>
<th>Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>8%</td>
<td>6 years</td>
</tr>
</tbody>
</table>

Initial investment $100

$100 principal

$8 interest
Major risks of bonds

Credit rating

- Moody's: AAA (lowest risk) → C (highest risk)
- Standard Poor’s: AAA (lowest risk) → D (highest risk)
- Interest rate risk
- Exchange rate risk
- Liquidity risk
- Inflation risk
Savings and investment products

Stocks

• ownership of a company.
• divided into a definite number of shares.
• Shareholders’ percentage of ownership equals percentage of shares owned.

Classes of shares:

• Ordinary shares
• Preference shares
ABC of stocks

- “Blue” Chips
- “Red” Chips
- H shares
- A shares
- B shares
- Second/third liner stocks
- Stock Exchange of HK (SEHK)

Primary market
- Initial public offerings (IPOs)
- Seasoned offerings

Secondary market
- Open market of securities trading
Stock market structure

Companies → List → Stock market

Stock brokers (a bank or stock brokerage) → Trade stocks → Regulate

Regulators

Investors

Order

① online
② phone
③ branch
Fees and Charges of Stock Trading

Case: Buy 1,000 shares of Stock A at price $30.5

<table>
<thead>
<tr>
<th>Fee</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brokerage</td>
<td>0.25 of a transaction (Minimum charge for each transaction: $80)</td>
</tr>
<tr>
<td>SFC Transaction Levy</td>
<td>0.0027% of a transaction</td>
</tr>
<tr>
<td>SEHK TradingFee</td>
<td>0.005% of a transaction</td>
</tr>
<tr>
<td>SEHK TradingTariff</td>
<td>$0.50 per transaction</td>
</tr>
<tr>
<td>Stamp Duty</td>
<td>0.1% of a transaction (rounded up to the nearest dollar)</td>
</tr>
<tr>
<td>CCASS SettleFee</td>
<td>0.002% of a transaction (Minimum $2, Maximum $100)</td>
</tr>
</tbody>
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### Fees and Charges of Stock Trading

**Case: Buy 1,000 shares of Stock A at price $30.5**

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<tr>
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<td>0.005% of a transaction</td>
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<tr>
<td>SEHK Trading Tariff</td>
<td>$0.50 per transaction</td>
</tr>
<tr>
<td>Stamp Duty</td>
<td>0.1% of a transaction (rounded up to the nearest dollar)</td>
</tr>
<tr>
<td>CCASS Settle Fee</td>
<td>0.002% of a transaction (Minimum $2, Maximum $100)</td>
</tr>
</tbody>
</table>

Total cost for each transaction amounted $30,500 = $115.85
Avoid Trading Stock on Margin

Case: High interests charged on margin account

<table>
<thead>
<tr>
<th></th>
<th>Cash Account</th>
<th>Margin Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal</td>
<td>$20,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Purchasing Power (2.5x)</td>
<td>$20,000</td>
<td>$50,000 (Borrowing $30,000)</td>
</tr>
<tr>
<td>Interests</td>
<td>$0</td>
<td>$200</td>
</tr>
<tr>
<td>Price Movement:+10%</td>
<td>Gain $2,000(+10%)</td>
<td>Gain $4,800(+24%)</td>
</tr>
<tr>
<td>Price Movement:-10%</td>
<td>Loss $2,000(-10%)</td>
<td>Loss $5,200(-26%)</td>
</tr>
</tbody>
</table>
Savings and investment products

Funds

- Collective investment schemes managed by fund management companies according to investment objectives

Mutual funds vs Unit trusts

- Mutual funds: Limited liability companies  Unit trusts: Trust structures
- Use the rating agencies to review and compare a fund’s performance with the market

<table>
<thead>
<tr>
<th>Rating agencies</th>
<th>Website</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morningstar</td>
<td><a href="http://hk.morningstar.com">http://hk.morningstar.com</a></td>
</tr>
<tr>
<td>Standard and Poors</td>
<td><a href="http://www.standardandpoors.com">http://www.standardandpoors.com</a></td>
</tr>
<tr>
<td>LIPPER</td>
<td><a href="http://www.lipperweb.com">http://www.lipperweb.com</a></td>
</tr>
</tbody>
</table>
Trading with fund houses

Channel: fund management companies or their HK representatives

Pros

• Direct contractual relationship
• First hand information on the fund

Cons

• Can only choose funds of that fund house
Trading with fund distributors

Channel: fund management (e.g. investment advisers / banks)

Pros
- One-stop channel to manage your fund investment
- Able to obtain advice on selection of funds offered by different asset management companies

Cons
- Unable to obtain first hand information from fund management companies
- Choices restricted to funds sold by that intermediary
- No direct contractual relationship with the fund management companies
- May have to pay additional handling charges for the nominee services
## Fees of fund investment

<table>
<thead>
<tr>
<th>Deducted directly from fund assets</th>
<th>Payable by the fund holders</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Management Fee (0.25% - 2.5%)</td>
<td>• Initial Charge (0% - 6%)</td>
</tr>
<tr>
<td>• Trustee, Custodian and Auditor Fee (0.03% - 0.2%)</td>
<td>• Redemption Charge (0.5% - 1%)</td>
</tr>
<tr>
<td>• Brokerage Commissions (0.25% - 0.5%)</td>
<td>• Switching Charge (1% - 2%)</td>
</tr>
</tbody>
</table>
Savings and investment products

Exchange Traded Fund
- funds you can buy and sell via stock exchanges
- The investment goal is to track the underlying index
- This can be a stock market, a group of regional or global stock markets, or an industry sector

Benefits
- Easy to trade
- Diversification
- Track the performance of an index
- Cost effectiveness
Savings and investment products

Structured products

- one or more underlying securities
- Leverage
- More suitable for experienced investors with a high risk appetite

Two main categories

- Listed structured products
- Unlisted structured products
ABC of Warrants

• The right-but not the obligation-to buy or sell the underlying assets at a pre-set price on or before a specified date

• Underlying asset can be a single stock, a basket of stocks, an index, a currency, a commodity, a futures contract, etc.

• Warrants can be bought or sold prior to their expiry in the market provided by HKEx

• Settlement is made in cash

• Issued by a third party

• Life of six months to two years
Terms used in Warrants

- Call Warrant
- Put Warrant
- Strike Price/ Exercise
- Price Conversion
- Ratio
- Expiry Date
- Premium
How to calculate the return of a Put Warrant?

Put Warrant of Stock B

- Warrant Price: $1
- Strike Price: $30
- Expiry Date: 2016-09-30

If the price of Stock B on the expiry date is:

<table>
<thead>
<tr>
<th>Stock Price</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$29</td>
<td>Take profit</td>
</tr>
<tr>
<td>$29 - $30</td>
<td>Loss after deducting the cost of put warrant</td>
</tr>
<tr>
<td>&gt;$30</td>
<td>Lose the cost of put warrant</td>
</tr>
</tbody>
</table>
How to calculate the return of a Call Warrant?

Call Warrant of Stock A

- Warrant Price : $2
- Strike Price : $40
- Expiry Date: 2016-10-31

If the price of Stock A on the expiry date is:

<table>
<thead>
<tr>
<th>Price Range</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;$42</td>
<td>Take profit</td>
</tr>
<tr>
<td>$40 - $42</td>
<td>Loss after deducting the cost of call warrant</td>
</tr>
<tr>
<td>&lt;$40</td>
<td>Lose the cost of call warrant</td>
</tr>
</tbody>
</table>
Practical investment tips
There are no quick wins in investing
1. **Investment is not speculation**

<table>
<thead>
<tr>
<th>Investment</th>
<th>Speculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term commitment</td>
<td>Short-term holding</td>
</tr>
<tr>
<td>Investing in an asset to enjoy possible return</td>
<td>Buying an asset with expectation of profile on sale due to price changes</td>
</tr>
<tr>
<td>Achieve planned investment goals</td>
<td>Follow the trend</td>
</tr>
<tr>
<td>Relatively steady</td>
<td>Relatively uncertain</td>
</tr>
<tr>
<td>Evaluation through analysis</td>
<td>No analysis, just past trend</td>
</tr>
</tbody>
</table>
2. Discipline

- **Investor behaviours** such as herding, over-confidence and loss-aversion (the tendency to prefer avoiding losses to acquiring gains) are a major contributor to investment performance.

- **When deviating from long-term investment goals**, investors can cause considerable harm to their investments' returns.

- **However, “stop loss” is needed when the fundamentals have changed from positive to negative.**
2. Discipline

• Differentiate between facts, analysis and views:

Data 1
Trading of ABC Corp. has been suspended, pending release of price sensitive info. The last price is HK $10

Data 2
ABC Corp. is upgraded to “Outperform” with target price lifted to HK$15 because of positive profit alert

Data 3
Column: I have been optimistic for the stock market since last year and my favorite stock, ABC Corp. has shown a strong price growth and is likely to double within this year, so I suggest to chase it at HK$11
3. Practical Tips of Investment

- Keep investment records and check for any unauthorized transactions.
- Read websites and newspapers for economic conditions, interest rates, fundamentals, etc.
- If you have invested for the long term, don't be spooked by short-term ups and downs.
4. Watch out for warning signs

Regularly monitor the company announcements and annual reports

- Profit warnings
- Management problems
- Over-promising and under-delivering
5. Get to know investment advisors

- Deal with regulated persons

- Investment advisors who advise on securities (e.g. stocks and funds) or future contracts are required to be licensed by the SFC

- Three principal groups of investment advisors selling or advising on financial products in Hong Kong and their registration can be checked online:
  - Intermediaries who are licensed by the SFC
    http://www.sfc.hk/publicregWeb/searchByName?locale=en
  - Banks
    http://apps.hkma.gov.hk/cgi-bin/hkma/eng/ereg.pl
  - Insurance intermediaries
    http://www2.piba.org.hk/~ima/pn01_0.php?srhtyp=T&lang=en
    http://www.hkfi.org.hk/#!/consumer-zone/agent-search
6. The dos and don’ts of investing

<table>
<thead>
<tr>
<th>DO</th>
<th>DON’T</th>
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<tbody>
<tr>
<td>• Save a portion of your savings for emergency funds</td>
<td>• Pour all of your disposable income into investment</td>
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<td></td>
<td>• Borrow money to invest</td>
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<td>• Evaluate your risk tolerance and manage the risks</td>
<td>• Invest in high risk products that you don’t fully</td>
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<tr>
<td>of investing</td>
<td>understand or are not suitable to your risk tolerance</td>
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<tr>
<td>• Use the dollar cost averaging to reduce short-term</td>
<td>• Engage in day trading, which speculates on the timing of</td>
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<tr>
<td>market fluctuations</td>
<td>stocks and has high investment risk</td>
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</table>

The above information is for discussion and reference only and should not be treated as investment advice.
Thank You!

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