Market Guide
In collaboration with SEC

Invest wisely in the stock market: Advice from your regulator for 2016

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The Securities and Exchange Commission of Sri Lanka (SEC) wishes the investor community a prosperous New Year. Striving towards prosperity greatly depends on the financial decisions we make. Thus, today's article will provide the basic information that would assist investors in financial decision-making.

It will focus on selecting a brokerage firm and investment advisor, making an initial investment decision, monitoring an investment and addressing an investment problem. It is also intended to help you identify questions you should ask and warning signs to look for in order to avoid possible investment problems.

Selecting your broker

Before making an investment in the stock market, you must decide which stockbroking firm you should select. Before making these decisions you should:

- Think through your financial objectives.
- Talk with potential advisors at several firms. If possible, meet them face to face at their offices. Ask each sales representative about his or her investment experience, professional background and education.

- Find out about the disciplinary history of the stockbroking firm and representative.
- Determine the level of service you need. Some brokerage firms provide recommendations, investment advice and research support, while others may not. The charges you pay may differ depending upon what services are provided by the firm.
- Remember part of making the right investment decision is finding the brokerage firm and the advisor that best meets your personal financial needs. Do not rush. Do the necessary background investigation on both the firm and advisor. Resist the sales people who urge you to immediately open an account with them.

Making an investment

Generally, a stockbroking firm will require a customer to sign a few agreements and forms. You should carefully review the information contained in this document because it may affect your legal rights regarding your account.

Ask to see any account documentation prepared for you by the sales representative. Do not sign the new account agreement unless you thoroughly understand it and agree with the terms and conditions it imposes on you. You cannot rely on verbal representations from the staff that are not contained in this agreement.

The investment advisor will ask for information about your investment objectives and personal financial situation, including your income, net worth and investment experience. Be honest. The sales representative will use this information in making investment recommendations to you.

Completion of the new account agreement requires that you make three critical decisions:

1. Who will control decision-making in your account? You will control the investment decisions made in your account unless you decide to give discretionary authority to your investment advisor to make investment decisions for you. ‘Discretionary authority’ allows a sales representative to make investment decisions based on what the sales representative believes to be best – ‘without consulting you’ about the price, type of security, amount and when to buy or sell. Do not give discretionary authority to your sales representative without seriously considering whether this arrangement is appropriate for you.

2. How will you pay for your investment? Most investors maintain a cash account that requires payment in full for each security purchase. An alternative type of account is a ‘margin account’. Buying securities through a margin account means that you can borrow money from the brokerage firm to buy securities and requires that you pay interest on that loan. You will be required to sign a margin agreement disclosing interest terms. If you purchase securities on margin (by borrowing money from the brokerage firm), remember that it entails a certain level of risk.

3. How much risk should you assume? You have to identify your overall investment objective in terms of risk - categorise risk as ‘income’, ‘growth’ or ‘aggressive growth’. Be careful you understand the distinctions between these terms and be certain that the risk level you choose accurately reflects your investment goals. The investment products recommended to you should reflect the category of risk you have selected.

Investment decision

Never invest in a product that you don’t fully understand. Consult information sources such as business and financial publications. Information regarding the fundamentals of investing and basic financial terminology can be found online.

Ask your advisor for the prospectus, relevant circulars or most recent annual report. You can also access it through the Colombo Stock Exchange (CSE) website. Read them. If you have questions, talk with your investment advisor before investing.

You also may want to check with another brokerage firm, an accountant or a trusted business adviser to get a second opinion about a particular investment you are considering.
Keep good records of all information you receive - copies of forms you sign and conversations you have with your sales representative.

Nobody invests to lose money. However, investments always entail some degree of risk.

Be aware:

- The higher the expected rate of return, the greater the risk; thus manage your risk to maximize returns.
- Investments in securities issued by a company with a short history or published information may involve greater risk.
- Securities you own may be subject to tender offers, mergers, reorganizations or third party actions that can affect the value of your ownership interest. Pay careful attention to public announcements and information sent to you about such transactions. They involve complex investment decisions. Be sure you fully understand the terms of any offer to exchange or sell your shares before you act. In some cases, such as partial or two-tier tender offers, failure to act can have detrimental effects on your investment.
- The past success of a particular investment is no guarantee of future performance.

Protect yourself

A high pressure sales pitch can mean trouble. Be suspicious of anyone who tells you, “Invest quickly or you will miss out on a once-in-a-lifetime opportunity.”
Remember:

- Never send money to purchase an investment based simply on a telephone sales pitch.
- Never make a cheque out to a sales representative personally.
- Never send a cheque to an address different from the business address of the brokerage firm or a designated address listed in the prospectus.

If your sales representative asks you to do any of these things, contact the compliance officer of the brokerage firm.
Never allow your transaction confirmations and account statements to be delivered or mailed to your investment advisor as a substitute for receiving them yourself. These documents are your official record of the date, time, amount and price of each security purchased or sold. When you receive them, you should ‘verify’ that the information in these statements is correct.
Certain activities may indicate problems in the handling of your account and possibly violations of laws.

Be alert for:

- Recommendations from a sales representative based on ‘inside’ or ‘confidential information’, an ‘upcoming favourable research report’, a ‘prospective merger or acquisition’ or the announcement of a ‘dynamic new product’.
- Representations of spectacular profit, such as, “Your money will double in six months.” Remember, if it sounds too good to be true, it probably is!
- ‘Guarantees’ that you will not lose money on a particular securities transaction or agreements by a sales representative to share in any losses in your account.
- An excessive number of transactions in your account. Such activity generates additional commissions for your investment advisor but may provide no better investment opportunities for you.
- A recommendation from your sales representative that you make a dramatic change in your investment strategy, such as moving from low-risk investments to speculative securities or concentrating your investments exclusively in a single product.
- Pressure to trade the account in a manner that is inconsistent with your investment goals and the risk you want or can afford to take.
- Assurances from your sales representative that an error in your account is due solely to computer or clerical error. Insist that the branch manager or compliance officer promptly send you a written explanation. Verify that the problem has been corrected on your next account statement.

If you have a problem

If you have a problem with your advisor, promptly talk to the stockbroker firm’s compliance officer. Confirm your complaint to the firm in writing. Keep written records of all conversations. Ask for written explanations.
If the problem is not resolved to your satisfaction, contact the CSE. A special committee will look into the matter.