Investment Information Brochure

unitplus

UnitPlus InnoInvest GmbH
Monbijoustr. 7, C/O ZEITGEIST
10117 Berlin
www.unitplus.eu

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What is a stock?

A share is a securitized document that represents a share in a public limited company and makes people who own shares shareholders of the company. For the public limited company, this is a financing instrument, as it can raise capital by selling shares on the stock exchange. When acquiring a share, shareholders receive co-ownership of the company's assets. Thus, they are directly involved in the economic success and failure of the company. Economic success can be expressed, for example, through the distribution of a dividend to the shareholders.
Profits, however, do not have to be distributed, but can also remain in the company and be used, for example, for investments in new factories, employees, research and development, etc. Economic failure is reflected in falling company profits and can even lead to the insolvency of the company, which can result in the total loss of the capital invested by shareholders.

Shares are traded on stock exchanges. In Germany, the best-known stock exchange is the German Stock Exchange. Prices are formed on stock exchanges through the interaction of supply and demand. If there is more demand than supply for a share, share prices rise. Conversely, share prices fall when there is more supply and less demand.
Supply and demand depend on numerous factors. For example, company sales figures, analysts' forecasts, sudden and unexpected company announcements and economic data play an important role. The emotions and opinions of market participants also have an influence. While share prices cannot be predicted in the short term, in the long term share prices are based on the true value (intrinsic value) of the company, which is determined by sales and profit trends. As shares can rise and fall suddenly and unexpectedly, share investments are not suitable for every investment period. Let's make the situation even clearer with a fictitious example.

An investor buys a share of company AB for the price of 100€. After three years, the share price has risen to 150€ thanks to a good profit performance of company AB. Now the investor sells his shares and achieves a pre-tax return of 50€, or 50%. Possible dividend payments are not taken into account here. On the other hand, it is also possible that the share price has fallen to 50€ due to poor profit development. If the investor sells now, the investor would suffer a loss of 50€, or 50%.
The main obligation of shareholders is to pay the purchasing price of the shares. In return,

shareholders receive rights that can be divided into asset rights and management rights. Asset rights include profit sharing such as dividends, warrants and right to receive liquidation proceeds. Administrative rights include participation rights, voting rights and the right of information.

Investing in stocks can lead to very high price losses and even a total loss. A total loss is suffered when the share price falls to zero. A variety of factors such as falling profits, political regulation, management misappropriation, an increasingly competitive situation, etc. can contribute to share price losses. If not only one share of a company is bought, but shares of companies in different industries and in different countries, the risk of a total loss can be reduced. However, this risk cannot be excluded even with a broader spread of the investment (diversification).

What is a sovereign bond?

A bond is a fixed-interest security that grants the lender (= investor) the right to repayment and payment of agreed interest. In contrast to shares, where one receives co-ownership of the company, bonds can be compared to a loan, as interest and repayment date are specified in the bond conditions. The investor's claim can therefore be divided into interest payments and redemption at maturity. The interest payments serve as compensation for the money lent to the company over the term of the bond. At the end of the term, the debt relationship ends with the repayment of the nominal value of the bond to the investing person. Bonds are also traded on the stock exchange.

Governments and corporations are the two largest issuers of bonds. We take a closer look at government bonds below. Governments issue government bonds for the purpose of raising liquidity. The government uses the money raised for infrastructure projects or to pay off old debts, for example. By purchasing a government bond, the investor makes money available to the government for a limited period of time until the bond matures. Let's take a brief look at a fictitious example:

Assume that €1,000 is invested in a government bond of the Federal Republic of Germany with a term of 5 years and an annual interest payment of 3%. Each year, the Federal Republic of Germany will therefore pay €30 in interest to bond investors. At the end of the term after 5 years, the invested amount of €1,000 is also repaid.

The corresponding interest rate is largely dependent on the creditworthiness of the state and the term of the bond. Countries with a high credit rating, such as Germany and the United States of America, usually pay significantly lower interest rates than countries that are economically and politically more unstable. Creditworthiness can be measured, among other things, by so-called ratings. The worse the creditworthiness and thus the rating, the higher the probability that the bond will not be repaid in full. Bond investors should be compensated for the higher default risk by higher interest payments. As a rule, full repayment at maturity is not guaranteed and a total loss cannot be ruled out.

If you want to reduce the risk of a total loss, you can do so by spreading your investment in government bonds from different countries. However, the risk of a total loss cannot be completely excluded even by diversification.

What is a corporate bond?

A bond is a fixed-interest security that grants the lender (= investor) the right to repayment and payment of agreed interest. In contrast to shares, where one receives co-ownership of the company, bonds can be compared to a loan, as interest and repayment date are specified in the bond conditions. The investor's claim can therefore be divided into interest payments and redemption at maturity. The interest payments serve as compensation for the money lent to the company over the term of the bond. At the end of the term, the debt relationship ends with the repayment of the nominal value of the bond to the investing person. Bonds are also traded on the stock exchange.

Governments and corporations are the two largest issuers of bonds. We take a closer look at corporate bonds below. As the name suggests, corporate bonds are issued by companies and subsequently purchased by investors. The primary objective for the company is to raise liquidity for entrepreneurial purposes such as the construction of new factories, research & development or the repayment of old debts. With the purchase of a bond, the investor makes money available to the company over a predefined period of time. In return, the investor receives an annual interest payment and, as a rule, the amount invested is returned at the end of the term. The terms of the bonds vary and can range from a short period such as a few years to a term of over 10 years. Let's take a brief look at this using a fictitious example:

Assume that €1,000 is invested in a corporate bond with a maturity of 5 years and an annual interest payment of 5%. Each year, the company will pay €50 in interest to bond investors. At the end of the term after 5 years, the invested amount of €1,000 will also be repaid.

The interest rate that the company pays annually to the investor as compensation for the money lent depends in particular on the creditworthiness. Factors such as the stability of the company's revenue situation, the degree of indebtedness and also the basic economic conditions can have an impact on the credit rating. The lower the credit rating, the higher the likelihood that the company will experience payment difficulties and thus be unable to make part or even all of the repayment of the bond. For this higher risk, the investor receives compensation in the form of higher interest rates. By investing in corporate bonds a total loss cannot be completely ruled out even if the investment sum is spread over bonds of companies in different industries.

What are Exchange Traded Funds (ETFs)?

Exchange traded funds (ETFs) are investment funds that are traded on stock exchanges. They track an index or a group of assets, such as shares, bonds or commodities. ETFs offer investors broad diversification as they invest in a variety of assets, which reduces the risk of individual investments.

The benefits of ETFs include low costs compared to actively managed funds, high liquidity as they can be traded on exchanges throughout the day, and transparency as investors can monitor the value of their portfolio at any time. ETFs also offer an easy way to invest in different markets or sectors without having to pick individual stocks.

However, ETFs also carry risks. These include market fluctuations, as the value of an ETF depends on the underlying assets. Tracking errors can also occur if the ETF does not exactly track the index it is supposed to. In addition, investors may suffer potential losses if the markets perform negatively.

What is a money market fund?

The money market is used by banks, companies and governments to raise money in the short term or to invest surplus money in the short term. Money market funds are investment funds that invest in short-term, highly liquid securities, such as money market instruments, short-term bonds and term deposits with a term of less than 12 months. These funds aim to achieve a stable return while preserving investors' capital.

As money market funds only invest in short-term bonds, they have a low interest rate risk and are therefore less volatile. Nevertheless, there is also an issuer default risk here, for example if an issuer of a bond in which the money market fund has invested can no longer meet its obligations. Losses may also be incurred due to costs or an interest rate policy of the central banks that results in negative interest rates.

How do currencies affect investment?

If securities are acquired in a currency other than the home currency, the return on the security does not depend exclusively on the pure performance, but also on the performance of the respective currency pair (such as the US dollar to the Euro). Currency fluctuations occur daily and are influenced by a variety of factors. For example, central banks can influence the exchange rate by buying and selling the currency. Interest rate developments and the opinion of market participants about the future prospects of the country's economic situation also play a role. So does the trade in goods between the individual countries.

Let us fictitiously assume that the US dollar to the Euro stands at exactly 1 to 1. This means that one US dollar can be exchanged for one Euro and one Euro can be exchanged for one US dollar. Now one invests in a share in US dollars with a purchase price of 100 US dollars. In the course of the investment period, the price of the share rises from 100 US dollars to 110 US dollars. This results in a price gain of 10%. If the share is now sold, not only the price gain plays a role, but also how the currencies have developed in relation to each other in the course of the investment period. If the Euro appreciates by 10% in the investment time period against the US dollar, more US dollars have to be paid when the share is sold and then exchanged for Euros. In our example, the price gain is even fully amortised by the currency fluctuation. Conversely, if the euro depreciates against the US dollar, currency gains occur. It can thus be seen that the currency can have a major influence on the actual realised gains in the home currency and that currency fluctuations result in an increased risk.

What is overnight money?

Overnight money can be understood as a form of flexible investment, as the savings deposits are available daily. The amount invested is paid into an overnight money account. The bank that manages the overnight money account pays interest on the invested amount. This interest is not fixed, but can change daily and thus increase or decrease. Even though the deposits can be used daily, it is not to be confused with a current account, since, for example, transfers, standing orders and payments from an overnight money account are not possible.

In the European Union, sums of money up to €100,000 per person and bank are guaranteed by the statutory deposit guarantee.

The risks associated with investing in securities

Investment in the capital market and in securities involves various forms of risk. These are discussed and explained below.

Market risk refers to losses incurred as a result of unfavorable price movements due to changes in the market prices of certain asset classes such as interest rates, share prices, commodities or currencies. In this context, price risk indicates the possible fluctuations in the value of financial products within a period of time. The price risk therefore depends on the period between the purchase and sale of the financial product and the fluctuation range (volatility) and can lead to a total loss of the capital invested.

Generally speaking, share prices, for example, are based on the economic development of the respective company and on the general economic and political situation in the country. However, **psychological and emotional** factors can also influence the price, even though the economic situation of the company may not have changed.

If an investment is made in foreign currencies, the performance also depends on the development of the exchange rate of the respective foreign currency to the home currency. This **currency risk** can therefore reduce or increase the return on the investment.

Liquidity risk is the risk of not being able to sell an investment immediately at market prices. While a liquid market is characterized by the ability to sell at any time, this is not the case in an illiquid market. When a security is sold in an illiquid market, significant price fluctuations may occur, that might result in a lower price level than originally envisaged.

Inflation risk is understood to be the risk of a loss of assets due to a devaluation of money. This relates not only to the real value of the existing assets, but also to the real income generated by the assets.

The risk of a debtor's insolvency is referred to as **credit risk** or issuer risk. If, for example, an issuer of a security is unable to meet its obligations in terms of dividend payments, interest payments or redemption on time or at all, this has a negative impact on the return on the investment. The worse the economic situation of the debtor or its region or industry, the higher the credit risk as a rule.

Economic risk is understood to mean the change in the general economic development. If, for example, the economic situation deteriorates, this can also worsen the economic situation of the issuers of securities and thus lead to price losses. An incorrect assessment of the economic situation can also lead to losses if the timing of the investment is unfavorable, or the investment is held in an unfavorable market situation.

Tax risks can also arise and might have a negative impact on returns, as taxes are deducted from the gross return. Thus, if the tax environment changes when investing, this can lead to a higher or lower return.

Interest rate risk is the risk that interest rates will fluctuate. In the case of fixed-income securities such as bonds, an increase in interest rates leads to price losses. In contrast, a decrease in interest rates leads to price gains. The interest rate level can also influence other asset classes, such as equities, and lead to price changes.

If an investment is made abroad, political, and economic instability may result in a loss of assets. Thus, there is a risk that a sale of the investment is not possible due to restrictions existing in the respective country. If a foreign issuer can no longer fulfill its obligations due to restrictions, even if the economic situation allows it, this is referred to as country risk.

The predictability of financial investment

In principle, an investment is always associated with risks and therefore a positive return or even the preservation of the invested capital cannot be guaranteed. There is always also the possibility of a total loss. Due to numerous factors that affect the investment of money, capital markets are not predictable in the short term. Rather, sometimes large, and inexplicable price jumps can occur. Depending on the type of investment, a long-term period is therefore more suitable for investing money. This applies, for example, to equity investments, where large short-term fluctuations can happen, whereas in the long-term positive returns are more likely. Nevertheless, even investing for decades the risk of a loss can never be completely ruled out.

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