FINANCIAL GUIDE

A GUIDE TO

HOW TO INVEST IN 2014/15

INVESTING IN A SOPHISTICATED AND HIGHLY COMPLEX WORLD

WELCOME

How to Invest in 2014/15

In *How to Invest in 2014/15* we aim to help you understand the various investments available to you. Each section explains the investment's basic facts.

There are a number of factors you should consider before deciding on what kind of investment is most suitable for you. These include the purpose of the investment, the length of time your money can be tied up for and your attitude to risk.

As all investments carry some degree of risk, we recommend that you seek professional financial advice to find the best strategy to achieve your long- or short-term goals. Everybody has investment goals, from the old adage of saving for a rainy day to planning a comfortable retirement. It's important to define your investment goals at the outset, as the choice of investments will vary depending on what they are.

Which type of approach is right for you?

Starting an investment strategy can be daunting, so it is essential that you get good professional advice on what's best for you. This is a general guide designed to help you think about investing. It does not provide specific advice. If you are unsure of your financial position or about which type of approach is right for you, please contact us for further information.

Content of this guide is for your general information and use only and is not intended to address your particular requirements. They should not be relied upon in their entirety and shall not be deemed to be, or constitute, advice. Although endeavours have been made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough examination of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of any articles. The pension and tax rules are subject to change by the Government. Tax reliefs and state benefits referred to are those currently applying. Their value depends on your individual circumstances. The performance of the investment funds will have an impact on the amount of income you receive. If the investments perform poorly, the level of income may not be sustainable.

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Developing an investment strategy

Allow your lifestyle to dictate your investment approach

To make the most of your investment opportunities, allow your lifestyle and not stock market fluctuations to dictate your investment approach. Your goals are what count, so keep them firmly in mind when you make financial decisions.

LONG-TERM STRATEGY

Many investors use a consistent, long-term strategy to build a more secure financial future through steady purchases of well-diversified investments. But speculators and market timers are usually less concerned about consistency. They may switch investment philosophies on an emotional whim, sometimes treating their investments more like play money than the serious money needed for their financial future.

Most people would probably say they are investors, but the question is not so easily answered. During a bull market, it can be relatively easy to be a long-term investor. However, when the stock market really starts fluctuating, this is when an investor's resilience can be tested – revealing many closet speculators.

PREDICTABLE CYCLE

Market timers follow a fairly predictable cycle. When prices seem low relative to historical norms, they buy. When an investment's value seems to peak, they sell.

In theory, market timing seems fairly rational, but in practice it rarely works. Even the most sophisticated investors, with years of experience and the best analytical tools, cannot predict the whims of the financial markets. What's more, market timers are often misled by emotional factors such as greed or fear. Many end up potentially buying at the tail end of a market rally or selling in a panic at a loss.

The difficulty of timing the markets is complicated by the fact that most market rallies occur in brief spurts. Market timers waiting for the right opportunity to buy or sell risk being out of the market during these sudden market changes.

MARKET TIMING

To benefit from market timing, you must accurately predict the future, not once, but twice. First, you must correctly determine when to

sell. Second, you must accurately determine when to get back in. Because falling markets can rise steeply within days, your timing must be nearly perfect.

To avoid falling into the speculator's trap, focus on the term 'individual' before making any investment decision. Your individual long-term goals and your individual financial circumstances – not the daily fluctuations of the stock market – should govern your decision.

ASTUTE INVESTOR

By focusing on your individual needs and sticking to your investment strategy, you could actually benefit from the stock market's fluctuations. For example, a good long-term investment strategy generally includes investing a set amount at regular intervals.

Of course, changing your investments during a fluctuating market is not always speculating. It can be the mark of an astute investor if the reasons for your changes are consistent with your individual long-term goals.

Instead of market timing, try lifestyle timing. Look at your own investment portfolio and compare it to your long- and short-term goals.

LIFESTYLE CHANGE

Do you need to withdraw money within the next year or so to begin funding your retirement or to make some other lifestyle change? If so, you might want to rebalance your portfolio to a more conservative mix of assets.

What about your long-term goals? Short-term market fluctuations will probably not significantly affect your long-term plans, and it may be wise to stick with your current strategy.

EMOTIONAL FACTOR

Disciplined, systematic investing does not promise a profit or protect you from a loss, but it does reduce the odds of you putting too much money into an investment when prices are high, and it also removes the emotional factor from your investment strategy.

To avoid falling into the speculator's trap, focus on the term 'individual' before making any investment decision.

Main types of investment

Understanding asset classes

CASH

This involves putting your money into a savings account, with a bank, building society or credit union. Your money may not hold its spending power if inflation is higher than the interest rate. Cash is the most basic of all investment forms. Saving money into a deposit account with a bank, building society or credit union is considered cash saving. Cash can be used to save for immediate needs or as a parking place in-between investing in other assets.

WHY HAVE CASH SAVINGS?

If you need instant access to your money or are saving for the near future, cash could be a good option. You earn interest on cash. How much you earn varies from one account to another. You can save in cash without paying tax on the interest by saving in a Cash ISA

WHAT ARE THE RISKS?

The amount you invest will not go down in actual terms, but you may lose spending power if interest rates you receive don't keep up with inflation rates while you are saving. In other words, the nominal value of your savings will stay the same, but the real value could fall.

Cash deposits are guaranteed against the failure of a bank, building society or credit union to the value of £85,000 per person by the Financial Services Compensation Scheme.

BONDS

A bond is a loan to a government or company. In return for the loan, you receive interest and the amount you invested back at an agreed future date. Bonds are issued by governments and companies as a way for them to borrow money. In return, lenders get paid interest and the full value of their money back at a specified date, called the 'redemption date'.

The market price of a bond will rise as interest rates are expected to fall. Bonds have a fixed interest rate. Imagine you hold a bond with a fixed interest rate of 5% whilst general interest rates fall from 4% to 2%. Your bond would be a lot more attractive when general interest rates are 2%; therefore, its price on the market rises.

WHAT ARE BONDS?

Bonds issued by the UK Government are called 'gilts'. You can buy these directly at the Post Office or the Government Debt Management Office.

Bonds issued by companies are called 'corporate bonds'. They are bought and sold on the stock market. Their price will go up and down, which means that if you decide to sell before the agreed redemption date, you may get more or less than the price you originally paid.

The interest you receive from your bond will be specified before you buy. While the end value and annual interest payments are normally fixed amounts, in some cases such as with UK Government index-linked gilts, they may be related to a price index.

Index-linked bonds ensure your money keeps in line with inflation, but at times of low inflation, a fixed rate bond could provide higher returns.

WHAT ARE THE RISKS OF INVESTING IN BONDS?

There is still the risk that the issuer may be unable to fulfil its promise to return your money on the redemption date. This could mean that you lose some or all of your initial investment. To help you manage this risk, bonds are rated by credit rating agencies. The rating on a bond is a good guide on how capable the issuer is in paying back their debt i.e. how likely you are to get your money back when the term of the bond ends.

SHARES

You can invest in a company by buying shares. In return, you may get a proportion of any profit the company makes (depending on how many shares you hold). Shareholders are entitled to have a say on the way the company operates, including voting at company general meetings.

Companies issue shares, often referred to as 'equities', as a way of raising money from outside investors. In return, the investor may receive a portion of the company's profit, called

a 'dividend'. Investors receive a dividend for each share they own. Shareholders are in effect the owners of a company.

WHY INVEST IN SHARES?

- Historically, shares have been one of the highest performing asset classes over long periods
- Dividends are normally paid annually or biannually
- Dividend payments have usually risen over time. But if a company suffers a loss, dividend payments can decline or even stop

WHAT ARE THE RISKS?

The value of your shares is dependent on a number of things including the performance of the company and the wider economic outlook. The value can go up and down over time. It is sensible to invest in shares only if you can afford to put money away for a period of years. The fluctuating nature of the value of shares means you do not want to be forced to withdraw your money when share prices are low, as you may get back less than your original investment.

PROPERTY

Becoming a landlord is a well-known way to invest in property. The aim is to get an income from the rent you charge and that the house or flat increases in value after expenses so you make a profit if you sell it. Land and commercial buildings, such as shopping centres, are other forms of property investments.

WHY INVEST IN PROPERTY?

Property provides a relatively high and stable rental income with the possibility of making your money grow over time.

WHAT ARE THE RISKS OF INVESTING IN PROPERTY?

Buying and selling buildings can take a long time, and if you invest in property you might not be able to withdraw your cash as quickly as you would wish. Investing in property via a fund generally means it is easier to get access to your cash when you need it.

However, providing this level of access can mean lower returns. The value of properties fluctuates over time so there is a potential that you could lose money.

You can invest in property by buying a property on a buy-to-let basis. However, the cost and complexity of owning and managing an individual property is high.

You can also invest in property indirectly; there are two ways you can do this:

Invest in shares of companies that own or develop properties.

Invest in a property fund which gives you exposure to a range of assets. These may include property company shares or commercial property, such as offices, shopping centres and warehousing.

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PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE PERFORMANCE.

The value of your shares is dependent on a number of things including the performance of the company and the wider economic outlook.

Asset class	Main Advantages	Main Risks
Cash	Relatively secure	May lose value if the interest rate doesn't keep up with inflation.
Bonds	Regular income	The bond issuer is sometimes unable to repay in full.
Shares	Regular income and opportunity to grow over time	Share prices can go up and down. A fall in share price will reduce the value of your investment.
Property	Stable and regular income, potential to grow over time	Property prices can fall, reducing the value of your investment. Property transactions take a long time, so your money may be tied up for longer than you want it to be.

Investing in a highly complex world

Generalisation groupings should be viewed with caution

Investors like to sort things into neat categories; it helps make sense of a highly complex world. Categories like 'Emerging Markets', 'BRICs' – Brazil, Russia, India, China – and the 'Fragile Five' have all been invented as easy-to-understand groupings of supposedly similar countries. Yet we have to be careful of such generalisations, because the more research you do, the more you realise that there are often more differences than similarities between these groupings.

DEVELOPED MARKET STATUS

Take 'BRICs' as an example. Aside from the fact they are all large countries on the cusp of developed market status, you'd be hard pushed to find four more different countries than Brazil, Russia, India and China. Linguistically, culturally, historically, politically and economically, they are actually about as different as you can get.

Looking more closely at India and China, far from being similar, India and China are so different they often look like negative images of each other. India is a raucous, noisy democracy; China is a single party system. India's development has been heavy on consumption, light on infrastructure; China's has been heavy on infrastructure, light on consumption. China has a current account surplus of around 2% of GDP; India has a similar-sized deficit. China has less than 3% inflation; India has over 9%.

BROAD-BRUSH DECISIONS

It's hard to see how the two can be squashed into the same artificial investment grouping when the fundamentals are this different. So if you generalise about 'BRICs' or 'Emerging Markets', and you sell them as a group or buy them as a group, you will potentially miss out on big differences in performance between them.

The difference between China and India's stock market performance is a good example of one of the most important things to understand about markets – that is that the second derivative drives performance. If you examine the economic fundamentals, you might conclude that China is a better investment than India. It has much higher GDP growth, a sounder currency, a current account surplus, a stronger fiscal position, lower inflation and lower interest rates. Yet the market has performed worse than India. Why?

Because it is the second derivative that is important. What we mean by this is that it is not the absolute level of things that matters, it's whether at the margin they are getting better or worse.

GDP GROWTH RATE

Take China as an example. China's GDP growth rate is high at 7.5% – much higher than India's and far higher than the developed world. But the rate of GDP growth has been steadily declining over recent years. This change in the second derivative of GDP – the rate of growth of the rate of growth – is one of the main reasons that Chinese equities have not done well over that period. India, on the other hand, has a large current account deficit. But at the margin, it has been improving recently, from around 5% of GDP to around 2.5% of GDP. This marginal improvement is one important reason the India equity market has done well.

Just as generalisation in the form of grouping countries or markets together can be dangerous, generalising at the country level is also a mistake, because it hides a wide variation in sector performance within the country.

The poor performance of China equities in aggregate has been driven by the very large sectors such as banks (down 18% over 12 months), energy (down 21%), materials (down 20%) and telecoms (down 16%). These sectors are often grouped together by those who like to generalise as the 'old economy' sectors or state-owned enterprise (SOE) sectors. These sectors, because of their size and therefore weight in the index, have outweighed the excellent performance of the smaller 'new economy' sectors which have done so well.

CATALYST FOR PROFIT

Perhaps the answer lies with our old friend the second derivative if, at the margin, some of the old economy sectors are looking 'less bad'. Examples of this could be sectors like cement, where consolidation driven by the Government's need to remove capacity may be to the benefit of the surviving players in the industry, or perhaps selected banks where the fundamentals don't look too bad and the valuations are supportive. Equally, if some of the 'new economy' sectors are looking less good at the margin, and are already very expensive, then that could be a catalyst for profit taking. An example of this could be something like increased government focus on regulating Internet finance, a recent but fast-growing part of the Internet sector.

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Investment diversification

Protecting your money from adverse market conditions

Today's markets are as uncertain as ever. But there is one certainty – the future is coming. It may no longer be enough to simply preserve what you have today; you also have to build what you will need for tomorrow. When deciding whether to invest, it is important that any investment vehicle matches your feelings and preferences in relation to investment risk and return.

Recent market volatility has left investors feeling uncertain, and many have stepped away from investing in the stock markets. But not all stocks and shares are the same. For those seeking long-term total returns, there still are some high-quality companies – at attractive prices – offering the potential to grow wealth over time.

LONG-RANGE FINANCIAL GOALS

Diversification is a term that can be summed up with this phrase: 'Don't put all your eggs in one basket'. Diversification is a technique that reduces risk by allocating investments among various financial instruments, industries and other categories. It aims to maximise return by investing in different areas that would each react differently to the same event. Diversification is the most important component of reaching long-range financial goals while minimising risk.

Hence your asset allocation needs to be commensurate with your attitude to risk. Another key question to ask yourself is: 'How comfortable would I be facing a short-term loss in order to have the opportunity to make long-term gains?' If your answer is that you are not prepared to take any risk whatsoever, then investing in the stock market is not for you.

When deciding whether to invest, it is important that any investment vehicle matches your feelings and preferences in relation to investment risk and return.

Allocating wealth

One of the most important investment decisions you ever make

How you choose to allocate your wealth between different asset classes will be one of the most important investment decisions you ever make. Asset allocation can account for the majority of your portfolio returns over the long term, so it's essential that you achieve the right balance of cash, fixed income, equities and property in your portfolio.

DIFFERENT TYPES OF ASSETS

If you are an income investor, you need to understand that different types of assets generate different forms of income. These can broadly be classified into three groups: fixed income, guaranteed income and variable income.

Fixed income is generated by investments that yield income payments on the basis of a fixed schedule. Bonds, whether corporate, government or anything in between, are collectively referred to as 'fixed income investments'. The term 'fixed' in this case refers to a schedule of obligatory payments, not the amount of income or its predictability.

Variable income, on the other hand, cannot be predicted ahead of time and will fluctuate depending on factors such as interest rate changes, inflation rate movements or the profitability of a company. The dividend income paid by company shares can be seen as a variable form of income, as this will depend on the company's results and profits. Rental income from a property investment will also vary over time, depending on factors such as demand and supply in the property market.

Guaranteed income is backed by a third party, such as the Government or an insurance company. As such, it is viewed as the safest form of investment income you can get, although the strength of this guarantee will depend on the party backing the investment.

Examples of investments which could fall into this category include those backed by government-backed institutions such as National Savings & Investments (NS&I) or purchasing an annuity in retirement, in which case the insurance company issuing the annuity guarantees income for the rest of your life.

DRAWING A RANGE OF INCOMES

By holding a sensible mix of different assets, you can draw a range of incomes, each paying out at different times and in different sizes. The aggregation of these will be your portfolio income, which you can use to live off of or to supplement your active income – your salary or wage. You could also choose to reinvest this income back into your investment portfolio, thereby growing your original capital invested.

HOW DO YOU DECIDE ON THE RIGHT MIX OF ASSETS?

There is no rigid formula, but it is worth noting that the ideal mix will differ from one individual to the next, depending on variables such as your age, wealth, investment goals, risk appetite and the amount of income you would eventually like to draw from your portfolio.

Generally, those more risk-averse

will weight their portfolio's asset allocation mix more towards the safe asset classes such as cash and bonds, while those willing to accept more risk in the search for a higher income will opt for riskier investments such as equities or property. The important thing is that you diversify your investments across a mixture of assets.

DIFFERENT 'STYLES' OF INVESTING

Some assets are said to be 'negatively correlated', for instance, bonds and property often behave in a contrarian way to equities by offering lower, but less volatile returns. This provides a 'safety net' by diversifying many of the risks associated with reliance upon one particular asset. It is also important to diversify across different 'styles' of investing, such as growth or value investing, as well as across different sizes of companies, different sectors and different geographic regions.

Growth stocks are held as investors believe their value is likely to grow significantly over the long term, whereas value shares are held because they are regarded as being cheaper than the intrinsic worth of the companies in which they represent a stake. By mixing styles that can out- or under-perform under different economic conditions, the overall risk rating of the investment portfolio is reduced. Picking the right combination of these depends on your risk profile, so it's essential to seek professional advice to ensure that your investment portfolio is commensurate with your attitude to investment risk.

A 'PAPER LOSS'

The important thing to remember with investments is that even if your investment goes down, you will only actually make a loss if you cash it in at that time. When you see your investment value fall, this is known as a 'paper loss', as it is not a real loss until you sell.
If you are going to invest, you need to be prepared to take some risk and to see at least some fall in the value of your investment.

While all investments carry an element of risk, the amount of risk you take directly affects any potential returns and losses. Generally speaking, if there is less risk to your investment, your money will grow more slowly, and with more risk your investment may fluctuate more.

CURRENCY RISK

You should also be aware of currency risk. Currencies, for example, sterling, euros, dollars and yen, move in relation to one another. If you are putting your money into investments in another country, then their value will move up and down in line with currency changes as well as the normal share-price movements.

Another consideration is the risk of inflation. Inflation means that you will need more money in the future to buy the same things as now. When investing, therefore, beating inflation is an important aim. Investing in cash may not beat inflation over the long term.

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THE FINANCIAL CONDUCT AUTHORITY DOES NOT REGULATE NATIONAL SAVINGS & INVESTMENTS.

Taking a long-term view

Remember your reasons for investing in the first place

Stock markets can be unpredictable. They move frequently – and sometimes sharply – in both directions. It is important to take a long-term view (typically ten years or more) and remember your reasons for investing in the first place.

Be prepared to view the occasional downturns simply as part of a long-term investment strategy, and stay focused on your goals.

Historically, the longer you stay invested, the smaller the likelihood you will lose money and the greater the chance you will make money. Of course, it's worth remembering that past performance is not a guide to what might happen in the future, and the value of your investments can go down as well as up.

TIME TO GROW

Give your money as much time as possible to grow – at least 10 years is best. You'll also benefit from 'compounding', which is when the interest or income on your original capital begins to earn and grow too.

STAYING INVESTED

There will be times of market volatility. Market falls are a natural feature of stock market investing. During these times, it is possible that emotions overcome sound investment decisions – it is best to stay focused on your long-term goals.

DON'T TRY TO TIME THE MARKET

Resist the temptation to change your portfolio in response to short-term market movement. 'Timing' the markets seldom works in practice and can make it too easy to miss out on any gains.

The golden rule to investing is allowing your investments sufficient time to achieve their potential.

When deciding whether to invest, it is important that any investment vehicle matches your feelings and preferences in relation to investment risk and return.

Pound-cost averaging

A time-tested method for controlling risk over time

It's natural to be looking for ways to smooth out your portfolio's returns. Investing regularly can smooth out market highs and lows over time. In a fluctuating market, a strategy known as 'pound-cost averaging' can help smooth out the effect of market changes on the value of your investment and is one way to achieve some peace of mind through this simple, time-tested method for controlling risk over time.

It enables investors to take advantage of stock market corrections, and by using the theory of pound-cost averaging, you could increase the long-term value of your investments. There are however no guarantees that the return will be greater than a lump sum investment, and it requires discipline not to cancel or suspend regular Direct Debit payments if markets continue to head downwards.

REGULAR INTERVALS

The basic idea behind pound-cost averaging is straightforward: the term simply refers to investing money in equal amounts at regular intervals. One way to do this is with a lump sum that you'd prefer to invest gradually – for example, by taking £50,000 and investing £5,000 each month for 10 months.

Alternatively, you could pound-cost average on an open-ended basis by investing, say, £5,000 every month. This principle means that you invest no matter what the market is doing. Pound-cost averaging can also help investors limit losses, while also instilling a sense of investment discipline and ensuring that you're buying at ever-lower prices in down markets.

MARKET TIMING

Investment professionals often say that the secret of good portfolio management is a simple one – market timing. Namely, to buy more on the days when the market goes down, and to sell on the days when the market rises.

As an individual investor, you may find it more difficult to make money through market timing. But you could take advantage of market down days if you save regularly, by taking advantage of pound-cost averaging.

SAVINGS HABIT

Regular savings and investment schemes can be an effective way to benefit from pound-cost averaging, and they instil a savings habit by committing you to making regular monthly contributions. They are especially useful for small investors who want to put away a little each month.

Investors with an established portfolio might also use this type of savings scheme to build exposure a little at a time to higher-risk areas of a particular market.

The same strategy can be used by lump sum investors too. Most fund management companies will give you the option of drip-feeding your lump sum investment into funds in regular amounts. By effectively 'spreading' your investment by making smaller contributions on a regular basis, you could help to average out the price you pay for market volatility.

POUND-COST AVERAGING

Any costs involved in making the regular investments will reduce the benefits of pound-cost averaging (depending on the size of the charge relative to the size of the investment, and the frequency of investing).

As the years go by, it is likely that you will be able to increase the amount you invest each month, which would give your savings a valuable boost. No matter how small the investment, committing to regular saving over the long term can build to a sizeable sum. The key to success is giving your investment time to grow. Choose the amount you want to invest and set up automatic deposits. Once this is up and running, the chances are you won't even notice it going out of your monthly budget.

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Pooled investment schemes

Investing in one or more asset classes

Investing in funds provides a simple and effective method of diversification. Because your money is pooled together with that of other investors, each fund is large enough to diversify across hundreds and even thousands of individual companies and assets. A pooled (or collective) investment is a fund into which many people put their money, which is then invested in one or more asset classes by a fund manager.

There are different types of pooled investment but the main ones are:

- Open-ended investment funds
- Unit trusts
- Investment trusts
- Investment bonds

GOOD RETURN FOR INVESTORS

Most pooled investment funds are actively managed. The fund manager researches the market and buys and sells assets to try and provide a good return for investors.

Trackers, on the other hand, are passively managed; they simply aim to track the market in which they are invested. For example, a FTSE100 tracker would aim to replicate the movement of the FTSE100 (the index of the largest 100 UK companies).

Trackers might do this by buying the equivalent proportion of all the shares in the index. For technical reasons, the return is rarely identical to the index, in particular because charges need to be deducted.

ACTIVELY MANAGED FUND

Trackers tend to have lower charges than actively managed funds. This is because a fund manager running an actively managed fund is paid to invest so as to do better than the index (to beat the market) or to generate a steadier return for investors than tracking the index would achieve. Of course, the fund manager could make the wrong decisions and under-perform the market. And there is no guarantee that an actively managed fund that performs well in one year will continue to do so. Past performance is no guarantee of future returns.

Trackers do not beat or under-perform the market (except as already noted), but they are not necessarily less risky than actively managed funds invested in the same asset class. Open-ended investment funds and investment trusts can both be trackers.

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A pooled (or collective) investment is a fund into which many people put their money, which is then invested in one or more asset classes by a fund manager.

Open-ended investment funds

Acting in the investors' best interests at all times

Open-ended investment funds are often called 'collective investment schemes' and are run by fund management companies. There are many different types of fund.

These include:

- Unit trusts
- OEICs (Open-Ended Investment Companies, which are the same as ICVCs – Investment Companies with Variable Capital)
- SICAV (Société d'Investissement à Capital Variable)
- FCPs (Fonds Communs de Placement)

This list includes certain European funds, which are permitted under European legislation to be sold in the UK.

OPEN-ENDED FUNDS

There are many funds to choose from, and some are valued at many millions of pounds. They are called 'open-ended funds', as the number of units (shares) in issue increases as more people invest and decreases as people take their money out.

As an investor, you buy units/shares in the hope that the value rises over time as the prices of the underlying investments increase. The price of the units depends on how the underlying investments perform.

You might also get income from your units through dividends paid by the shares (or income from the bonds, property or cash) that the fund has invested in. You can either invest a lump sum or save regularly each month.

DIFFERENT ASSET CLASSES

Open-ended investment funds generally invest in one or more of the four asset classes – shares, bonds, property and cash. Most invest primarily in shares but a wide range also invest in bonds. Few invest principally in property or cash deposits. Some funds will spread the investment and have, for example, some holdings in shares and some in bonds. This can be useful if you are only taking out one investment and, remembering that asset allocation is the key to successful investment, you want to spread your investment across different asset classes.

The level of risk will depend on the underlying investments and how well diversified the open-ended investment fund is. Some funds might also invest in derivatives, which may make a fund more risky. However, fund managers often buy derivatives to help offset the risk involved in owning assets or in holding assets valued in other currencies.

TRUSTEE OR DEPOSITORY PROTECTION

Any money in an open-ended investment fund is protected by a trustee or depository, who ensures the management company is acting in the investors' best interests at all times.

For income, there is a difference in the tax position between funds investing in shares and those investing in bonds, property and cash. Whichever type of open-ended investment fund you have, you can reinvest the income to provide additional capital growth, but the taxation implications are as if you had received the dividend income. No capital gains tax (CGT) is paid on the gains made on investments held within the fund. But, when you sell, you may have to pay capital gains tax.

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Open-ended investment companies

Expanding and contracting in response to demand

Open-Ended Investment Companies (OEICs) are stock market–quoted collective investment schemes. Like investment trusts and unit trusts, they invest in a variety of assets to generate a return for investors. They share certain similarities with both investment trusts and unit trusts, but there are also key differences.

POOLED COLLECTIVE INVESTMENT VEHICLE

OEICs are a pooled collective investment vehicle in company form and were introduced as a more flexible alternative to established unit trusts. They may also have an umbrella fund structure, allowing for many sub-funds with different investment objectives. This means you can invest for income and growth in the same umbrella fund, moving your money from one sub fund to another as your investment priorities or circumstances change.

By being 'open ended', OEICs can expand and contract in response to demand, just like unit trusts. The share price of an OEIC is the value of all the underlying investments divided by the number of shares in issue. As an open-ended fund, the fund gets bigger and more shares are created as more people invest. The fund shrinks and shares are cancelled as people withdraw their money.

SHARE ALLOCATION

You may invest into an OEIC through a Stocks & Shares Individual Savings Account (ISA). Each time you invest in an OEIC fund, you will be allocated a number of shares. You can choose either income or accumulation shares, depending on whether you are looking for your investment to grow or to provide you with income, providing they are available for the fund you want to invest in.

Like unit trusts, OEICs provide a mechanism for investing in a broad selection of shares, thus aiming to reduce the risks of investing in individual shares. Therefore, you have an opportunity to share in the growth potential of stock market investment. However, do remember that your capital is not secured and your income is not guaranteed.

INVESTMENT OBJECTIVES

Each OEIC has its own investment objectives, and the fund manager has to invest to achieve these objectives. The fund manager will invest the money on behalf of the shareholders.

The value of your investment will vary according to the total value of the fund, which is determined by the investments the fund manager makes with the fund's money. The price of the shares is based on the value of the investments in which the company has invested.

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Unit trusts

Participating in a wider range of investments

Unit trusts are collective investments that allow you to participate in a wider range of investments than can normally be achieved on your own with smaller sums of money. Pooling your money with others also reduces the risk.

A unit trust fund is divided into units, each of which represents a tiny share of the overall portfolio. Each day, the portfolio is valued, which determines the value of the units. When the portfolio value rises, the price of the units increases. When the portfolio value goes down, the price of the units falls.

INVESTMENT DECISIONS

The unit trust is run by a fund manager, or a team of managers, who will make the investment decisions. They invest in stock markets all round the world and, for the more adventurous investor, there are funds investing in individual emerging markets, such as China, or in the so-called BRIC economies (Brazil, Russia, India and China).

Alternatively, some funds invest in metals and natural resources, and many put their money into bonds. Some offer a blend of equities, bonds, property and cash and are known as 'balanced funds'. If you wish to marry your profits with your principles, you can also invest in an ethical fund.

MULTI-MANAGER FUNDS

Some funds invest not in shares directly but in a number of other funds. These are known as 'multi-manager funds'. Most fund managers use their own judgement to assemble a portfolio of shares for their funds, which are known as 'actively managed funds'. However, a sizeable minority of funds simply aim to replicate a particular index, such as the FTSE All-Share Index. These are known as 'passive funds', or 'trackers'.

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When the portfolio value rises, the price of the units increases. When the portfolio value goes down, the price of the units falls.

Investment trusts

Reflecting popularity in the market

An investment trust is a company with a set number of shares. Unlike an open-ended investment fund, an investment trust is closed ended. This means there are a set number of shares available, which will remain the same no matter how many investors there are. This can have an impact on the price of the shares and the level of risk of the investment trust. Open-ended investment funds create and cancel units depending on the number of investors.

The price of the investment trust shares depends on two main factors:

- the value of the underlying investments (which works in the same way as open-ended investment funds); and
- the popularity of the investment trust shares in the market

CLOSED-ENDED FUNDS

This second point applies to investment trusts but not to open-ended investment funds or life assurance investments. The reason is because they are closed-ended funds. The laws of economics say that if there is a high demand for something, but limited supply, then the price goes up. So, if you own some investment trust shares and there are lots of people queuing up to buy them, then you can sell them for more money. On the other hand, if nobody seems to want them, then you will have to drop the price until someone is prepared to buy.

The result is that investment trust shares do not simply reflect the value of the underlying investments: they also reflect their popularity in the market. The value of the investment trust's underlying investments is called the 'net asset value' (NAV). If the share price is exactly in line with the underlying investments, then it is called 'trading at par'. If the price is higher because the shares are popular, then it is called 'trading at a premium', and if lower, 'trading at a discount'. This feature may make them more volatile than other pooled investments (assuming the same underlying investments).

IMPROVING PERFORMANCE

There is another difference that applies to investment trusts: they can borrow money to invest. This is called 'gearing'. Gearing improves an investment trust's performance when its investments are doing well. On the other hand, if its investments do not do as well as expected, gearing lowers performance.

Not all investment trusts are geared, and deciding whether to borrow and when to borrow is a judgement the investment manager makes. An investment trust that is geared is a higher-risk investment than one that is not geared (assuming the same underlying investments).

SPLIT-CAPITAL INVESTMENT TRUSTS

A split-capital investment trust (split) is a type of investment trust that sells different sorts of shares to investors depending on whether they are looking for capital growth or income. Splits run for a fixed term. The shares will have varying levels of risk, as some investors will be ahead of others in the queue for money when the trust comes to the end of its term.

The tax position is largely the same as for open-ended investment funds. You should be aware that tax legislation changes constantly and you should find out the most current position.

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Investment bonds

A range of funds for the medium- to long-term

Investment bonds are designed to produce medium- to long-term capital growth, but can also be used to give you an income. They also include some life cover. There are other types of investment that have 'bond' in their name (such as guaranteed bonds, offshore bonds and corporate bonds) but these are very different. With an investment bond, you pay a lump sum to a life assurance company and this is invested for you until you cash it in or die.

MEDIUM- TO LONG-TERM

Investment bonds are not designed to run for a specific length of time, but they should be thought of as medium- to long-term investments, and you'll often need to invest your money for at least five years. There will usually be a charge if you cash in the bond during the first few years.

The bond includes a small amount of life assurance and, on death, will pay out slightly more than the value of the fund. Some investment bonds offer a guarantee that you won't get back less than your original investment, but this will cost you more in charges.

RANGE OF FUNDS

You can usually choose from a range of funds to invest in, for example, UK and overseas shares, fixed interest securities, property and cash. Investment bonds can also offer a way of investing in funds managed by other companies, but this may lead to higher charges.

Investment risk can never be eliminated, but it is possible to reduce the ups and downs of the stock market by choosing a range of funds to help you avoid putting all your eggs in one basket. Different investment funds behave in different ways and are subject to different risks. Putting your money in a range of different investment funds can help reduce the loss, should one or more of them fall.

TAX PAYMENTS

Depending on your circumstances, the overall amount of tax you pay on investment bonds may be higher than on other investments (such as a unit trust, for instance). But there may be other reasons to prefer an investment bond. Or you may want to set up the investment within a trust as part of your inheritance tax planning (but note that you normally lose access to at least some of your money if you do this).

You can normally withdraw up to 5% of the original investment amount each year without any immediate income tax liability. The life assurance company can pay regular withdrawals to you automatically. These withdrawals can therefore provide you with regular payments, with income tax deferred, for up to 20 years.

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New Individual Savings Accounts

Providing you with increased simplicity and greater flexibility

Individual Savings Accounts (ISAs) have been around since 1999, providing a tax-efficient wrapper for savings and investments. However, in the recent Budget, the Chancellor, George Osborne, promised to increase the simplicity and flexibility of ISAs. As of 1 July 2014, there is now a single ISA which has been named the new ISA, or 'NISA', which provides a bigger tax break than ever before and more flexibility about how it can be used.

All ISAs have now become NISAs, including any ISAs opened from 6 April 2014 to 30 June 2014.

HOW DO NISAS DIFFER FROM ISAS?

- **Greater flexibility** – You can invest your whole allowance in stocks and shares or cash, or any mixture of the two

- **Freedom to transfer** – You can transfer existing ISAs from stocks and shares into cash, or the other way around

- **Improved tax efficiency** – You can now earn tax-efficient interest on cash held in a NISA. Previously, with the exception of a Cash ISA, any cash held within the stocks and shares element of an ISA was subject to a 20% charge on the interest earned

GENEROUS TAX BREAK

The ISA allowance has now been increased from £11,880 to £15,000 for the 2014/15 tax year. For any couple, that means they can put aside £30,000 for this tax year, which is a generous tax break. This means you can now save another £3,120 into either cash or stocks and shares in the current tax year. The amount that can be paid into a Junior ISA for the 2014/15 tax year has also increased from £3,840 to £4,000. Do bear in mind that whilst the NISA does allow a generous amount to be sheltered from tax during your life, the total amount forms part of your estate on death and so could be subject to 40% tax.

MOVING YOUR EXISTING INVESTMENTS

You also now have the full flexibility of moving your existing investments in a Stocks & Shares ISA to a Cash ISA, or vice versa. You should not withdraw sums from your Stocks & Shares account yourself in order to deposit it into a Cash NISA, or the other way around. If you do, any amount that you pay in may count as a fresh payment against your overall limit of £15,000.

NISA SUBSCRIPTION LIMIT

It is worth noting that if you have paid into a Cash or Stocks & Shares ISA since 6 April 2014, you will not be able to open a further NISA of the same type before 6 April 2015. You may however make additional payments – up to the £15,000 NISA subscription limit – into your existing account(s).

INCREASED FLEXIBILITY

As of 1 July 2014, there is now increased flexibility in the way that you can use your ISA allowance.

You can now allocate:

- the full £15,000 in a Stocks & Shares ISA
- the full £15,000 in a Cash ISA
- any combination of amounts between a Stocks & Shares ISA and a Cash ISA up to the new limit

NISA LIMITS

For example, from 1 July you could choose to save or invest:

- £15,000 to a Cash NISA and nothing to a Stocks & Shares NISA
- £15,000 to a Stocks & Shares NISA and nothing to a Cash NISA
- £5,000 to a Cash NISA and £10,000 to a Stocks & Shares NISA
- £10,000 to a Cash NISA and £5,000 to a Stocks & Shares NISA – a combination of amounts between a Cash and Stocks & Shares NISA, up to the overall annual limit of £15,000

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Offshore bonds

Utilising tax deferral benefits to minimise tax liabilities

Finding the right offshore investments can be a key factor in making the most of your wealth, and it's not only for the wealthiest of investors. With a few well-advised decisions, you could broaden your investment portfolio.

If appropriate, offshore bonds may provide an opportunity for your assets to grow in a tax-free environment. They also allow you to choose when any tax liability becomes payable. There are a number of other tax benefits with offshore bonds, especially if you have spent time living abroad. But they are complex structures that require professional financial advice.

INTERNATIONAL FINANCE CENTRES

While many investors will be aware that investing in an Individual Savings Account (ISA) or pension can help reduce their tax bill, you may be less familiar with offshore bonds. Like pensions and ISAs, offshore bonds are effectively 'wrappers' into which you place your investments, for example, funds or cash. They are offered by life insurance companies which operate from international finance centres.

The main tax benefit of investing in an offshore bond is gross roll-up. This means that any underlying investment gains are not subject to tax at source – apart from an element of withholding tax. With an onshore bond, life fund tax is payable on income or gains made by the underlying investment. This means your offshore investment has the potential to grow faster than one in a taxed fund.

TAX DEFERRAL

As long as investments are held within the offshore bond wrapper, you don't pay any income tax or capital gains tax on them, and you can switch between different funds tax-free. While you do have to pay tax on any gains when you withdraw assets, there are a number of ways you can potentially reduce the amount you pay.

You can withdraw up to 5% of your initial investment every year for 20 years, and defer paying tax until a later date. If you are a higher-rate taxpayer now but expect to become a basic-rate taxpayer when you retire, you can defer cashing in your assets until retirement and possibly pay half the tax due on any gain realised.

NEW OWNER'S TAX RATE

You can assign (transfer ownership) an offshore bond – or parts of it – as a gift without the recipient incurring any income or capital gains tax, although this may cause an Inheritance Tax (IHT) liability if you were to die within seven years. All future tax on withdrawals will be charged at the new owner's tax rate, if any. This can be a tax-efficient way to help fund your children's university fees, for example, since your children are likely to be low or non-earners as students. Putting an offshore bond in a trust could help your family reduce or avoid IHT, provided you live for seven years after setting it up.

UNDERSTAND EACH JURISDICTION

Investor compensation schemes tend not to be as developed as in the UK, so you should always obtain professional advice to ensure that you fully understand each jurisdiction. It is also important to ensure that you are investing in an offshore investment that is appropriate for the level of risk you wish to take.

If you are an expatriate, you should make sure that you are aware of all the investment opportunities available to you and that you are minimising your tax liability. Investing money offshore is a very complex area of financial planning, and you should always obtain professional advice. Currency movements can also affect the value of an offshore investment.

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Investing for income

Safeguarding your money at a time of low interest rates

How do you generate a reliable income when interest rates are stuck at all-time lows and the Bank of England's quantitative easing policy of 'printing' money is squeezing yields on government bonds (gilts) and other investments? Investors today can still rely on a well-balanced portfolio to meet their needs for income. However, they must be open-minded about the sources of that income and recognise that low-risk income generation is a thing of the past.

If you are an income seeker, much will come down to your attitude to risk for return. If you want no or very low risk, you may wish to consider a traditional cash bank account and accept that income levels are likely to remain low for the foreseeable future. However, if you're further up the risk scale, you may wish to opt for some of these other alternatives.

GILTS

If you're willing to take on a slightly higher degree of risk and you need the extra income, you may wish to consider gilts (or gilt-edged stocks), which are bonds issued by the Government that pay a fixed rate of interest twice a year. Gilts involve more risk than cash, because there's a chance the Government won't be able to pay you back. It's highly unusual for a government to default on a debt or default on the interest payments, so they have been considered safe. But in this current economic climate, this risk increases.

You are not guaranteed to get all your capital back under all circumstances. Not all gilts are bought from the Government and held to maturity; some are bought and sold along the way, so there's a chance for their value, and the value of gilt funds, to rise and fall. There are other types, such as index-linked gilts, which form the largest part of the gilt portfolio after conventional gilts. Here the coupon is related to movements in the Retail Prices Index (RPI) and is linked to inflation.

CORPORATE BONDS

Next along the risk scale, if you are looking for a higher yield, are corporate bonds. These are issued by companies and have features that are exactly the same as gilts except that, instead of lending money to the Government, you're lending to a company. The risk lies in the fact that companies may go bust and the debt may not be repaid. They have a nominal value (usually £100), which is the amount that will be returned to the investor on a stated future date (the redemption date). They also pay a stated interest rate each year, usually fixed. The value of the bonds themselves can rise and fall; however, the fact that

bonds are riskier at the moment means companies are paying more in order to induce people to buy their debt. There are an increasing number of global bond funds entering the market that may enable you to get value from a lot of different markets.

EQUITY INCOME

If your primary objective is the preservation of income, you may not consider the stock market as the obvious place for your money. However, for investors who are prepared to see their investments fluctuate in value while hopefully providing a stable income that grows over time, you may wish to consider equity income funds. These invest in shares, focusing on the big blue-chip firms that have a track record of good dividend payments. The dividends will be your income.

GLOBAL EQUITY INCOME FUNDS

Further up the risk scale are global equity income funds. These are similar to UK funds, except that there are only a handful of the big blue-chip firms that pay reliable dividends in the UK, whereas global diversification offers a significant range of companies to choose from. Investing in other currencies brings an added level of risk, unless the fund hedges the currency.

EQUITY INCOME INVESTMENT TRUSTS

Equity income investment trusts are higher risk but similar to other equity income investments. They are structured differently from unit trusts and open-ended investment companies. Investment trusts are closed ended. They are structured as companies with a limited number of shares. The share price of the fund moves up and down depending on the level of demand, so the price of the trust depends not only on the value of the underlying investments but also on the popularity of the trust itself. In difficult times, when investors are selling up, trusts are likely to see their share price fall more than the value of their underlying investments. This means they also have more potential for greater returns once better times resume. Investment trust share prices are therefore often at a 'discount' or 'premium' to the value of the assets in the fund.

Equity income investment trusts are higher risk but similar to other equity income investments.

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Socially responsible investing

Not sacrificing your life principles in exchange for chasing the best financial returns

For investors concerned about global warming and other environmental issues, there are a plethora of ethical investments that cover a multitude of different strategies. The terms 'ethical investment' and 'socially responsible investment' (SRI) are often used interchangeably to mean an approach to selecting investments whereby the usual investment criteria are overlaid with an additional set of ethical or socially responsible criteria.

ETHICAL CRITERIA

The Ethical Investment Research Service (EIRIS) defines an ethical fund as 'any fund which decides that shares are acceptable, or not, according to positive or negative ethical criteria (including environmental criteria)'.

Funds that use negative screening, known as 'dark green funds', exclude companies that are involved in activities that the fund manager regards as unethical. Each fund group has a slightly different definition of what is unethical, but this typically includes gambling, tobacco, alcohol and arms manufacturing. It could also cover pollution of the environment, bank lending to corrupt regimes and testing of products on animals.

POSITIVE SCREENING FUNDS

Positive screening funds use positive criteria to select suitable companies. Funds that take this approach look for companies that are doing positive good, such as those engaged in recycling, alternative energy sources or water purification. So an ethical fund of this type might buy shares in a maker of wind turbines or solar panels.

ENGAGEMENT FUNDS

Engagement funds take a stake in companies and then use that stake as a lever to press for changes in the way that the company operates. This could mean persuading oil and mining companies to take greater care over the environmental impact of their operations or pressing companies to offer better treatment of their workers.

In addition, this process may involve making judgements regarding the extent to which such investments are perceived to be acceptable and about the potential for improving, through engagement, the ethical performance of the party offering the investment.

BEST FINANCIAL RETURNS

Ethical investors will believe that they should not (or need not) sacrifice their life principles in exchange for chasing the best financial returns, with some arguing that in the long term, ethical and SRI funds have good prospects for out-performing the general investment sectors.

Since ethical investment, by definition, reduces the number of shares, securities or funds in which you can invest, it tends to increase the volatility of the portfolio and therefore the risk profile. This can be mitigated by diversifying between funds, and between different styles of funds and fund managers. Like their non-ethical equivalents, some ethical funds are much higher risk than others.

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Venture Capital Trusts

Spreading risk over a number of small companies

A Venture Capital Trust (VCT) is a company whose shares trade on the London stock market. A VCT aims to make money by investing in other companies. These are typically very small companies which are looking for further investment to help develop their business.

STRICT RULES

There are very strict rules on how VCTs can invest your pooled money in order to qualify as VCTs. Investments in them carry tax relief to encourage you to invest in these smaller, higher risk companies. By pooling your investments with those of other clients, VCTs allow you to spread the risk over a number of small companies.

You can invest by subscribing to new shares when a trust is launched or by buying shares from other investors when the trust has been established.

TAX CREDIT

You receive Income Tax relief when you buy newly issued VCTs, currently at the rate of 30% on investments of up to £200,000 per tax year. This relief is provided as a tax credit to set against your total income tax liability and, therefore, cannot exceed your total tax liability for the tax year. You won't receive this tax relief if you buy existing VCT shares.

CAPITAL GAINS TAX

You have to hold shares in a VCT for at least five years to keep the income tax relief – if you have to sell them before then, you'll lose this benefit. In addition, there is no capital gains tax to pay on profits from selling your VCT shares, no matter how short a period you have held them, provided the company maintains its VCT status.

NEWLY-ISSUED SHARES

You can sell your shares in VCTs at any point – but in practice, you lock your investment in for at least five years if you invest in newly issued shares. Any tax credit you receive will be claimed back by HM Revenue & Customs if you sell them before then.

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SMALL, UNLISTED COMPANIES OFFER YOU THE CHANCE AT MAKING HIGHER RETURNS BUT THEY CARRY A HIGH RISK.

There are very strict rules on how VCTs can invest your pooled money in order to qualify as VCTs.

Enterprise Investment Schemes

A tax-efficient investment offering capital gains tax deferral

Enterprise Investment Schemes (EISs) are tax-efficient vehicles set up to encourage investment into small, unquoted trading companies. The EIS is the only tax-efficient investment offering a capital gains tax (CGT) deferral. CGT on the disposal of other assets can be deferred by reinvesting the proceeds in EIS shares.

An EIS allows income tax relief of 30% on a maximum subscription of £1 million (provided that an individual does not acquire an interest of more than 30% of the company). Individuals may elect to treat their subscription for EIS shares, up to their maximum annual allowance, as if made in the previous tax year.

Gains are exempt from CGT if held for a period of three years or more. Any size of capital gain made on the disposal of any kind of asset can be 'deferred' by re-investment into EIS-compliant companies. The deferred gain is then due on the sale of the EIS shares, unless the sale is to a spouse or on the death of the shareholder.

Investments in EIS-compliant shares can attract Inheritance Tax business property relief (BPR) equal to 100% of the investment value on gifting or on death.

TAX-FREE GROWTH

EIS funds fall into two distinct camps: those that wind up after the three years required for investments to be held to qualify (known as 'planned exit EISs') and those that carry on until investors agree that a wind-up makes commercial sense. For EIS funds and portfolios, the manager may not be able to invest as quickly as hoped. This may reduce the return on your investment, and the investment may lose its EIS status or tax relief may be delayed.

Investments in smaller companies will generally not be publicly traded or freely marketable and may therefore be difficult to sell. There will be a big difference between the buying price and the selling price of these investments. The price may change quickly, and it may go down as well as up.

An EIS allows income tax relief of 30% on a maximum subscription of £1 million (provided that an individual does not acquire an interest of more than 30% of the company).

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Which type of approach is right for you?

Starting an investment strategy can be daunting, so it is essential that you get good professional advice on what's best for you. This is a general guide designed to help you think about investing. It does not provide specific advice. If you are unsure of your financial position or about which type of approach is right for you, please contact us for further information.

Contact us today

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