



# YOUR MONEY

GUIDE TO

# INVESTING IN 2016

TAKE STOCK OF WHERE YOU ARE AND  
WHERE YOU WANT TO BE, AND PLAN  
HOW BEST TO GET THERE

FINANCIAL GUIDE

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# WELCOME

## *Guide to Investing in 2016*

Successful long-term wealth creation requires the right balance between shares, bonds and other investments. In *Guide to Investing in 2016*, we consider a number of different solutions available to you, and each section explains the basic facts.

There are a number of factors you should consider before deciding on what kind of approach 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. An investment portfolio is simply where you keep your money. If all your money is held as cash in your bank account, that's your portfolio.

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.

### **The right investment strategy plays a vital role in securing your financial future**

Creating and maintaining the right investment strategy plays a vital role in securing your financial future. Whether you are looking to invest for income, growth or both, we can provide the quality professional financial advice, comprehensive investment solutions and ongoing service to help you achieve your financial goals.

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# CREATING 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 benefit from market timing, you must accurately predict the future, not once, but twice.*



# MAIN TYPES OF INVESTMENT

## *Understanding asset classes*

There are four main types of investments, known as 'asset classes'. Each asset class has different characteristics and advantages and disadvantages for investors.

### **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 from 1 January 2016 to the value of £75,000 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; this 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.

#### **There are two ways to invest in property indirectly:**

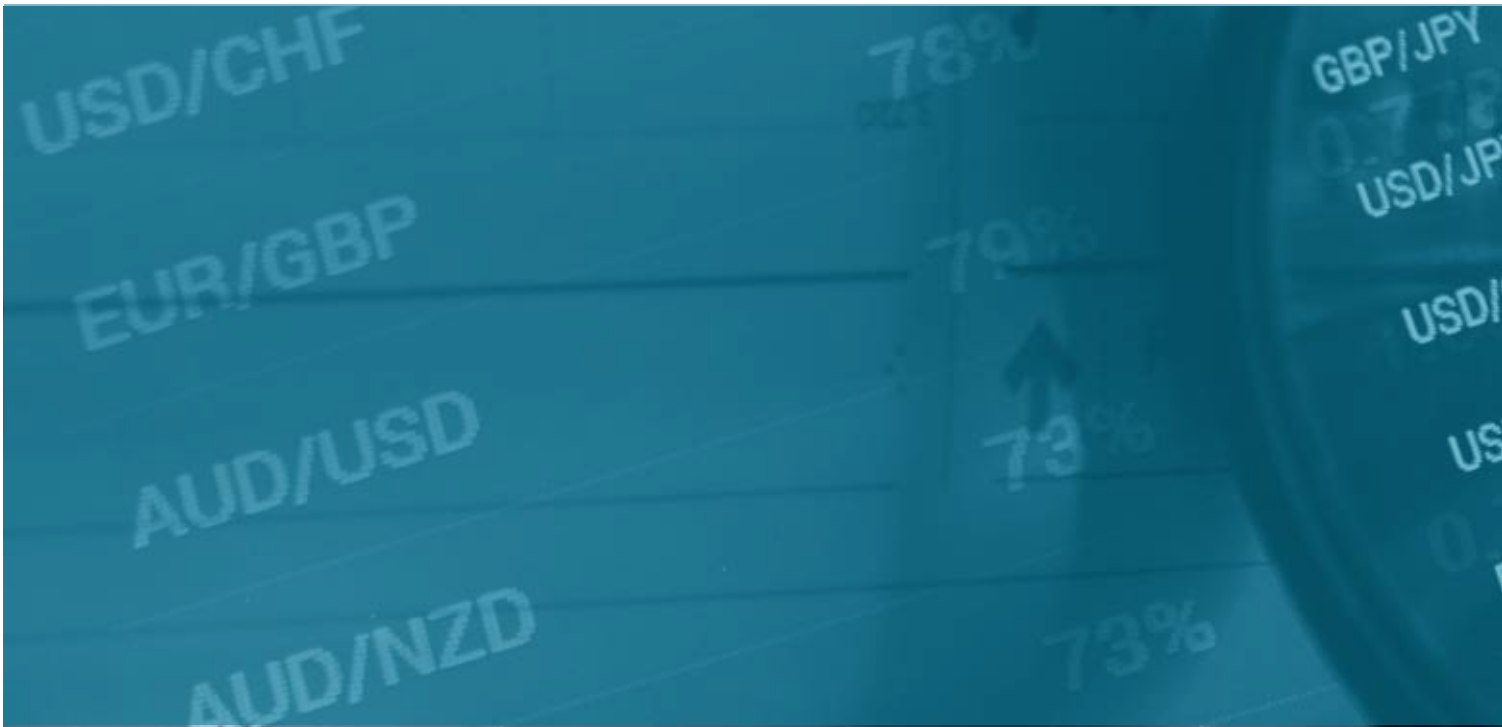
- Invest in shares of companies that own or develop properties
- Invest in a property fund which gives you exposure to a range of assets. These may include property company shares or commercial property, such as offices, shopping centres and warehousing

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*The interest you receive from your bond will be specified before you buy.*



# 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.

*Diversification is a term that can be summed up with this phrase: 'Don't put all your eggs in one basket'.*





# 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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# 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 goal.

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.

Warren Buffett, the American investor and philanthropist, puts it very succinctly: 'Our favourite holding period is forever.' Over the long term, investors do experience market falls which happen periodically. Generally, the wrong thing to do when markets fall by a reasonable margin is to panic and sell out of the market – this just means you have taken the loss. It's important to remember why you're invested in the first place and make sure that rationale hasn't changed.

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

# 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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# 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 CGT.

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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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*A unit trust fund is divided into units, each of which represents a tiny share of the overall portfolio.*



# 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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# INDIVIDUAL SAVINGS ACCOUNTS

*Tax-efficient investment wrapper holding a range of investments*

Individual Savings Accounts (ISAs) have been around since 1999 and are tax-efficient investment wrappers in which you can hold a range of investments, including bonds, equities, property shares, multi-asset funds and even cash, giving you control over where your money is invested.

During his 2015 Spending Review and Autumn Statement, Chancellor George Osborne announced he would also be extending the list of qualifying investments for the new Innovative Finance Individual Savings Account from Autumn 2016 to include debt securities offered via crowdfunding platforms.

ISAs are a highly tax-efficient way to save or invest your money because you don't pay Income Tax on your interest or Capital Gains Tax on any profits.

## **Tax year 2015/16 ISA allowance**

Between 6 April 2015 and 5 April 2016, you have an ISA allowance of £15,240. The rules now mean you can split the ISA allowance as you wish between a Stocks & Shares ISA and a Cash ISA. The ISA allowance limit will remain at £15,240 for tax year 2016/17.

You don't have to declare any investments held in ISAs on your tax return. This may not seem like much, but, if you have to file an annual tax return, you'll know that any way of simplifying your financial administration can be very helpful.

**ISAs are becoming an important part of financial planning, and they offer a unique range of benefits.**

**These include:**

- No income is tax payable on interest payments – which are made by bond funds
- No higher rate tax is payable on dividends, which are paid by equity funds (you can't claim back the 10% dividend tax paid by the fund in an ISA)
- You can access your money whenever you need to but it cannot be returned (if you withdraw your ISA, you will automatically lose all of its associated tax benefits – unless you need to liquidate your cash, you should transfer it between providers to retain its tax-efficient status)
- Income from an ISA doesn't affect your personal allowance or age-related allowance

- No Capital Gains Tax is payable on any growth you may achieve, so you could use withdrawals to increase your income when necessary (any losses made in the ISA cannot be used to offset gains made elsewhere)

It is important to remember that an ISA is just a way of sheltering your money from tax – it's not an investment in its own right.

## **Change to ISA inheritance rules**

Under the new rules, additional ISA subscriptions are now available to a surviving spouse or registered civil partner, as long as the ISA holder passed away on or after 3 December 2014.

This comes in the form of an Additional Permitted Subscription (APS) ISA allowance (additional to the personal annual ISA) equal to the amount that was held in the ISA on the day the holder died.

## **Transferring your investment between providers**

If you want to change your existing ISA provider or are looking to consolidate your investments under one roof, with

an ISA you can transfer your investment between providers to suit your individual needs. However, your current provider may apply a charge when you transfer your investment. While your investment is being transferred, it will be out of the market for a short period of time and will not lose or gain in value.

#### Control over your retirement income

ISAs can give you control over your retirement income, as you can take as much money out as you require, whenever you want. Savings in an ISA and withdrawals from an ISA are tax-efficient, but, if you withdraw money and put it back later, it will count towards your ISA annual subscription limit in the year that you re-invested your money.

#### Junior ISAs – a straightforward way to save for a child's future

Junior ISAs offer investors a straightforward way to save for a child's future and offer similar tax advantages to 'adult' ISAs, but with a lock-in, making the child's investment inaccessible until they turn 18. Like an ISA, Junior ISAs can invest in bonds, equities, cash, property and even multi-asset funds, giving you even more flexibility over the future of your child's long-term savings.

Since April 2015, it is possible for existing Child Trust Funds (CTFs) to be transferred into Junior ISA accounts. You can invest up to £4,080 in the current tax year and switch from a Cash Junior ISA to a Stocks & Shares Junior ISA and back again.

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\*only applies to Stocks & Shares ISAs

	Cash ISA	Stocks & Shares ISA
<b>How much can I save or invest each year?</b>	£15,240 less any amount held in a Stocks & Shares ISA.	£15,240 less any amount held in a Cash ISA.
<b>Who can apply for one?</b>	UK residents aged 16 and over.	UK residents aged 18 and over.
<b>Is there risk involved?</b>	The value of your initial investment cannot decrease. However, the current low rates of interest could mean that the return on your money does not outpace inflation.	While the long-term potential returns are greater, the value of your investment can go down as well as up, and you could get back less than you have paid in.
<b>Can I switch between ISAs?</b>	You can transfer funds between Cash ISAs or from a Cash ISA into a Stocks & Shares ISA.	You can transfer funds between Investment ISAs or from an Investment ISA into a Cash ISA.

# 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 (CGT) 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 Tax or CGT, 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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*You can withdraw up to 5% of your initial investment every year for 20 years, and defer paying tax until a later date.*

# 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.

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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 outperforming the general investment sectors.

Since ethical investment, by definition, reduces the number of shares, securities

*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.*

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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# CARRYING OUT REGULAR PORTFOLIO REVIEWS

*Make sure that any changes in your attitude to risk are accurately reflected*

It is important to carry out regular portfolio reviews to consider the suitability of your investments and to make sure that any changes in your attitude to risk are accurately reflected. Over time, your attitude to risk is likely to change. If you are approaching retirement, for example, you may want to preserve capital or generate an income, while if you are investing for growth, you may need to take on more risk to potentially boost returns.

**There are two key questions that you should ask yourself:**

- How much capital can you afford to lose?
- How long is your investment horizon?

The general rule is that the more risk you are prepared to take, the greater your potential returns could be. At the same time, however, it is important to realise that there is a greater potential for loss.

**Reviewing the amount of risk**

As these two factors can change over time, it is crucial that you are able to adjust your portfolio to reflect them. Please remember that the value of your investments and the income received from them may go down as well as up, and you may not get back the full amount invested.

As well as regularly reviewing the amount of risk taken in your portfolio,

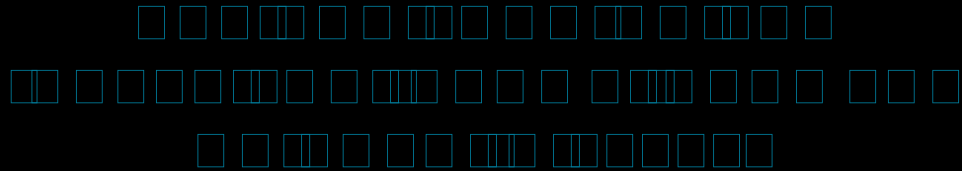
it is also important to make sure your portfolio remains as diversified as it can be and that it reflects any changes in your investment objectives. The key to building a diversified portfolio is to take a balanced approach. This means combining a range of investments that can help you meet your investment goals within an appropriate level of risk.

**Exposure to different markets**

Income-seeking stock market investors may want to diversify away from their home UK market to take advantage of dividend opportunities globally. Meanwhile, in fixed income, the current low yield environment means that investors may need to look across a wider range of global bond sectors and markets to maintain attractive future returns. Either way, you need to make sure you have the right levels of exposure to different markets for the outcomes you're looking for. However, please note that diversification does not guarantee investment returns and does not eliminate the risk of loss.

Investing outside of the UK can involve a higher degree of risk and also involves a degree of exchange rate risk. If you are in any doubt about the suitability of an investment or understanding your risk appetite, you should always seek professional financial advice.





**Creating and maintaining the right investment strategy plays a vital role in securing your financial future. Whether you are looking to invest for income, growth or both, we can provide the quality professional financial advice, comprehensive investment solutions and ongoing service to help you achieve your financial goals.**

**To discuss your situation, please contact us for further information.**

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