Investing Your Money

Q: How can I achieve a greater return than cash?

A: Generally, the higher the potential return of an investment, the higher the risk. There is no guarantee that you will get a higher return by accepting more risk. Stocks have a potentially higher return than bonds over the long term, but they are also riskier.

Shareholders are owners. As a shareholder, if the company is unsuccessful, you could lose all your money. But if the company is successful, you could see higher dividends and a rising share price. Some investments, such as those sold on the exempt market are highly speculative and very risky. They should only be purchased by investors who can afford to lose all the money they have invested.

Stocks and Shares

When you buy shares you become a partial owner of the company, shareholders are not lending the company money they are the company. This means that the value of your investment goes up as the value of the company rises on the market. It also brings a share in any profits that might be distributed through dividends. As a shareholder you have a right to vote on key decisions when they arise.

Dividends are payments made to shareholders from a company's profits but not all businesses pay dividends, the directors may decide to keep some cash for development. UK company dividends are usually paid twice yearly and shareholders can either take cash or choose to use the money to buy more shares in the company.

One of the big positives for those investing over long term is reinvested dividends which allows you to benefit from compounding.

If you want to value shares, then you need to do so using one of the typical valuation methods. The most commonly used is the price-to-earnings ratio or P/E. This compares a company's share price to the profits it makes per share.

A company with a P/E of 10 is being valued at a lower level than a company with a P/E of 20. This maybe because it is judged to have poor growth prospects or because the market has overlooked it. Always compare share valuations to the kind of company that it is, its peers and the market as a whole.

What makes shares go up or down?

Over the long term, the single most important factor is rising profits, or the expectation of them. Several other factors influence price, though.

If the overall stock market is rising, many shares will be dragged up in its wake and if stockbrokers are optimistic about a particular sector – property for example – then shares in companies in the property sector will benefit.

Remember that the market looks at the future, not the past, so brokers and big investors are far more interested in how a company is expected to do in the years ahead than how it performed last year. Sentiment is a key driver when it comes to share prices. If the market doesn't like a company for whatever reason, its share price can remain depressed even as it continues to grow profits.

In contrast, the market may have decided that it loves a company - these are often called story stocks - and rate it more highly than you would expect. These anomalies in valuation can provide opportunities for investors.

Should you invest in funds or investment trusts?

Picking individual shares is not for everyone. You need to make sure you research companies very carefully, learn to understand how to read their balance sheets and financial statistics and don't just get swept along by what the hot tips of the moment are. The classic share investor's mistake is to buy too few different companies. A report by specialist magazine Investors Chronicle said the ideal number of shares for a portfolio is 15, spread across different sectors.

A simple way around this is to invest in either active funds or investment trusts, where a fund manager chooses a basket of shares for you, or in passive tracker funds or exchange traded funds, which follow an index up or down. Fund managers will tell you that the advantage of an active fund is their expertise but you actually have to choose the right manager to benefit from this. Many consistently fail to beat their benchmark and still levy their fees - a handful do actually outperform year after year.

Of course, investing in shares and funds does not have to be mutually exclusive. One investing idea is to build a core portfolio of funds and use a smaller part of your portfolio to add some spice by dabbling in picking individual shares.

How do I buy and sell shares?

When a company first floats on the stock market, such as Royal Mail did, it is sometimes possible to apply for shares directly from that firm. This is known as an Initial Public Offering (IPO).

Generally, however, shares are bought through a stockbroker or a financial services firm. Many of these firms allow investors to buy and sell shares online simply by filling out an online form. Investors can also buy and sell shares over the phone by ringing a stockbroker or a financial adviser.

The best bet for a DIY investor is one of the many investing platforms available, ranging from those that offer funds only, to those that allow you to invest across shares, funds, investment trusts, bonds and more.

These will allow you to set up an account online and then pay in a lump sum to invest how you choose, or sign up for regular direct debit monthly payments into a selection of investments - or do both. Most platforms are very simple to use and easy to get used to. They will offer varying degrees of tips, analysis, tools and service.

How do I choose which stockbroker to use?

This depends on what service you want. Investors who just want to trade online may be tempted to seek out the cheapest provider. That is fine, as long as the firm is regulated by the Financial Conduct Authority.

Some investors may prefer dealing with a firm whose name they recognise and websites differ too, so it is important to find one that is easy to navigate. Investors who are looking for advice as well as trading services should talk to a range of brokers before making any firm decision. Look for a broker that you trust and respect.

How long should I hold shares?

Shareholders can be divided into traders and investors. Traders buy and sell shares frequently, hoping to make quick profits. Investors hold on to their shares for at least five years and generally a lot longer.

Long-term investment in shares should prove rewarding, particularly when investors reinvest their dividends to acquire more shares. Sometimes, however, if a share has risen significantly, investors might choose to sell some of their stock. This is known as top-slicing.

What should I consider before buying?

The first point to consider is whether you can afford to lose the money. Shares are not risk-free investments, so if you need the cash to pay the mortgage or school fees, tread very carefully. It is also useful to do your own research.

Read a company's latest annual report, look at its website and seek advice from your broker. Think about your investment aims and your time horizon, too. This will influence the type of shares that you want to buy. Big, stable companies with decent dividends tend to deliver long-term rewards. Smaller, riskier companies can offer short-term excitement.

Finally, if you do fancy trading, rather than investing, it can be helpful to set price targets so that you sell at least some of your shares once you have made a profit.

Self-invested Personal Pension (SIPP)

A self-invested personal pension (SIPP) is a DIY pension in that you can invest almost anywhere you like and choose your own investments. However, you will need to understand investing, must carry out research and you must be comfortable managing your own investment portfolio and choosing your own investments.

Like other pensions the SIPP is protected from the tax man, this means for example a basic rate taxpayer paying 20% invests £100 it only costs £80 and when you come to take your money anytime from age 55 you will be able to take 25% tax free and the rest will be taxed as income.

The experts advise that if you're new to the investment game, it's a good idea to buy share-based funds rather than individual shares - this will reduce your risk exposure if an individual company fails. To reduce your risk even further, buy a range of different funds.

Investments which can be held in a SIPP include:

- Unit trusts and Open Ended Investment Companies (OEICs)
- Shares
- Exchange traded funds (ETF)
- Investment trusts
- Gilts and corporate bonds
- Cash
- Commercial property

How much can be paid into a SIPP each year?

- **Earners**

You can contribute 100% of your annual earnings before tax up to a limit of £40,000 for 2017/18. If you earn more than £150,000, the amount you can contribute is gradually reduced at a rate of £1 for every £2 earned over £150,000, until the tax-free limit hits £10,000.

- **Non-earners**

You can contribute up to £3,600 per tax year and still get basic-rate tax relief. So, non-workers can pay in £2,880 per tax year, to which the taxman will add £720. In addition to your annual allowance, there's also what's known as a 'growth time allowance' - this is the amount you can save tax-free into your pension in your lifetime. It's currently £1,000,030.

You can start a SIPP from scratch or transfer money in.

You can either start your SIPP from scratch with money that hasn't been held in a pension, or you can move it from an existing pension.

- **New contributions**

If you don't have a pension already and decide you want to start investing in a SIPP, you can open one either by making monthly contributions, or if you have a big lump sum you can invest that.

- **Transfers from other pensions**

If you already have a few pension pots, you can consolidate them all into a SIPP so they're in one place (or just one or two if you wish). Or, if you're not happy with your current pension plan, this could be an option.

If you do this, make sure you check there aren't any penalties for leaving your existing pension and that it'll actually be beneficial.

Bear in mind that unless you've opted out, or are self-employed, you already will have or will soon have a personal pension thanks to the new pension auto enrolment rules. Here, your employer contributes to your pension as well, so this should be your first option if it's a choice between the two.

When can you take money out of a SIPP?

There used to be restrictions to how you could take your pension money, but since April 2015, you can take money from your pension from age 55 when you want, how you want.

For a lot of people, gaining access to their pension at age 55 will be too early, so you can just keep it in your pension until you need it. Some people however will want to take all their pension money at once. If you do this, the first 25% will be a tax-free lump sum and you'll get charged tax on the rest as if it were income.

Other options include:

- Leave it invested in your pension for when you need it
- Take 25% tax free, then buy a flexible income drawdown product
- Take 25% tax free, then buy an annuity

Can a SIPP be inherited?

If you die before taking any money out of your pension, it'll be passed on tax-free to any beneficiaries. But there are a few caveats:

If you die before age 75

Your beneficiaries can take the whole pension fund as a lump sum tax-free. Dependants (but not other beneficiaries) can also choose drawdown or to buy an annuity to take an income tax-free.

If you die after age 75

Your beneficiaries have three options:

1. Take the whole fund as cash in one go: If they choose this, the pension fund will be subject to their income tax rate at the time.

2. Take a regular income: If they chose this through income drawdown or an annuity (option available only to dependents), the income will be subject to income tax at their income tax rate at the time.
3. Take periodical lump sums: If they choose this, the lump-sum payments will be treated as income, so subject to income tax at their income tax rate at the time.

Make sure your SIPP isn't being eaten away by charges

SIPP charges change from provider to provider and some can be expensive. You need to think about what sort of investor you're going to be so you don't get stung.

Take a moment to think about the investments you'll hold, how much they'll be worth and how often you'll change them, before working out which provider will be cheapest for you.

Charges going in vs charges on the way out

You need to look at how much the SIPP will cost you while you're putting money into it, and then how much the platform will charge you when you want to get access to your money again.

There's no point having a really cheap platform for your money on the way in, which costs you the earth when you come to take it out. However, like with a lot of things, how much this will impact you will depend on how much money you're investing and for how long.

The main charges you need to keep an eye out for are:

- **Annual administration charge**

Also sometimes referred to as the 'platform fee', this is a charge for having the SIPP wrapper. It can be either a flat fee, for example £80/yr, or a percentage - which is usually tiered in accordance to your investment - for example, 0.30%. Some platforms don't charge anything for this.

- **Annual charges for funds and shares**

Some platforms have an annual charge for funds and shares. This can either be a percentage, for example 0.45%, or a flat fee - for example, £80/yr. Sometimes the flat fee can go towards your trades. You'll often find the platforms that charge a percentage fee here, don't also have an annual administration charge. Yet some platforms charge an annual fee for investing in funds and shares, as well as a charge every time you trade. So if you know you're going to be an active trader, you want to look for a platform with the lowest annual and trading charges.

- **Dealing charges**

Each time you buy and sell an investment you pay a fee. This can be up to £12.50 per trade. Some platforms will charge you for shares, but not for funds.

- **Exit/transfer fees**

If you're moving money into a SIPP from another pension or shares you may be charged (and if you move it elsewhere). This can cost around £50.

- **Income drawdown charges**

When it comes to taking the money, if you want to start drawdown on your SIPP, you'll have to pay a charge. This can cost anything up to £300 for the initial set-up, then up to £150 a year in ongoing charges.

Are SIPPs safe?

Usually with SIPPs, the broker you buy it through, e.g. Hargreaves Lansdown, doesn't hold any of the cash; it simply acts as a conduit for you to put the money into whatever funds or investments you want. Therefore, in the unlikely event it went bust, your money should be OK, and still held by the fund manager or bank it resides with. The protection applies should any of those go into default.

If the operator of a fund, trust or other investment vehicle you've put money into goes bust, you're eligible to get your money back, up to a maximum of £50,000.

If you decide to hold the money as cash within the SIPP, you're then normally covered under the standard £85,000 cover per person, per institution rule, the same as normal savings. Ask your individual SIPP provider which bank the cash is held in (often it spreads it around up to five). Then check whether any other savings you may have are in institutions linked to those used for the SIPP cash, as cumulatively you'll only get up to £85,000 protection in each.

If you put money in stocks and shares or funds that invest in them, then you've got a risk-based investment, NOT savings, and a totally different FSCS protection applies. Critically, FSCS protection for SIPPs is very complex - so this is just a general guide, always check with your provider. It's very important to understand that any protection only applies if you lose money because the investment's product provider goes bust - in this case the fund manager that you've bought into through the SIPP.

If the underlying investment goes bust, for example, if you have shares in a company and it goes kaput, or you've bought a fund and it performs poorly, then you've no protection as that's the nature of investing.

Growth Funds

What is a 'Growth Fund'

A growth fund is a diversified portfolio of stocks that has capital appreciation as its primary goal, with little or no dividend payouts. The portfolio mainly consists of companies with above-average growth that reinvest their earnings into expansion, acquisitions and/or research and development

(R&D). Most growth funds offer higher potential capital appreciation but usually at above-average risk.

Breaking down 'Growth Fund'

This high-risk, high-reward mantra makes growth funds ideal for those not retiring anytime soon. Investors need a tolerance for risk and a holding period with a time horizon of five to 10 years. Growth fund holdings often have high price-to-earnings and price-to-sales multiples. This trade-off from investors is the above-average revenue and earnings gains these companies produce.

Main Type of Mutual Fund

Growth funds, along with value funds and blend funds, are one of the main types of mutual funds. They are more volatile than funds in the value and blend categories. Growth funds are typically split by market capitalization, with funds representing small-cap, mid-cap and large-cap groupings.

Large-cap growth funds are the biggest class of growth funds with a 9.9% market share and $2.2 trillion in assets. This trails only large-blend funds, which offer investors value and growth. Large-blend funds have a 15.9% market share. Foreign large-cap growth funds rank 11th of all mutual fund classes with a 2.3% market share.

Foreign growth funds are becoming more common for investors who want to take advantage of global growth. These funds invest in international stocks posting strong revenue and earnings growth. For international growth funds, technology and consumer sectors are the most common. Large internet names such as Tencent, Baidu and Alibaba can be found among the top 10 holdings for many international growth funds.

The Largest Growth Fund

As of 2018, the largest growth fund is the Growth Fund of America from American Funds. This mutual fund has $180.8 billion in assets under management (AUM). It continues to perform well with an average gain of 8.5% annually over the last 10 years.

The Growth Fund of America has Amazon.com Inc. as its largest holding, representing 5.8% of assets. Technology stocks represent the largest sector weighting at 27.3%. Consumer discretionary stocks follow closely behind with 20.8% of assets.

Technology stocks are a major part of growth funds. With high growth and high price-to-earnings and price-to-sales valuations, technology stocks fit the criteria perfectly for growth funds.

Performance of Growth Funds

With the bull market of the past decade, growth stocks have been on a tear, lifting the returns of growth funds compared to their value and income kindred. Large growth U.S. equity funds have returned 13.5% annualized for the past five years, making them one of the best-performing types of asset classes. By contrast, large value U.S. equity funds, which invest in slower-growing, low-priced stocks, appreciated 9.5% for the same period, and high-yield bonds offered only 3.34%.

ISA's Individual Savings Accounts

An ISA is a tax efficient pot in which to have cash savings and investments in equities, bonds and collectives. There are limits on the amount of cash you can transfer in and there is no tax payable on the interest you earn. For the current tax year 2018-2019 the maximum amount you can put into an ISA is £20,000.

A cash ISA is simply a tax-free savings account whereas a stocks and shares ISA is a tax efficient investment account that enables you to put money into a range of different investments. These include unit trusts, open ended investment companies, and investment trusts and include government bonds and corporate bonds. It is also possible to buy individual company shares and put into your stocks and shares ISA. Stocks and shares ISA are higher risk as investments can go up or down in value.

Cash ISA's can be transferred from providers, usually when interest rates drop dramatically when fixed terms come to an end. The transfer is completed through the new receiving provider. It's important to note that transfers should not be done by withdrawing the investment and re investing in a new account as this would remove the tax-free status of the investment.

A junior ISA is a long-term tax-free savings account for a child who is under 18, live in the UK and are not entitled to a Child Trust fund account. There are two types, a cash ISA and a stocks and shares ISA and a child can have both however the total amount that can be paid into both combined is £4,260.

Other types of investments – Bonds, investment trusts and unit trusts

Bonds come in many different varieties, and here we will cover just the most common types.

Government Bonds

Government bonds can be issued by national governments as well as lower levels of government. At the national or federal level, these government bonds are known as "sovereign" debt, and are backed by the ability of a nation to tax its citizens and to print currency. All debt issued by the U.S. government is regarded as extremely safe, often referred to as "risk-free" securities, as is the debt of many stable countries. The debt of developing countries, on the other hand, does usually carry substantial risk. Like companies, countries can therefore default on payments. Credit ratings agencies also rate a country's risk to repay debt in a similar way that they issue ratings on corporate bond issuers. Countries with greater default risk must issue bonds at higher interest rates – which essentially increases their cost of borrowing.

Corporate Bonds

The other major issuer of bonds are corporations, and corporate bonds make up a large portion of the overall bond market. Large corporations have a great deal of flexibility as to how much debt they can issue: the limit is generally whatever the market will bear. A corporate bond is considered short-term corporate when the maturity is less than five years; intermediate is five to 12 years, and long-term is over 12 years. Corporate bonds are characterized by higher yields than government securities because there is a higher risk of a company defaulting than a government. The upside is that they can also be the most rewarding fixed-income investments because of the risk the investor must take on, where higher credit companies that are more likely to pay back their obligations will carry a relatively lower interest rate than riskier borrowers. Companies can issue bonds with fixed or variable interest rates and of varying maturity. Bonds issued by highly rated companies are referred to as investment grade while those below investment grade are junk or high-yield.

Asset-Backed Securities

A third category of bonds is issued by banks or other financial sector participants and are referred to as asset-backed securities or ABS. These bonds are created by packaging up the cash flows generated by a number of similar assets and offering them to investors. If such a bond is backed by a number of mortgages, they are known as mortgage-backed securities or MBS. These bonds are typically reserved for sophisticated or institutional investors and not individuals.

Unit trusts and OEICs are by far the most popular investment funds. With a unit trust, a fund manager buys bonds or shares in companies on the stock market on behalf of the fund.

The fund is split into units, and this is what you'll buy. The fund manager creates units for new investors and cancels units for those selling out of the fund. The creation of units can be unlimited, hence why the fund is 'open-ended.'

The price of each unit depends on the net asset value (NAV) of the fund's underlying investments and is priced once per day. This means that the value of the units you buy directly reflects the underlying value of the investment. OEICs operate in a similar way to unit trusts except that the fund is actually run as a company. It therefore creates and cancels shares rather than units when investors come in and go out of the fund, but they still directly reflect the value of the assets that your fund manager has invested in.

Investment trusts are publicly listed companies that invest in financial assets or the shares of other companies on behalf of their investors. When you invest you are buying shares in an investment trust, the value of which fluctuates based on:

- The underlying value of the assets they own
- The supply and demand for their shares

How does an investment trust work?

When you purchase shares in an investment trust your money is pooled with other investors and used to purchase a diverse range of shares and assets. In simple terms:

1. You buy shares in an investment trust
2. The money from your shares is put into one big pot, with the money from other shareholders - this is called the fund
3. The fund is then used to buy shares and assets by the fund manager
4. The value of these shares and assets fluctuate and are bought and sold over time
5. You sell your shares for the market price

Investment trusts tend to be more stable than buying shares in a single company because your money is invested across a variety of companies. This does not eliminate the risk to your money but means that the performance of a single share has less impact because there are many others to counteract it.

For more information on Investing Your Money please contact us.