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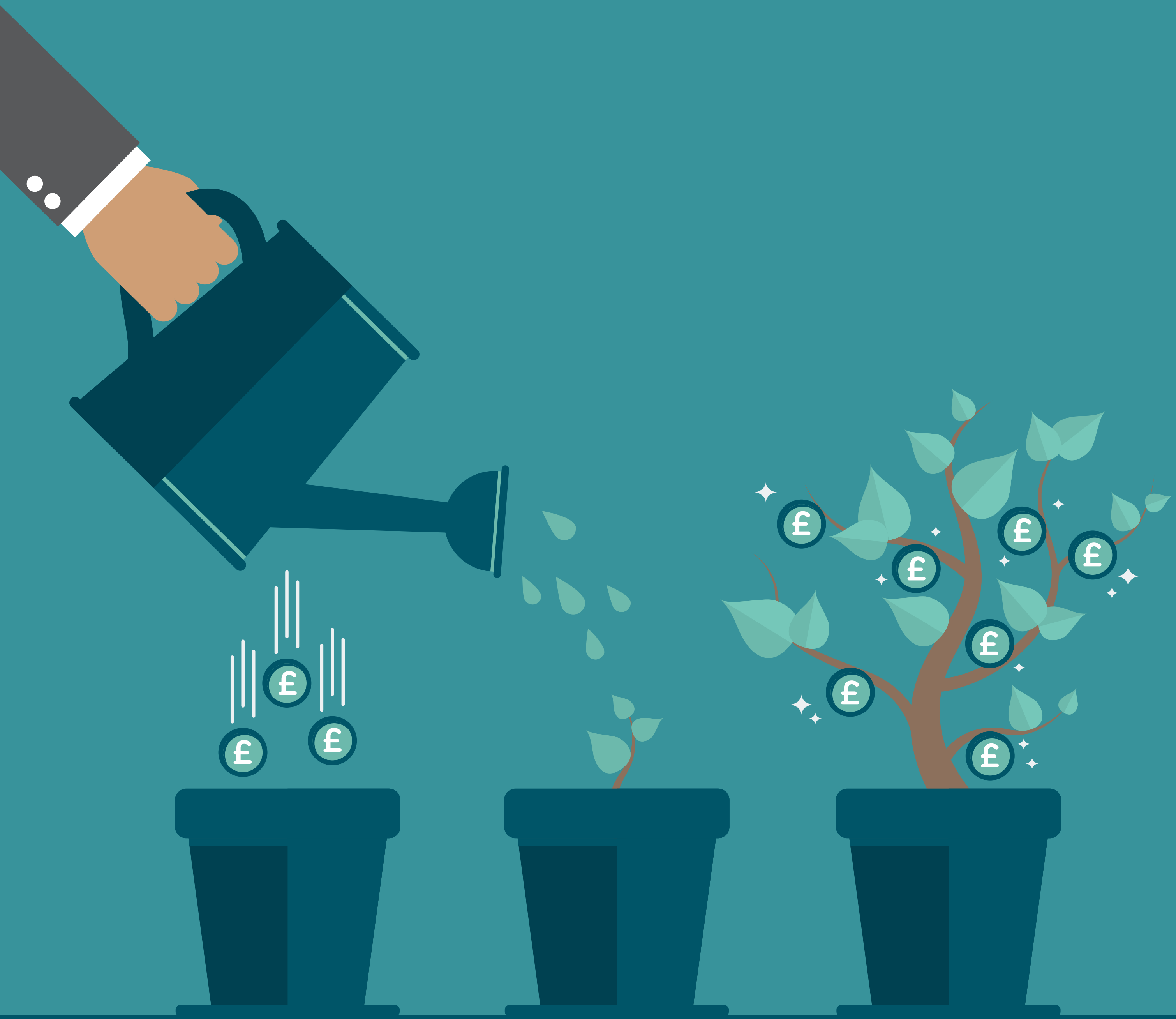

Guide to the Basics of Investing

MOGERS DREWETT
Financial Planning

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Guide to the basics of investing

Some basic guidelines to help you maximise the potential return from your money.

When you have taken the time and effort to set money aside, you want to be sure those savings are working for you as hard as they can. This guide lays out some of the main points you may wish to consider when planning what to do with those savings, and some general rules you might want to follow to keep them on track to meet your goals.

Asset classes

There are 5 main types of investment, although there are many sub-categories within each one.

Cash

This includes savings accounts, cash ISAs, NS&I Premium Bonds and also very liquid, short term debt to Government (known as Treasury Bills) and companies (known as commercial bills). All cash investments are very liquid, i.e. they can be used to spend very quickly. The only growth is through a rate of interest and the spending power of cash can be eroded over time if inflation is higher than the rate of interest paid.

Fixed Interest

These are loans to Government, such as gilts, or companies. They are usally until a fixed date (known as the redemption date), for an interest rate (known as the coupon), for a fixed amount that is given back at the redemption date (known as the par value). After they have been issued, they can be traded and the price may be higher or lower than the par value. The main factors that affect the price are inflation, interest rates and the creditworthiness of the companies or Governments.

Property

Includes residential (houses) and commercial (offices, warehouses, shops etc) property that are rented out for investment purposes. The main returns are through rent and the capital appreciation in the value of the property.

There are always costs associated with being a landlord, such as insurance, mandatory checks, maintenance of the property etc. which reduce the returns. There is also the risk of periods where the property is not rented out, known as void periods. Buying and selling property tends to be expensive and slow, which can create problems if cash is needed quickly.

Equities

Also known as shares, they give part ownership of a company. Returns come from a share of the profits as a distribution, known as a dividend, or from the increase in value over time due to the expectation that the company will produce more profit. Shares can be listed on a stock exchange which means that valuing the shares and trading is very easy. Shares held privately are not listed, which makes valuing and trading more difficult.

Alternative Investments

Include items such as collectibles, works of art, wine, commodities and crypto currencies. These items are often such subject to trends or fashions, which means that values can move up and down to a large extent, making them much more risky than the other forms of investment.

Risk

Risk has several definitions depending on the context in which it is being considered. In the context of investing, it is the chance and extent of capital loss.

Risk is a spectrum, starting with cash which has no risk of capital loss but a risk of losing purchasing power as a result of inflation, and finishing with alternative investments which could be worth nothing.

"When you have taken the time and effort to set money aside, you want to be sure those savings are working for you as hard as they can."

Using different combinations of the 5 asset classes gives different levels of risk. There is an optimum mix of asset classes which provides the best return for a given level of risk. This is known as the efficient frontier.

There are three important aspects to risk:

"Investment trusts are a popular investment for children."

Risk Tolerance – how much risk are you comfortable taking, for example would the thought of losing money keep you awake at night or are you comfortable with the idea of that an investment could lose money in no need to have 'the' here pursuit of higher return?

Risk Need – how much risk do you need to take, for example could you achieve your goals with a modest return or do you need a higher return?

Risk Capacity – how much risk can you afford to take, for example, would the loss of some of your capital mean that you could not afford to meet your living costs or would it have little impact?

It is likely that these three aspects will give different results and they all need to be taken into account when deciding how much risk you should take.

Common investment vehicles

Investment Trusts

Investment trusts are a popular investment for children. They are a type of collective fund that is listed on the London Stock Exchange, and are invested across a range of assets in order to diversify risk. There are many different underlying investment strategies available – from emerging markets to solid, global blue-chip stocks and even corporate bonds – so you can pick and choose the type of fund you require. They have some inherent advantages in that they tend to be cheaper than other forms of collective equity investment. In addition, they are accessible for smaller savers; using specific savings products, you can invest at a low minimum investment level – perhaps as low as £25 or £50 per quarter.

Unit Trusts/Open Ended Investment Companies

These are also collective funds. Again, they are available from a broad range of fund managers offering a wide variety of different investment strategies, including bonds, equities, and alternatives. These tend to have slightly higher minimum investment levels than investment trusts. Savings plans usually start around £50 per month, although some providers offer lower minimum investments to encourage smaller savers.

Individual Holdings

This is a higher-risk option. Put simply, if one company goes bust in a collective fund, an investor may lose perhaps 1-2% of their money. However, if that company is the only share that the investor owns and it goes bust, the investor loses all their money.

Common tax wrappers

Tax can have a significant impact on the returns that you generate. There are several accounts or "wrappers" available to help manage the tax you pay on your investments.

"Money can be withdrawn from an ISA at any time without losing the tax breaks."

Individual Savings Accounts (ISAs)

ISAs serve as a 'wrapper' to fully protect savings from tax, allowing individuals to invest monies up to maximum limits (by way of regular or single amounts) each tax year in a range of savings and investments and pay no personal tax at all on the income and/or profits received.

The main ISA benefits are:

- No personal tax (income or capital gains) on any investments held within an ISA
- Income and gains from ISAs do not need to be included in tax returns
- Money can be withdrawn from an ISA at any time without losing the tax breaks

There are five types of ISA:

Stocks & shares - in the form of either individual shares or bonds, or pooled investments such as open-ended investment funds, investment trusts or life assurance investments.

Cash - usually containing a bank or building society savings account.

Innovative Finance (IF-ISA) - in the form of loans made through peer-to-peer (P2P) platforms.

Lifetime ISA (LISA) - for those aged between 18 and 40 designed to help them save up for their first home or retirement.

Help to Buy – aimed at helping first time buyers to save for their mortgage deposit. Available until 30th November 2019. It is not possible to subscribe to both a cash and a Help to Buy ISA in the same tax year

Investment Bonds

An investment bond is technically a single premium life assurance contract although the life cover aspect is only nominal. Bonds are collective investments in which the investments of many individual investors are pooled. This pooling enables relatively small investors to benefit from the economies of scale made available to institutional fund managers.

"Bonds are collective investments in which the investments of many individual investors are pooled."

The minimum lump sum is usually £5,000 but this may be higher or lower depending on the provider. The maximum limit will be set by the provider.

General Investment Accounts (GIA)

Although a GIA does not shield the underlying investments from tax, these accounts can allow investors to make use of their available tax allowances each year.

Cost

Alongside tax, costs have the biggest impact on the returns generated. The main costs to consider when considering how to invest your savings are:

Transaction costs – these occur when purchasing or selling the investment. Examples are stamp duty, legal costs, broker commissions etc.

Management Costs – these cover the management of the investments by a third party. Examples would be an investment manager, rental manager or some other portfolio manager.

Adviser costs – these are paid to a third party to advise you on suitable investments where you do not have the necessary experience. Examples would be surveyors, financial advisers or relevant expert.

Custody or storage costs – many forms of investment will require storage somewhere safe or will be held by a third party on your behalf to avoid the risk of losing the ownership documents. Examples would be wine, gold, deed storage for property or platform costs.

Whilst it is attractive to minimise costs by taking on much of the responsibility for these individual elements yourself, they can be time consuming and carry significant risk. Ensuring that you are getting the correct level of service for the best price is important.

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Top Investment Tips

Build a Firm Base

A general rule of thumb is that, before you do anything else, you should build up an amount equalling between three and six months’ salary and place it in a deposit account. This should be easily accessible so that you can get hold of what you need, should an emergency arise.

There are two benefits to having an amount set aside in this way. First, you can feel reassured that, should the worst happen – perhaps if you need to undertake significant repairs to your house or car or you lose your job – there is a fund readily available to help you financially whilst you deal with the other issues. Second, this frees you up to make the right decisions about any additional savings. If you invest in the stock market, for example, the value of that investment can go down as well as up. It is therefore no place for money that you might need in an emergency. Building funds on deposit means you can then begin to consider longer-term investments without the worry that you might have to take money out of the market at the wrong time. (But more of that later...)

Holding money on deposit does not, however, mean you have to compromise on return. Careful study of the "best buy" lists and interest rate surveys can help you maximise the interest you earn on this money. You can also spread your money between a number of accounts; some on immediate access; some on 30 days' notice; some perhaps even on 90 days' notice. Spreading your money between institutions also helps you to make the most of the guaranteed cover provided by the Financial Services Compensation Scheme (FSCS).

"Careful study of the "best buy" lists and interest rate surveys can help you maximise the interest you earn on this money."

Diversify

If you are averse to the idea of exposing your entire portfolio to the whims of the stock market, you can further cushion your investment by spreading money across different asset classes. There are not only equities to consider; there are also other asset classes such as property, gilts, and corporate bonds. In this way, when equities are suffering, one of your other choices might be doing better and can compensate for some of that loss. Even if they all have a bad day, they will not all perform equally badly.

Buy Low, Sell High

This is a basic tenet of investing that is, however, a lot more difficult than it looks. Calling the top or bottom of markets has proved impossible to do with any consistency, even for experts – if it were easy, there would be many more Warren Buffetts around. Therefore, we would not recommend that you try and turn your hand to market timing.

Trying to "buy low and sell high" has been the undoing of many investors over the years, even though some of the cautionary signals are relatively easy to spot. For example, if a lot of people are talking about a sector that has recently increased significantly, and particularly if they are saying you will miss out unless you get in now, then it's likely that any potential gains are already accounted for in the price. Getting in "now" might make you a little money as the sector peaks, but the downside could be harsh and sudden. As the technology bubble demonstrated very well, you should ignore hype, particularly all of your neighbours, friends and relatives are talking about it as well.

"Getting in "now" might make you a little money as the sector peaks, but the downside could be harsh and sudden."

Conversely, if a sector has fallen a long way, it might be time to invest. Hype works just as much on the downside as it does on the upside. Markets are very prone to herd behaviour – the art is to spot it and make sure you do the opposite. Baron Rothschild is believed to have advised investors to buy when there is "blood in the streets" – that is, when everyone is focusing on the downside – and, historically, times of maximum pessimism have been amongst the best times to buy.

Market downturns do not happen without reason, but they usually result in good companies and bad falling together. Nevertheless, if you want to do well, you need to be able to differentiate the good companies from the bad ones – and also be aware that things can get worse before they get better.

If you are unsure or inexperienced, opt for a collective investment such as a unit trust or an open-ended investment company (OEIC). In this way, if one chosen company does turn out to be a bad investment, not all your money has to go with it.

Save Monthly

Not all of us have the time to research and monitor markets. However in pursuit of the good and bad times. However, there is a way to benefit from the swings and roundabouts of the stock market without even thinking about it. If you stagger your investment, you benefit from "pound-cost averaging". This allows you to buy shares over a period of time at a range of different prices as the market moves up and down. A monthly savings plan - particularly within a tax-efficient wrapper like an ISA—is a particularly efficient way to do this because it disciplines your budgeting. When prices are high you will buy fewer shares, but when prices are low, you get more units for your money. Your average buying price is therefore likely to be lower in volatile markets and will benefit overall when markets rise again. You don't have to worry about the right time to invest – or the wrong time, for that matter – and you can continue the good savings habits you created whilst building your deposit account cushion.

> "If you are unsure or inexperienced, opt for a collective investment such as a unit trust or an open-ended investment company (OEIC)."

Look to the Long Term

Many investors focus on investing in equities because, over the long term, they have traditionally outperformed all other asset classes. However, by "long term", we mean at least five years and preferably longer. The drawback to equities is that, in the short term, stock market investment is a volatile business and you need to be prepared for the value of your investment to fall from time to time. The trick is to remember why you invested and to look beyond any short-term issues towards your longer term goals.

However, there is one final rule which overrides all of these...

Don't Push Your Luck

Markets are constantly changing. Therefore, just as you prepare your portfolio at the outset, you also have to plan for your final objective. As your goal date moves closer, you might consider consolidating some of your gains in order to ensure that you can actually carry out your plans. After all, you do not want a sudden market downturn to halve your hard-earned savings in the final six months. Better, therefore, to consider moving money out of the stock market bit by bit; you might start two to three years ahead of your goal or, if you are retiring, five or even ten years ahead. Just like monthly savings on the way into the market, gradually moving your money out means the value you will receive will vary as the market moves up and down. However, the price you get will likely be higher than if your entire investment had been hit by a downturn at the last minute. The money you withdraw could then be invested in cash, or perhaps bonds, allowing you to earn interest over the final months or years until you want to access the full amount.

Similarly, during the life of your investment, watch out for market peaks. A good rule of thumb is: if your money doubles, consider taking out half. Switch to cash or put it in a deposit account – then when markets fall, you could buy back into the same investment at a lower price, and benefit a second time as markets recover.

Reviews

Whatever you choose to do with your savings, regular reviews to ensure that they are performing as expected are important. We generally suggest that you review your investments at least annually and also check whether there are better options available or whether the tax or legislation has changed since you set them up which might mean that they may no longer meet your needs.

"The trick is to remember why you invested and to look beyond any short-term issues towards your longer term goals."

Please contact us if you need our help

If you would like help and support with any investment decision, from starting your deposit account through to consolidating your long-held pension plan, please do not hesitate to get in contact with us. Our advice can help you make the most of your money and free your time, allowing you to get on with planning for your future. Please note: the value of any investment can down as well as up and you may not get back the amount you invested.

Meet the Financial Planning team

DANIEL GORNALL

With over fifteen years of industry experience, Chartered Financial Planner Daniel Gornall specialises in providing Independent Financial Advice:

- To those going through divorce or separation – being one of only approximately 35 other financial professionals in the UK to hold the Resolution Specialist Accreditation as a financial expert in divorce work.
- For individuals and families to help them plan to achieve their desired future lifestyles

Qualifications

- Fellow of the Personal Finance Society
- Chartered Financial Planner
- Resolution Accredited Specialist
- Advanced Diploma in Financial Planning
- Certificate in Equity Release
- Certificate in Mortgage Advice
- Certificate in Investment Operations

SEAN McCABE

Chartered Financial Adviser, Sean McCabe started his career in finance in 1988 and specialises in financial planning for:

- Later Life – including funding for care home
- Retirement & Pension Planning
- Investment after inheritance
- Trust & Trustee Investments
- Using your property to support you in retirement

Sean is also a Dementia Friend and was a founder member of the Frome Dementia Action Alliance which is looking to make his hometown of Frome a Dementia Friendly Community

Qualifications

- Chartered Financial Planner
- Member of the Society of Later Life Advisers (SOLLA)
- Advanced Diploma in Financial Planning
- Pension Transfer Specialist
- Certificate in Equity Release
- Certificate in Mortgage Advice

JON STEVENS

Jon is a Chartered Financial Planner with more than 25 years' experience in the financial services profession and specialises in financial planning and investment strategies for:

- People in later life and their families
- Personal injury claimants and their legal advisers
- Anyone wishing to make financial provision for someone with Special Needs
- Deputies Attorneys & Trustees

Qualifications

- Fellow of the Personal Finance Society
- Chartered Financial Planner
- Member of the Society of Later Life Advisers (SOLLA)
- Advanced Diploma in Financial Planning
- Certificate in Discretionary Investment Management
- Certificate in Financial Planning and Lifetime Mortgage Activities
- Certificate in Financial Planning and Long-Term Care Insurance
- Affiliate of the Society of Trust and Estate Practitioners (STEP)

STUART DOUGHTY

Founding Director Stuart Doughty has worked in the finance industry since 1985 having gained blue chip experience with Barclays, Aviva, and Eversheds prior to moving to Cavendish Grant (Bath) in 2001. Stuart specialises on financial planning for:

- Business owners – including succession planning
- Private client investment and pension planning
- Recipients of compensation awards and personal injury settlements

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