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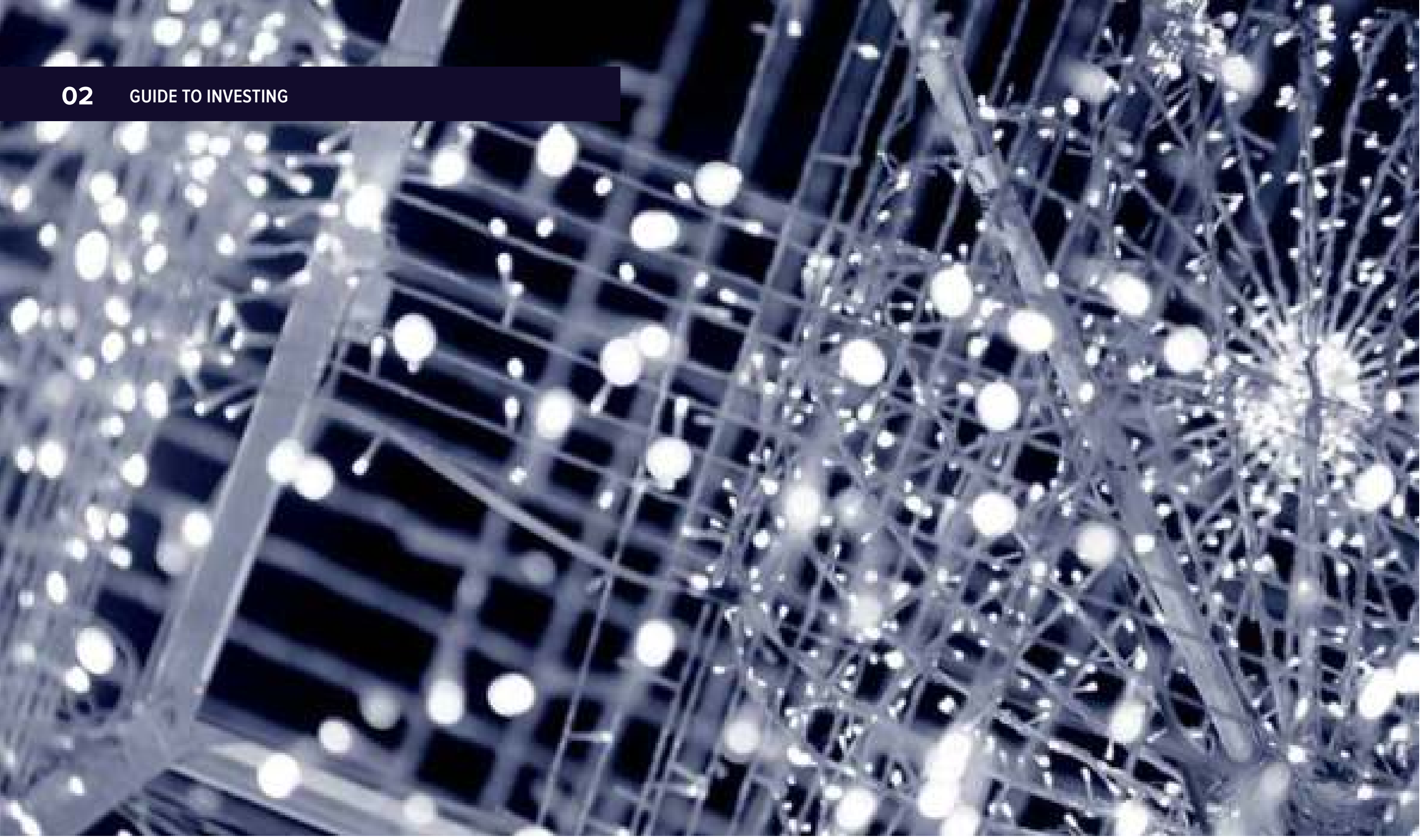
Guide to

Investing

Creating and maintaining the right investment strategy to secure your financial future



Guide to Investing

Creating and maintaining the right investment strategy to secure your financial future

Welcome to our *Guide to Investing*. It might seem complicated – and it isn't for everyone – but investing can make your money work a lot harder. Whatever stage of life you've reached and whatever plans you may have for the future, you want your money to earn the best return possible without taking undue risk. That's why it's important to invest in a way that's right for you and that will meet your goals.

By setting aside some of your money now in investments that could appreciate over time, you'll set yourself up for greater financial security in the future. Whether you want to build a pension for retirement, save a deposit for a house or generate extra income to cover an expense, any savings you may have been able to accrue that are not required to finance your day-to-day living may provide a more substantial return if you invest them.

Whether it's a large sum or a small amount, there are many different ways to invest to suit most people. Once you've made the decision to invest, you can either invest a lump sum or invest monthly to build up your investments over time. In broad terms, those with a medium to long-term investment goal – five years or more – should consider stocks and shares given the historically higher returns offered by stock markets and to protect their savings against the impact of inflation.

TIME TO IDENTIFY WHICH INVESTMENT OPTIONS ARE RIGHT FOR YOU?

Whether you are looking to invest for income or growth, we can provide the quality advice, comprehensive investment solutions and ongoing service to help you achieve your financial goals. To identify which investment options are right for your individual circumstances or to find out more, please contact us – we look forward to hearing from you.

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Reviewing your needs and goals

Take the time to think about what you really want from your investments

The sooner you start investing, the better off you will be. This is a simple truth, and it is based on the fact that even the most conservative investments grow on a compound basis.

It's well worth taking the time to think about what you really want from your investments. Knowing yourself, your needs and goals, and your appetite for risk is a good start.

1. GOALS

Be clear about what you're investing for. Investing is generally most appropriate for medium and long-term goals (at least five years). If you want access to your money before that, you might want to think about saving instead.

2. PAYMENTS

Before you start investing, first make sure that you can afford your essential living costs, as well as any debts. It's also a good idea to make sure you have some savings to cover emergencies.

3. INVESTMENT RISK

Have a think about how much risk you feel comfortable taking with your money. You should also consider your other financial commitments when deciding how much risk to take. If you don't want to or can't take any risk with your money, then investing may not be for you right now.

4. TIMESCALE

The longer your money is invested, the more opportunity it has to grow in value and reach your goal. Each year, not only will the money you invest potentially grow in value, you'll also potentially get growth on any previous growth. This is commonly known as 'compounding', and over longer time periods it can make a significant difference to the value of your investments.

5. WHAT YOU'LL GET BACK

The final value of your investments will depend on three main factors: how much you pay in, how your investments perform, and how long you're invested for. Generally speaking, the more you pay in, the better your investments perform. And the longer you can keep your money invested, the more you're likely to get back at the end.

6. MIX IT UP

Putting all your money in one type of investment can be a risky strategy. You can help reduce that risk by spreading your money across a mix of investment types and countries. Different investments are affected by different factors: economics, interest rates, politics, conflicts, even weather events. What's positive for one investment can be negative for another, meaning when one rises, another may fall.

7. BE TAX-EFFICIENT

You can do this by putting your money into your pension or using up your Individual Savings Account (ISA) allowance.

8. REVIEW, REVIEW, REVIEW

Make time to regularly review your investments to check they're on track to meet your goals.

Investment objectives – a lifelong process

Protecting your wealth from market ups and downs

If you've got a sufficient amount of money in your cash savings account – enough to cover you for at least six months – and you want to see your money grow over the long term, then you should consider investing some of it.

Investing is a lifelong process, and the sooner you start, the better off you may be in the long run. Regardless of the financial stage of life you are in, you will need to consider what your investment objectives are, how long you have to pursue each objective, and how comfortable you are with risk.

RIGHT SAVINGS OR INVESTMENTS

The right savings or investments for you will depend on how happy you are taking risks and on your current finances and future goals. Investing is different to simply saving money, as both your potential returns and losses are greater.

If you're retiring, for example, in the next one to two years, it might not be the right time to put all of your savings into a high-risk investment. You may be better off choosing something like a cash account or bonds that will protect the bulk of your money, while putting just a small sum into a more growth-focused option such as shares.

MORE CONSERVATIVE INVESTMENTS

You may be a few months away from putting down a deposit on your first home loan. In this case, you might be considering cash or term deposits. You might also choose a more conservative investment that keeps your savings safe in the short term.

On the other hand, if you have just recently started working and saving, you may be happy to invest a larger sum of your money into a higher risk with higher potential returns, knowing you won't need to access it in the immediate future.

DIFFERENT INVESTMENT OPTIONS

If appropriate, you should consider a range of different investment options. A diverse portfolio can help protect your wealth from market ups and downs. There are four main types of investments (also called 'asset classes'), each with their own benefits and risks.

These are:

- Cash – savings put in a bank or building society account
- Shares – investors buy a stake in a company
- Property – investors invest in a physical building, whether commercial or residential
- Fixed interest securities (also called 'bonds') – investors loan their money to a company or government

The various assets owned by an investor are called a 'portfolio'. You can invest directly in these assets, or you may prefer a managed fund that offers a range of different investments and is looked after by a professional fund manager.

DEFENSIVE INVESTMENTS

Defensive investments focus on generating regular income, as opposed to growing in value over time. The two most common types of defensive investments are cash and fixed interest.

Cash investments include:

HIGH INTEREST SAVINGS ACCOUNTS

The main benefit of a cash investment is that it provides stable, regular income through interest payments. Although it is the least risky type of investment, it is possible the value of your cash could decrease over time, even though its pound figure remains the same. This may happen if the cost of goods and services rises too quickly (also known as 'inflation'), meaning your money buys less than it used to.

Fixed interest investments include:

TERM DEPOSITS, GOVERNMENT BONDS AND CORPORATE BONDS

A term deposit lets you earn interest on your savings at a similar (or slightly higher) rate than a cash account (depending on the amount and term you invest for), but it also locks up your money for the duration of the 'term' so you can't be tempted to spend it.

Bonds, on the other hand, basically function as loans to governments or companies, who sell them to investors for a fixed period of time and pay them a regular rate of interest. At the end of that period, the price of the bond is repaid to the investor.

Although bonds are considered a low-risk investment, certain types can decrease in value over time, so you could potentially get back less money than you initially paid.

GROWTH INVESTMENTS

Growth investments aim to increase in value over time, as well as potentially paying out income.

Because their prices can rise and fall significantly, growth investments may deliver higher returns than defensive investments. However, you also have a stronger chance of losing money.

The two most common types of growth investments are shares and property.

SHARES

At its simplest, a single share represents a single unit of ownership in a company. Shares are generally bought and sold on a stock exchange.

Shares are considered growth investments because their value can rise. You may be able to make money by selling shares for a higher price than you initially pay for them.

If you own shares, you may also receive income from dividends, which are effectively a portion of a company's profit paid out to its shareholders.

The value of shares may also fall below the price you pay for them. Prices can be volatile from day to day, and shares are generally best suited to long-term investors, who are comfortable withstanding these ups and downs.

Although they have historically delivered better returns than other assets, shares are considered one of the riskiest types of investment.

Property investments include:

- Residential property such as houses and units
- Commercial property such as individual offices or office blocks
- Retail premises such as shops
- Hotel rooms or hotels
- Industrial property such as warehouses.

Similarly to shares, the value of a property may rise, and you may be able to make money over the medium to long term by selling a house or apartment for more than you paid for it.

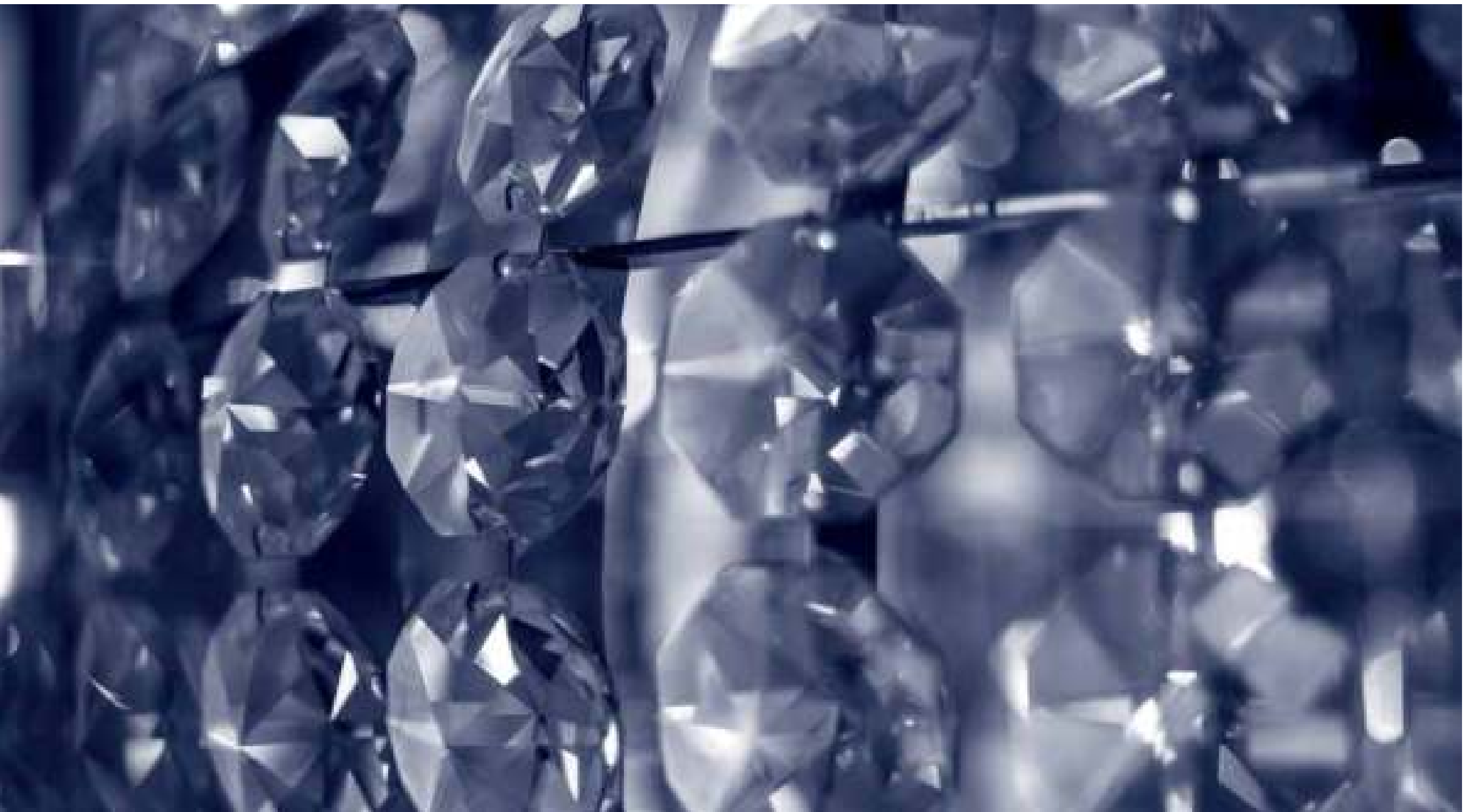
Prices are not guaranteed to rise though, and property can also be more difficult than other investment types to sell quickly, so it may not suit you if you need to be able to access your money easily.

RETURNS

Returns are the profit you earn from your investments.

Depending on where you put your money, it could be paid in a number of different ways:

- Dividends (from shares)
- Rent (from properties)
- Interest (from cash deposits and fixed interest securities)
- The difference between the price you pay and the price you sell for – capital gains or losses.



Understanding investment risk

Making informed decisions to improve your chances of achieving your financial goals

Your investment time frame will determine your risk profile to some extent, as this has a direct bearing on your capacity to take risk. Risk capacity is also influenced by factors such as your age, wealth, and the goals you are saving and investing for. Your capacity for risk is likely to change over the course of your life as your personal circumstances change.

If you understand the risks associated with investing and you know how much risk you are comfortable taking, you can make informed decisions and improve your chances of achieving your goals.

Risk is the possibility of losing some or all of your original investment. Often, higher-risk investments offer the chance of greater returns, but there's also more chance of losing money. Risk means different things to different people. How you feel about it depends on your individual circumstances and even your personality. Your investment goals and timescales will also influence how much risk you're willing to take. What you come out with is your 'risk profile'

DIFFERENT TYPES OF INVESTMENT

None of us likes to take risks with our savings, but the reality is there's no such thing as a 'no-risk' investment. You're always taking on some risk when you invest, but the amount varies between different types of investment.

As a general rule, the more risk you're prepared to take, the greater returns or losses you could stand to make. Risk varies between the different types of investments. For example, funds that hold bonds tend to be less risky than those that hold shares, but there are always exceptions.

LOSING VALUE IN REAL TERMS

Money you place in secure deposits such as savings accounts risks losing value in real terms (buying power) over time. This is because the interest rate paid won't always keep up with rising prices (inflation).

On the other hand, index-linked investments that follow the rate of inflation don't always follow market interest rates. This means that if inflation falls, you could earn less in interest than you expected.

INFLATION AND INTEREST RATES OVER TIME

Stock market investments might beat inflation and interest rates over time, but you run the risk that prices might be low at the time you need to sell. This could result in a poor return or, if prices are lower than when you bought, losing money.

You can't escape risk completely, but you can manage it by investing for the long term in a range of different things, which is called 'diversification'. You can also look at paying money into your investments regularly, rather than all in one go. This can help smooth out the highs and lows and cut the risk of making big losses.

CAPITAL RISK

Your investments can go down in value, and you may not get back what you invested. Investing in the stock market is normally through shares (equities), either directly or via a fund. The stock market will fluctuate in value every day, sometimes by large amounts. You could lose some or all of your money depending on the company or companies you have bought. Other assets such as property and bonds can also fall in value.

INFLATION RISK

The purchasing power of your savings declines. Even if your investment increases in value, you may not be making money in 'real' terms if the things that you want to buy with the money have increased in price faster than your investment. Cash deposits with low returns may expose you to inflation risk.

CREDIT RISK

Credit risk is the risk of not achieving a financial reward due to a borrower's failure to repay a loan or otherwise meet a contractual obligation. Credit risk is closely tied to the potential return of an investment, the most notable being that the yields on bonds correlate strongly to their perceived credit risk.

LIQUIDITY RISK

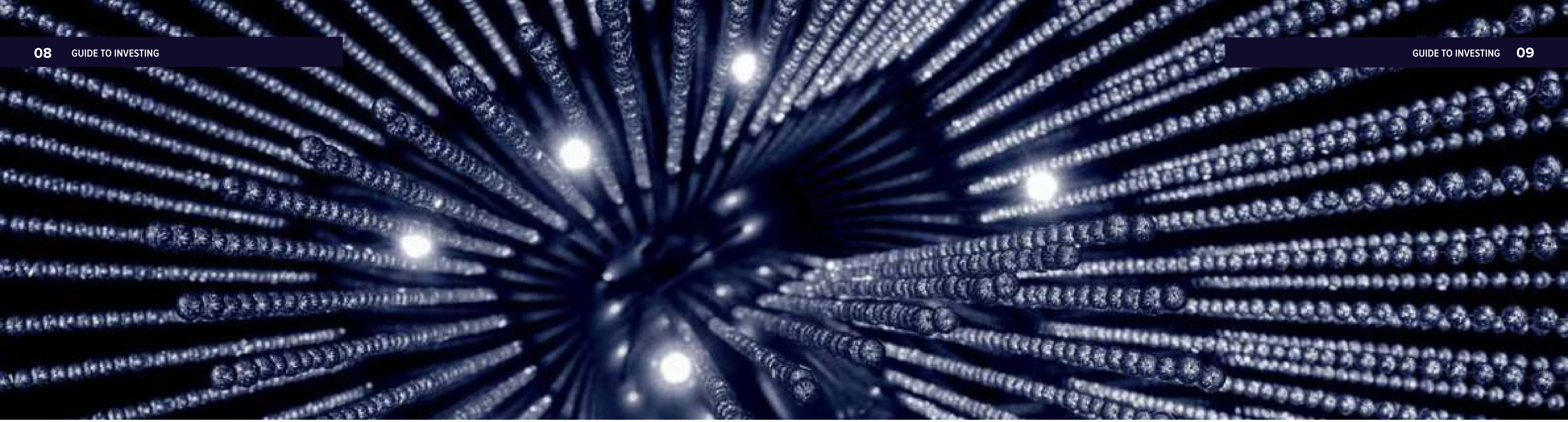
You are unable to access your money when you want to. Liquidity can be a real risk if you hold assets such as property directly, and also in the 'bond' market where the pool of people who want to buy and sell bonds can 'dry up'.

CURRENCY RISK

You lose money due to fluctuating exchange rates.

INTEREST RATE RISK

Changes to interest rates affect your returns on savings and investments. Even with a fixed rate, the interest rates in the market may fall below or rise above the fixed rate, affecting your returns relative to rates available elsewhere. Interest rate risk is a particular risk for bondholders.



Maintaining a diversified portfolio

Spreading risk between different kinds of investments

When you start investing, or even if you are a sophisticated investor, one of the most important tools available is diversification. Whether the market is bullish or bearish, maintaining a diversified portfolio is essential to any long-term investment strategy.

Diversification allows an investor to spread risk between different kinds of investments (called 'asset classes') to potentially improve investment returns. This helps reduce the risk of the overall investments (referred to as a 'portfolio') under-performing or losing money.

With some careful investment planning and an understanding of how various asset classes work together, a properly diversified portfolio provides investors with an effective tool for reducing risk and volatility without necessarily giving up returns.

[1] Cash you put into UK banks or building societies (that are authorised by the Prudential Regulation Authority) is protected by the Financial Services Compensation Scheme (FSCS). The FSCS savings protection limit is £85,000 (or £170,000 for joint accounts) per authorised firm.

If you have a lot of cash – more than six months' worth of living expenses – you might consider putting some of that excess into investments like shares and fixed interest securities, especially if you're looking to invest your money for at least five years and are unlikely to require access to your capital during that time.

If you're heavily invested in a single company's shares – perhaps your employer – start looking for ways to add diversification.

DIVERSIFYING WITHIN AN ASSET CLASS

There are many opportunities for diversification, even within a single kind of investment.

For example, with shares, you could spread your investments between:

- Large and small companies
- The UK and overseas markets
- Different sectors (industrial, financial, oil, etc.)

DIFFERENT SECTORS OF THE ECONOMY

Diversification within each asset class is the key to a successful, balanced portfolio. You need to find assets that work well with each other. True diversification means having your money in as many different sectors of the economy as possible.

With shares, for example, you don't want to invest exclusively in big established companies or small start-ups. You want a little bit of both (and something in between, too). Mostly, you don't want to restrict your investments to related or correlated industries. An example might be car manufacturing and steel. The problem is that if one industry goes down, so will the other.

With bonds, you also don't want to buy too much of the same thing. Instead, you'll want to buy bonds with different maturity dates, interest rates and credit ratings.

MAIN FOUR ASSET CLASSES

Asset class	Overview	Risk profile
Cash [1]	Savings and current account balances, savings bonds, premium bonds and other NS&I products, Cash ISAs and any cash you have.	Low, but your money's buying power is eroded over time if inflation is higher than the interest rates paid. Cash you put into authorised UK banks or building societies is protected by the Financial Services Compensation Scheme up to £85,000.
Fixed interest securities – also called 'bonds'. Essentially a loan to a company or government for a fixed period.	Gilts (government bonds), overseas bonds, local authority bonds and corporate bonds (loans to companies).	Relatively low and returns predictable if held to maturity. However, traded prices can be volatile. Your money's buying power can still be eroded over time if inflation is higher than the interest rate paid on the bond.
Shares – also known as 'equities'. A stake in a company.	You can hold shares directly or through an investment fund where you pool your money with other people's, like with a unit trust, OEIC (open-ended investment company) or life fund.	Investing in a single company is high risk. Investing in a fund provides more diversification, but risk levels will depend on the type of shares in the fund.
Property	Includes residential or commercial property and buy-to-lets, and investments in property companies or funds.	Price can vary and be more volatile than with bonds. Potential for gains but also losses. You might not be able to access your capital quickly if you have invested into property directly. Access to capital might also be restricted through property funds if closed to redemptions, meaning you will not have access until the redemption restriction has been lifted.

Ethical saving and investing

Making the world a better place

Whether it's termed ethical, responsible or sustainable investing, the aim is generally the same. It's investing your money in businesses which have some intention of making the world a better place. In the past, ethical investing was the only option if you wanted to invest in companies aligned to your values. But this 'good money' sector has moved on a lot in recent years.

SOCIETY AND THE ENVIRONMENT

Ethical is now just one of many options you can choose from. Green and ethical investments look at the wider impact of investing on society and the environment when seeking financial returns. They take into account social or environmental considerations in addition to financial criteria.

Just as you can now choose from a range of green or ethically produced goods in your local supermarket, you can also choose financial products that have positive benefits for the environment and society.

Green and ethical investments allow you to have a positive impact on the world around you. Green and ethical investments may promote greater corporate responsibility, invest in solutions to 21st century problems, or contribute to cleaner, greener profits.

VALUES-BASED INVESTMENT FUNDS ENABLE YOU CAN MAKE POSITIVE FINANCIAL DECISIONS THAT SUPPORT YOUR VALUES AND MORALS

Ethical – tends to follow a moral-based screening process that excludes industries such as tobacco, gambling and armaments, while seeking companies that contribute positively to the environment and society.

SRI – sustainable and responsible investment seeks to invest in the most sustainable companies, i.e. those that manage their environmental, social and community impacts for the greater good of society.

Impact – invests in companies that aim to achieve a measurable positive social or environmental impact in addition to a financial return.

Green – invests in companies involved in improving the environment.

Shariah – derives its principles from Shariah Islamic law. To comply with Shariah, investment is not allowed to earn interest.

Investing in a fund

Making investment decisions on behalf of the investor

There are many reasons to invest through a fund, rather than buying assets on your own. At a basic level, investing in a fund means having a fund manager make investment decisions on behalf of the investor.

You receive reports on the fund's performance but have no influence on the investment choices short of removing your money from the fund and placing it elsewhere.

Spreading risk is one of the main reasons for investing through a fund. Even if you have a small amount to invest, you can have a lot of different types of assets you're investing in – you're 'diversified'.

You can spread risk across asset classes (such as bonds, cash, property and shares), countries and stock market sectors (such as financials, industrials or retailers).

Reduced dealing costs by pooling your money can help you make savings because you're sharing the costs.

There is also less work for you as the fund manager handles the buying, selling and collecting of dividends and income for you. But of course there are charges for this. They also make the decisions about when to buy and sell assets.

ACTIVE OR PASSIVE FUND MANAGEMENT

ACTIVE MANAGEMENT

Most pooled investment funds are actively managed. The fund manager is paid to research the market, so they can buy the assets that they think might give a good profit. Depending on the fund's objectives, the fund manager will aim to give you either better-than-average growth for your investment (beat the market) or to get steadier returns than would be achieved simply by tracking the markets.

PASSIVE MANAGEMENT – TRACKER FUNDS

You might prefer to track the market. If the index goes up, so will your fund value, but it will also fall in line with the index. A 'market index tracker' follows the performance of all the shares in a particular market. In the UK, the most commonly used market index is the FTSE 100, a group of the 100 biggest companies based upon share value.

If a fund buys shares in all 100 companies, in the same proportions as their market value, its value will rise or fall in line with the change in the value of the FTSE 100.
Funds that track an index are called 'tracker funds'.

Tracker funds don't need to be managed so actively. You still pay some fees, but not as much as with an actively managed fund. Because of the fees, your real returns aren't quite as good as the actual growth of the market – but they should be close.

Pooled investment funds

Combining sums of money from many people into a large fund spread across many investments

Pooled investment funds – also known as 'collective investment schemes' – are a way of combining sums of money from many people into a large fund spread across many investments and managed by a professional fund manager.

There are a diverse range of funds that invest in different things, with different strategies – high income, capital growth, income and growth, and so on.

DIFFERENT TYPES OF POOLED INVESTMENT FUND

UNIT TRUSTS AND OPEN-ENDED INVESTMENT COMPANIES

Unit trusts and Open-Ended Investment Companies (OEICs) are professionally managed collective investment funds. Managers pool money from many investors and buy shares, bonds, property or cash assets, and other investments.

UNDERLYING ASSETS

You buy shares (in an OEIC) or units (in a unit trust). The fund manager combines your money together with money from other investors and uses it to invest in the fund's underlying assets.

Every fund invests in a different mix of investments. Some only buy shares in British companies, while others invest in bonds or in shares of foreign companies, or other types of investments.

BUY OR SELL

You own a share of the overall unit trust or OEIC – if the value of the underlying assets in the fund rises, the value of your units or shares will rise. Similarly, if the value of the underlying assets of the fund falls, the value of your units or shares falls. The overall fund size will grow and shrink as investors buy or sell. Some funds give you the choice between 'income units' or 'income shares' that make regular payouts of any dividends or interest the fund earns, or 'accumulation units' or 'accumulation shares' which are automatically reinvested in the fund.

HIGHER RETURNS

The value of your investments can go down as well as up, and you might get back less than you invested. Some assets are riskier than others, but higher risk also gives you the potential to earn higher returns.

Before investing, make sure you understand what kind of assets the fund invests in and whether that's a good fit for your investment goals, financial situation and attitude to risk.

SPREADING RISK

Unit trusts and OEICs help you to spread your risk across lots of investments without having to spend a lot of money.

Most unit trusts and OEICs allow you to sell your shares or units at any time – although some funds will only deal on a monthly, quarterly or twice-yearly basis. This might be the case if they invest in assets such as property, which can take a longer time to sell.

INVESTMENT LENGTH

Bear in mind that the length of time you should invest for depends on your financial goals and what your fund invests in. If it invests in shares, bonds or property, you should plan to invest for five years or more. Money market funds can be suitable for shorter time frames.

If you own shares, you might get income in the form of dividends. Dividends are a portion of the profits made by the company that issued the shares you've invested in.

TAXED DIVIDENDS

If you have an investment fund that is invested in shares, then you might get distributions that are taxed in the same way as dividends.

The tax-free Dividend Allowance is currently £2,000 a year (2018/19).

Dividends above this level are currently taxed at:

- 7.5% (for basic-rate taxpayers)
- 32.5% (for higher-rate taxpayers)
- 38.1% (for additional-rate taxpayers)

Any dividends received within a pension or Individual Savings Account (ISA) will remain effectively tax-efficient.

Basic-rate payers who receive dividends of more than £2,000 need to complete a self-assessment return.

Tracker funds and exchange traded funds

Market index following the overall performance of a selection of investments

Tracker funds and exchange-traded funds (ETFs) are investments that aim to mirror the performance of a market index. A market index follows the overall performance of a selection of investments. The FTSE 100 is an example of a market index – it includes the 100 companies with the largest value on the London Stock Exchange.

INDEX PERFORMANCE

These are financial instruments you buy from a fund company that aim to track the performance of an index. ETFs do the same but are listed on a stock exchange and can be bought and sold like shares. Trackers and ETFs are available to track many indices. Trackers and ETFs work either by physically buying a basket of investments in the index they're tracking or by using more complicated investments to mimic the movement in the index.

LOWER CHARGES

Investment decisions are made automatically according to the fund's rules. This passive trading makes index trackers cheaper to run than actively managed funds, so many have lower charges.

With index trackers, you own a share of the overall portfolio – if the value of the assets (shares, etc.) in the fund rises, the value of your share will rise. If the value of the assets falls, then so will the value of your share.

ASSET CLASS

Index trackers are a way to spread your risk within an asset class without having to spend a lot of money.

The tracked index can go down as well as up, and you may get back less than you invested. Because of charges, a tracker will usually underperform the index somewhat, and over a long period that underperformance could be more noticeable.

GOOD FIT

Before investing, make sure you understand whether the index tracker is physical or synthetic and whether it is a good fit for your goals and risk appetite. A synthetic tracker is an investment that mimics the behaviour of an ETF through the use of derivatives such as a swap.

Synthetic tracker funds and ETFs rely on a counterparty underwriting the risk, and so carry the risk of counterparty failure (for example, Lehman Brothers in 2008). There are various controls which aim to reduce this risk.

MARKET CONDITIONS

Assessing the risks in synthetic tracker funds and ETFs may be difficult. Many ETFs are not based in the UK. You can sell at any time, but the price you get will depend on market conditions on the day.

ETFs offer minute-to-minute pricing because they trade like a share so may be more appropriate than tracker funds for investors who trade more frequently. However, it is generally better to hold this type of investment for the longer term – you can ride out ups and downs in value and pick your moment to sell.

DIVIDEND ALLOWANCE

The current tax-free Dividend Allowance is £2,000 (2018/19).

Dividends received by pension funds or received on shares within an Individual Savings Account (ISA) will remain tax-efficient and won't impact your dividend allowance. There are three dividend tax bands which currently apply to all dividend income in excess of £2,000 per year:

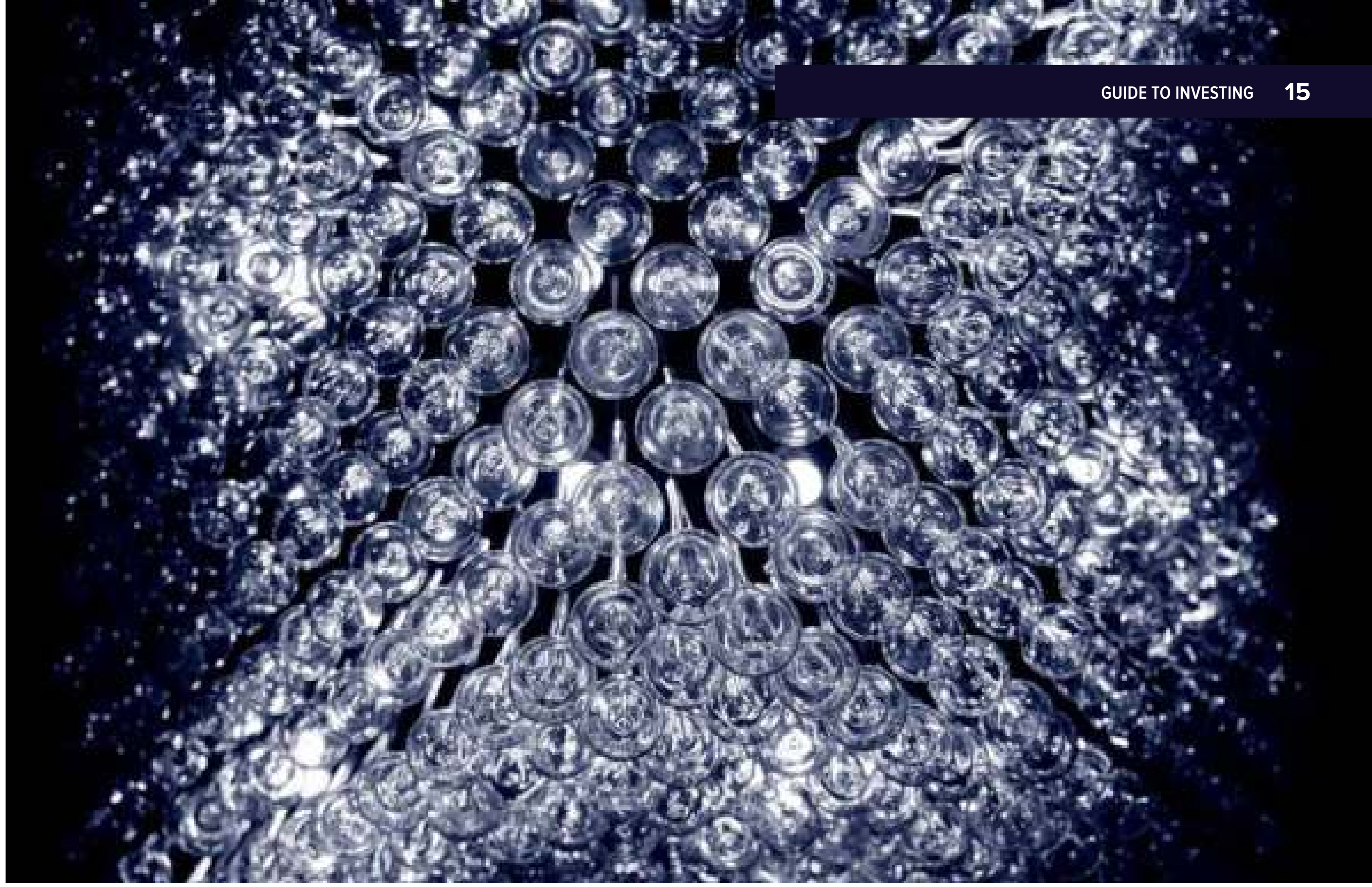
- 7.5% (for basic-rate taxpayers)
- 32.5% (for higher-rate taxpayers)
- 38.1% (for additional-rate taxpayers)

If your fund has invested in corporate bonds, gilts or cash, it should pay interest, and that interest will be treated differently to dividend income.

You are entitled to a personal savings allowance (2018/19). This means you don't pay tax on the first £1,000 you earn from interest from:

- Bank accounts
- Building societies
- Savings accounts
- Corporate bonds
- Credit union accounts
- Government bonds and gilts (or the first £500 if you're a higher-rate taxpayer).

Any profit you make when selling your shares or units counts towards your Capital Gains Tax annual exempt amount. Losses can be offset against other gains in the same tax year or carried forward to future years.



With-profits funds

Stock market return linked but with fewer ups and downs than investing directly in shares

If you save regularly or invest a lump sum using a life insurance policy, you might choose to invest in a with-profits fund. These aim to give you a return linked to the stock market but with fewer ups and downs than investing directly in shares. However, they are complex and are not as popular a form of investing as they used to be.

The money you invest is pooled together with money from other people and invested in the insurance company's with-profits fund. The fund is managed by a professional investment manager, who puts the fund's money into different types of investment, such as shares, property, bonds and cash.

ANNUAL BONUSES

The costs of running the insurance company's business are deducted from the fund, and what is left over (the profit) is available to be paid to the with-profits investors. You receive your share of profits in the form of annual bonuses added to your policy.

The company usually tries to avoid big changes in the size of the bonuses from one year to the next. It does this by holding back some of the profits from good years to boost the profits in bad years – this process is called 'smoothing'.

TERMINAL BONUS

You might also receive a 'terminal bonus' when your policy matures. You can ask the insurance company to give you details about its bonus policy before you buy. With most policies, the amount of profit you earn depends mainly on the performance of the investments in the with-profits fund. Usually, once added, bonuses can't be taken away. But the insurance company can claw back some or all of the bonuses paid by making a Market Value Reduction (MVR) – or Market Value Adjustment (MVA) – to your policy if you surrender early. This is most likely in times of adverse investment conditions like a stock market crash.

TYPES OF WITH-PROFITS FUND

CONVENTIONAL WITH-PROFITS FUNDS

An initial sum assured (guaranteed minimum sum) is increased by the addition of annual bonuses and a terminal bonus. The size of bonuses depends on fund performance, the costs of the insurance business, and the need to smooth bonuses between good and poor years.

The trend has been for bonus rates to fall as the result of difficult market conditions. Although market value reductions can be applied, this would not normally be the case. Instead, surrender penalties would usually apply if the policy was terminated early with no reductions applied on maturity.

UNITISED WITH-PROFITS FUNDS

A unitised fund is split into units – when you pay into it, you buy a certain number of units at the current price. Unit prices increase in line with bonuses declared and do not fall. Or if additional units have been added, these are not taken away (but market value reductions can be applied).

There might be surrender penalties if you decide to take your cash early. Bonuses are handled differently depending on the type of unitised with-profit fund you have.

A fixed price unit never changes, so bonuses are paid as extra units to your policy, as opposed to a variable price where bonuses are given as an increase in the unit price, so each unit you hold is worth more.

BONUSES

There are two kinds of bonus:

- Annual bonuses, also called 'regular' or 'revisionary' bonuses
- Final bonus, also called the 'terminal bonus'

POLICY TERMS

Once the bonus has been added, an annual bonus can't be taken away – even if the fund performs poorly in future – as long as you continue to meet the terms of your policy. A final bonus might be added at the end of your policy. Whether you receive one and how big it is depends on how well the fund does.

In good years, the fund manager can choose to keep some of the profits to help cover losses in bad years. This means that if there are long stretches without a profit, you might get low annual and final bonuses – or even no bonuses at all.

MARKET VALUE REDUCTION

The insurance company can make a Market Value Reduction to your policy if you surrender early, or in times of adverse investment conditions like a stock market correction.

If you leave a policy early, this reduction might claw back a large part – or even all – of any bonuses that have previously been added.

INHERITED ESTATE

A fund needs to keep enough money on hand to meet its expenses, run the business and to pay what it owes to policyholders.

But over time, some funds build up far more than they need – usually through profits that were held back to cover losses that never happened. This extra value is called the inherited estate. The insurance company can use the extra money in one of two ways – for a distribution or a re-attribution.

DISTRIBUTION – HANDING OUT EXTRA FUNDS

Each year, insurance companies must look at their inherited estate to see if they have more than they need to keep the fund running. If they have too much, they can choose – or in some cases be required – to pay out the extra to policyholders – this is called a distribution.

A distribution can be paid out over time or as a one-off payment. The company can use the extra money to either give you a cash payout or increase the value of your policy Distributions are not guaranteed – you won't necessarily receive a distribution even if you hold the policy to the end.

REATTRIBUTION –USING EXTRA FUNDS TO RESTRUCTURE

In rare cases, an insurance company might use the extra funds from the inherited estate to change the structure of the fund. For example, if a different structure would make the fund cheaper to manage.

If the company does this, you'll get compensation for the part of the inherited estate you're giving up to the insurance company. This is normally a one-off cash payment.

If your with-profits fund goes through reattribution, your insurer must write to you with information on:

- Reattribution process – including dates and a summary of who is involved
- Reattribution proposals – what the insurance company wants you to give up and what benefits and compensation you'll get in return
- Policyholder advocate's views – the policyholder advocate negotiates on your behalf with the company – they will write to you about whether the firm's proposals are in your best interest

Investment trusts

Public company aiming to make money by investing in other companies

An investment trust is a public company that raises money by selling shares to investors, and then pools that money to buy and sell a wide range of shares and assets. Different investment trusts will have different aims and different mixes of investments.

Investment trusts, unlike unit trusts, can borrow money to buy shares (known as gearing). This extra buying potential can produce gains in rising markets but also accentuate losses in falling markets. Investment trusts generally have more freedom to borrow than unit trusts that can be sold to the general public.

BUYING SHARES

Unlike with a unit trust, if an investor wants to sell their shares in an investment trust they must find someone else to buy their shares, usually this is done by selling on the stock-market. The investment trust manager is not obliged to buy back shares before the trust's winding up date.

The price of shares in an investment trust can be lower or higher than the value of the assets attributable to each share – this is known as trading at a discount or at a premium.

CONVENTIONAL INVESTMENT TRUSTS

Investment trusts are constituted as public limited companies and issue a fixed number of shares. Because of this they are referred to as closed ended funds.

The trust's shares are traded on the stock exchange like any public company. The price of an investment trust's shares depends on the value of its underlying assets and the demand for its shares.

Investment trusts are allowed to borrow money to buy shares (a practice known as gearing). Different investment trusts will do this at varying levels. It's worth checking before you invest because the level of gearing can affect the return on your investment and how risky it is.

SPLIT CAPITAL INVESTMENT TRUSTS

These run for a specified time, usually five to ten years, although you are not tied in. This type of investment trust issues different types of shares. When they reach the end of their term, payouts are made in order of share type.

You can choose a share type to suit you. Typically the further along the order of payment the share is the greater the risk, but the higher the potential return. You also need to bear in mind the price of shares in an investment trust can go up or down so you could get back less than you invested.

ASSET TYPE

The level of risk and return will depend on the investment trust you choose. It's important to know what type of assets the trust will invest in, as some are riskier than others.

In addition look at the difference between the investment trust's share price and the value of its assets as this gap may affect your return. If a discount widens, this can depress returns.

BORROWING MONEY

You need to find out if the investment trust borrows money to buy shares. If so, returns might be better but your loses greater. With a split capital investment trust, the risk and return will depend on the type of shares you buy.

All individuals are eligible for a £2,000 tax-free Dividend Allowance (2018/19). Dividends received by pension funds or received on shares within an Individual Savings Account (ISA) will remain tax-efficient and won't impact your dividend allowance.

TAX-EFFICIENT

Many unit trusts can be held in an ISA. In this case, your income and capital gains will be tax-efficient.

Any profit you make from selling shares outside an ISA may be subject to Capital Gains Tax.

Stocks & Shares ISAs

Investing in wide range of different tax-efficient investments

From July 2014, Individual Savings Accounts (ISAs) can now be used to hold stocks and shares or cash, or any combination of these, up to the current annual limit. An ISA is a 'wrapper' that can be used to help save you tax.

A Stocks & Shares ISA is a wrapper that can be put around a wide range of different investment products to help save you tax.

A number of different types of investment can be held in an ISA, including:

- Unit trusts
- OEICs (Open-Ended Investment Companies)
- Investment trusts
- Exchange-traded funds
- Corporate and government bonds
- Individual stocks and shares

WHOLE ALLOWANCE

You can pay a total of £20,000 a year into an ISA in the current 2018/19 tax year. The whole allowance of £20,000 can be paid into a Stocks & Shares ISA, a Cash ISA, or a combination of these.

Your yearly ISA allowance expires at the end of the tax year, and any unused allowance will be lost. It can't be rolled over to the following year. You can choose between making a lump sum investment and/or making regular or ad hoc contributions throughout the tax year.

INVESTMENT VALUE

Any increase in value of the investments in your Stocks & Shares ISA is free of Capital Gains Tax and most income is tax-efficient.

You can only pay into one Stocks & Shares ISA in each tax year, but you can open a new ISA with a different provider each year if you want to. You don't have to use the same provider for your Cash ISA, if you have one.

TRANSFERRING ISAS

Should you wish to switch your current or previous year's ISA to a different provider's ISA while simultaneously keeping future tax benefits intact, you have to arrange for a transfer rather than selling and reinvesting.

All ISA providers have to allow transfers out, but they don't have to allow transfers in. You can transfer money from a Cash ISA to a Stocks & Shares ISA.

If you transfer an ISA that you have paid into during the current tax year to a new provider, you must transfer the whole balance. For ISAs from previous years, you can choose how much to transfer.

For most of the investments you would put into a Stocks & Shares ISA, the value can go can go down as well as up, and you might get back less than you invested. The level of risk in your Stocks & Shares ISA will depend on the investments you choose to put into it.

> "Your yearly ISA allowance expires at the end of the tax year, and any unused allowance will be lost. It can't be rolled over to the following year."

Lifetime ISA

Helping you save for a first home or for your retirement at the same time

The start of the new tax year on 6 April 2017 saw the launch of the Lifetime ISA (LISA), which was announced in the 2016 Budget. This is a new type of Individual Savings Account (ISA) designed to help you save for a first home or for your retirement at the same time. To be eligible, you have to be aged between 18 and 39 years old (up until your 40th birthday).

SUPPLEMENTED BY A GOVERNMENT BONUS

You can save up to £4,000 a year into a LISA, and this will be supplemented by a government bonus of 25% of the money you put in. After year one, the bonus will be paid into your account monthly based on how much you pay in, but in the first year it will be paid in one lump sum at the end of the tax year.

The maximum bonus that you can receive is £1,000 each year. You'll obtain a bonus on any savings you make up until you reach 50 years of age, at which point you won't be able to make any more payments into your account. You only receive the bonus on the new money that you pay in (or transfer from another ISA) during the tax year, rather than it being based on the overall value of your LISA.

COMBINATION OF DIFFERENT ISA TYPES

You will be able to have any combination of different ISA types and a LISA at the same time. For example, if you have a Cash ISA and a Stocks & Shares ISA already, you can also have a LISA. You can't pay in more than the annual ISA allowance however, which in the 2018/19 tax year (that started on 6 April) is £20,000, with a maximum of £4,000 going into the LISA. The ISA allowance relates to each person and not per household, so two first-time buyers could both receive a bonus when buying their first home together.

If you already have a Help to Buy: ISA, you'll be able to transfer your balance into a LISA at any time if the amount doesn't exceed £4,000. In the tax year 2018/19 only, you'll be able to transfer the full balance of your Help to Buy: ISA – as it stood on 5 April 2017 – into your LISA without affecting the £4,000 limit. Alternatively, you could keep your Help to Buy: ISA and open a LISA, although you'll only be able to use the bonus from one of these accounts towards buying your first home.

APPROACH TO RISK, INVESTMENT TIME FRAME AND MAKING INVESTMENT DECISIONS

LISAs can hold cash, stocks and shares qualifying investments, or a combination of both. The option that is right for you will depend on your approach to risk, your investment time frame and how confident you are making your own investment decisions.

You will be able to use funds held in a LISA after 12 months to buy a first home valued up to £450,000. You must be buying your home with a mortgage.

Alternatively, after your 60th birthday, you will be able to take out all your savings from your LISA tax-efficiently for use in retirement.

CONTINUING TO SAVE INTO YOUR LISA

A LISA can be accessed like a normal ISA at any time for any reason, but if not used as above, you'll have to pay a withdrawal charge of 25% of the amount you withdraw (being the government bonus plus a penalty of 5%). However, this withdrawal charge won't apply if you decide to cash in your account during the first 12 months after its launch.

If you want to use your LISA to save for a property as well as for retirement, once you've bought your first home, you will be able to continue saving into your LISA as you did previously. You'll continue to receive the government bonus on your contributions until you reach the age of 50.

Investment bonds

Life insurance policies where you invest a lump sum in a variety of available funds

Investment bonds are life insurance policies where you invest a lump sum in a variety of available funds. Some investment bonds run for a fixed term, while others have no set investment term. When you cash investment bonds in, how much you get back depends on how well – or how badly – the investment has done.

When you invest a lump sum, the minimum is usually between £5,000 and £10,000. Most investment bonds are whole of life. There is usually no minimum term, although surrender penalties may apply in the early years.

TERMS AND CONDITIONS

Usually, you have a choice of funds to invest the money into. At surrender or on death (or if not a whole of life bond at the end of the term), a lump sum will be paid out. The amount depends on the bond's terms and conditions and may depend on investment performance.

Some investment bonds may guarantee your capital or your returns. These guarantees usually involve a counterparty. If so, they carry the risk of counterparty failure. You have a choice of two types of funds: with-profits or unit-linked. Both have the same tax rules where tax is paid on both growth and income accrued in the fund by the insurer.

VARIETY OF INVESTMENT FUNDS

Some investments offer a guarantee that you won't get back less than you originally invested. By choosing a bond that allows you to invest in a variety of investment funds and switch funds easily, you may weather the ups and downs of the market better. Because there's an element of life assurance, your investment bond policy may pay out slightly more than the value of the fund if you die during its term.

All gains and income earned within an investment bond are taxed at 20% and paid directly out of the investment bond. Withdrawals of up to 5% a year are allowed for up to 20 years without incurring an additional tax charge. If you don't use your 5% allowance in a given year, the allowance is carried over to the following year – for example, if you make no withdrawals in year one, you could draw up to 10% the following year without incurring a tax liability.

MINIMISE AN INCOME TAX BILL

So if you're a higher-rate or additional-rate taxpayer, paying 40% or 45% tax on income in the current tax year, an investment bond can minimise your Income Tax bill. However, your tax bill does not disappear entirely. Instead, the tax is deferred, and any additional tax due will be payable at the time you cash in the bond, or when it matures. All capital gains are treated as income at this point. Although tax at 20% has already been deducted, you may have an additional Income Tax bill if your gains push your income over the higher or additional-rate tax threshold in the year they mature.

You may be able to avoid this by using a method known as 'top slicing'. Top slicing works by dividing your profit over the lifetime of your bond (including withdrawals) by the number of years the bond has been held. If the resulting figure, when added to your other income for the tax year, is below the higher-rate tax threshold, there is no extra tax to pay. However, if the top-sliced profits still push you over the higher-rate tax threshold for the year, then additional tax must be paid on the entire gain.

Different investments options

Assessing which approach is best for your needs

There are many different ways to access investment funds, for example, through products such as an Individual Savings Account (ISA) or your workplace pension. It's important to remember that the price and value of investments and income derived from them can go down as well as up. You may not get back the amount originally invested. You should obtain professional financial advice before making any investment decisions.

"It's important to remember that the price and value of investments and income derived from them can go down as well as up."

Direct investments	Overview
Shares	Shares offer you a way of owning a direct stake in a company – also known as 'equities'. Their value rises and falls in line with a number of factors which might include the company's performance or outlook, investor sentiment, and general market conditions.

Investment funds (indirect)	Overview
Unit trusts and Open-Ended Investment Companies (OEICs)	Funds managed by a professional investment manager. There are lots of different strategies and risk levels to choose from, and they can invest in one or more different asset classes.
Investment trusts	Investment trusts are companies quoted on the stock exchange whose business is managing an investment fund, investing in shares and/or other types of investment. You invest in the fund by buying and selling shares in the investment trust either directly or through the products listed in the next table. Once again, there are lots of different strategies and risk levels to choose from.
Insurance company funds	Investment funds run by life insurance companies. When you invest through an insurance or pension product, you often choose how your money is invested. The choice might be from the insurance company's own funds or investment funds, such as unit trusts, run by other managers.
Tracker funds	Some investment funds adopt a 'tracker' strategy. The value of the fund increases or decreases in line with a stock market index (a measure of how well the stock market is doing). Tracker funds often have lower charges than other types of fund.
REITs	These are a special type of investment trust that invests in property. Similar OEICs are called 'Property Authorised Investment Funds' (PAIFs).

Investment products (indirect)	Overview
Stocks & Shares ISAs	A tax-efficient way of investing in shares or investment funds, up to an annual limit. Many unit trusts and OEICs come pre-packaged as ISAs. Alternatively, you can choose for yourself which investments and funds to put in your ISA.
Workplace pension	A way of investing for the future, with a contribution from your employer and tax relief from the Government. Your money is invested in pooled funds.
Personal pension	A way of investing for the future, with tax relief from the Government. You can use it instead of or as well as a workplace pension. Your money is invested in pooled funds.
Investment bonds	A life insurance contract that is also an investment vehicle. You invest for a set term or until you die.
Endowment policies	A life insurance policy that is also an investment vehicle. It aims to give you a lump sum at the end of a fixed term. Often you choose which investment funds to have in your policy.
Whole-of-life policies	A way of investing a regular amount or a lump sum as life insurance. It pays out on death and is often used for estate planning. Often you choose which investment funds to have in your policy.

Looking to secure your financial future?

Creating and maintaining the right investment strategy plays a vital role in helping to secure your financial future. To review your situation or discuss the options available, please contact us for further information – we look forward to hearing from you.

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