SFIA Group of Companies

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GUIDE TO

INVESTING FOR MY FUTURE

YOUR OPPORTUNITIES. YOUR WEALTH.
YOUR LEGACY.

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GUIDE TO

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Your opportunities. Your wealth. Your legacy.

WELCOME

Welcome to our *Guide to Investing for My Future*. As we move into the twenty-twenties, investors will still need to navigate the headwinds of volatility in markets, geopolitics and asset valuations.

Making the right choices to invest for your future can seem complex. But with the right investment strategy in place we can ensure you are able to make informed decisions to secure the financial future you want. We'll help you work out exactly what you want to get out of your investments, set realistic targets and keep you on track.

Life doesn't stand still, so your investment approach shouldn't either, whether you are looking to invest for income, growth or a combination of the two. We often think of investment goals in terms of a single investment strategy, but in reality they really require several strategies, each based on and tailored to your specific goals.

Planning your investment goals is essential if you're going to have a real chance of achieving them. How you invest your money in order to reach those short-term goals will be very different from the way you would do it for medium- and long-term goals. We can help you put in place the right strategies, whatever stage of life you're at, and guide you through the opportunities and challenges you may face.

Deciding where to start can feel overwhelming, but it doesn't have to be. This is why we provide an extensive range of services, plus the ability to tailor investment solutions based on your specific investment goals. ■

DEVELOPING A ROBUST PLAN TO HELP SECURE YOUR FINANCIAL FUTURE

We'll help you select the right solution to save and invest for your future, taking into consideration everything from your risk appetite to the term you want to invest for. We hope you enjoy reading our guide and the insights we've provided. To find out more or to arrange an appointment to discuss your unique requirements, please contact us – we look forward to hearing from you.

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GOALS-BASED INVESTING

Careful planning and successful investing

If your savings goal is more than five years away, putting some of your money into investments could allow you to earn more from your money and keep up with rising prices. Your wealth should work in all the ways you want it to. Whatever your goals are in life, careful planning and successful investing of your wealth can help you get there. Whatever stage of life you're at, we'll help you navigate through the opportunities and challenges you may face.

From the old adage of saving for a rainy day to planning a comfortable retirement, everybody has investment goals in their life. The starting point is to define exactly what you want to get out of your investments, set realistic targets and keep them on track. Goals-based investing places your goals right at the centre of the advice process.

Different types of investment

There are a variety of reasons why you might choose to invest. Some investment goals may be open-ended, while others may come with a specific deadline. As well as working out what your goals are, you also need to think about when you hope to achieve them.

None of us likes to be speculative with our savings but the truth 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. 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).

Good idea to spread your risk

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. 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.

When you start investing, it's usually a good idea to spread your risk by putting your money into a number of different areas and asset classes. That way, if one investment doesn't work out as you hope, you've still got your others to fall back on.

Portfolio of savings and investment

Setting your specific investment goals will also keep you focused on when you need to release the money and enable you to build a portfolio of savings and investments to get you where you want to be. Investment strategies should include a combination of various investment and fund types in order to obtain a balanced approach to risk and return.

Maintaining a balanced approach is usually key to the chances of achieving your investment goals, while bearing in mind that at some point you will want access to your money. This makes it important to allow for flexibility in your planning. ■

WEALTH CREATION LIFE STAGES

Meeting different goals throughout your life

With increased life expectancy, the goal posts for what are considered short, medium and long term are shifting, more so for younger individuals. This is because someone in their mid-20s today might spend 40 to 45 years working and then have 20 to 30 years in retirement. So those in their 20s and 30s may want to consider medium-term objectives to be between 10 and 30 years, and long term as anything over 30 years.

Recognising when it is appropriate to invest and when it is better to save money in cash to meet your different goals is very important. In general, anything you'll need money for in five years or less is seen as short term, while goals set for five to ten years from now are considered medium term. Long-term goals are usually those for which you'll need money in ten or more years.

Short-term goals

Short-term goals that you are aiming to achieve over the next one to five years, such as buying a new car or the next holiday, are better suited to cash savings. This is because investing in the stock market over short time frames exposes you to potential volatility, and if the market falls you will have little time to recoup any reductions in your money.

If you're only saving or investing for a relatively short period of time, you need more certainty about how your savings and investments will perform, and for your money to be easily accessible.

Medium-term goals

Medium term refers to investments with a five to ten-year time horizon. So your goal is further away than a short-term investment, but it's not in the distant future. Medium-term investment goals might include paying for a wedding, starting a business, paying for your children's education, or something similar. With medium-term investments, you can afford to ride out some market volatility, which you can't in a short-term investment.

You may also start introducing shares and bonds into your portfolio, as you'll have more time to grow your investments and longer to recover from any downturns along the way.

Long-term goals

Long-term investments sit on the distant horizon, typically ten years away or more. It's out of sight, but not entirely out of mind. A longer time horizon gives your money time to work, and time to enjoy the benefits of compounding. This is when you reinvest any returns, along with your initial investment, to generate further returns in future.

It also means you're able to diversify your portfolio, including a mix of assets that offer a healthy blend of risk and return, and with sensible protection and varied exposure. Relatively speaking, time is on your side, so you should be able to ride out the volatility of the market.

Risk and return

When people talk about risk, they're usually referring to market risk. Investing in the stock market can be volatile because of uncontrollable events like an economic downturn, political upheaval or a natural disaster that can cause large price swings.

Market risk varies depending on what you invest in. Emerging markets, for example, are considered riskier than developed markets. There are other risks to consider, such as currency risk (fluctuating exchange rates) and longevity risk (the risk that you'll outlive your savings). No investment comes without risk, and there's always the chance you could get back less than you invest.

As a rule of thumb, the more risk you take, the higher the potential return should be. While equities are seen as the highest-risk traditional investment, they have over the very long term delivered the strongest returns.

It's important to think carefully about how much risk you're comfortable taking on. If, for example, you're close to retirement, you'll want to avoid any market corrections just before you take your money out.

Asset allocation is the term used to describe how you split your money between different investment types such as cash, shares, bonds and property. There's a significant choice of investments to choose from, so you need to understand the risks associated with each. We'll help you to understand your approach to investment risk and determine the appropriate asset allocation for your investment goals.

Changes to keep your plans on track

As your goals are likely to change over time and also your attitude to investment risk, each year you should review how your savings and investments are growing and decide if you need to make any changes to keep your plans on track. Depending on your investments, you may even need to review your situation more than once a year. ■

INFLATION MATTERS

One of the biggest threats to the health of your investment portfolio

If you're investing – especially for major goals years away, such as retirement – you can't afford to ignore the corrosive effect rising prices can have on the value of your assets.

Is inflation finally returning to Western economies, aided by the 'Trumpflation effect'? It's been described as a 'hidden tax' because of the consistent destruction of value that it brings about.

Taking a bite out of your investment returns

Most people understand that inflation increases the price of their groceries or decreases the value of the pound in their wallet or purse. In reality, though, inflation affects all areas of the economy – and over time, it can take a bite out of your investment returns.

The reality is that inflation poses a stealth threat to all investors, which is why it's important to consider ways to mitigate inflation in your investment portfolio. When you consider the return on an investment, it's not just the interest rate you'll receive but also the real rate of return, which is determined by taking into account the effects of inflation.

Plan to achieve long-term financial goals

Clearly, if you plan to achieve long-term financial goals, such as university savings for your children or your own retirement, you'll need to create a portfolio of investments that will provide sufficient returns after factoring in the rate of inflation.

Protecting your portfolio against the potential threat of rising inflation might begin with a review of the investments most likely to provide returns that outpace inflation.

Navigating the threat that inflation poses

Over the long term – 10, 20, 30 years, or more – equities may provide the best potential for returns that exceed inflation. While past performance is no guarantee of future results, they have historically provided higher returns than other asset classes.

If you consistently receive below-inflation interest rates, this will slowly, but surely, erode what your savings are really worth. Investing some or more of your savings could help you navigate the threat that inflation poses to your long-term financial health.

Putting a strong investment strategy in place

Not only does the value of many investment assets often rise with inflation, offering some protection from rising prices, but successful investments should also deliver higher returns than cash savings alone can muster. Inflation is a market force that is impossible to avoid completely.

There are a number of different factors which may create inflationary pressures in an

> Protecting your portfolio against the potential threat of rising inflation might begin with a review of the investments most likely to provide returns that outpace inflation.

economy. These include rising commodity prices that can have a major impact, particularly higher oil prices, which translates into steeper petrol costs for consumers.

However, by planning for it and putting a strong investment strategy in place, you might be able to help minimise the impact of inflation on your savings and long-term financial plans.

Volatile periods

Investments are usually a better option than cash savings if you want to protect or grow the real value of your money, although it is still worthwhile holding some of your assets in cash as opposed to investments, as this will help to protect your money during more volatile periods.

Historically, investments such as shares and bonds have outperformed cash – particularly over long periods, although remember that past performance isn't a guide to future performance. So if you're saving for your retirement, investing can put you in a stronger financial position and put you on track towards your dream retirement.

Inflation protection

Different asset classes provide varying degrees of protection against inflation. Equities are often cited as being one of the best long-term defences. Intuitively, this makes sense. On a basic level, by investing in shares of companies, as the price of goods rises so too do the profits the companies earn on those goods, and in turn the returns to shareholders.

Pension pot

Changes to pension legislation in more recent years have given us all more freedom about how we use our pension pot and when we take that money. This means you can leave your money invested until you're ready to take it, and then release it gradually, rather than being at the mercy of stock market performance on the day of your retirement.

This also means that you're giving your money more opportunity to grow in value and to beat inflation. So although they have the potential to be more volatile, stock market investments have historically performed well, benefiting from the earnings of companies usually rising along with inflation and reinvesting dividends. It is these dividends that help in the battle to beat inflation, particularly when returns compound. ■

MAXIMISING RETURNS

Importance of mitigating key investment risks

Asset allocation depends on your goals, your attitude to risk, your capacity for loss and market conditions. Understanding investment risk and determining what level of risk you feel comfortable with before you invest is an important part of the investment decision process. Potential returns available from different kinds of investment, and the risks involved, change over time as a result of economic, political and regulatory developments, as well as a host of other factors.

When assessing your overall asset allocation, it needs to reflect your future capital or income needs, the timescales before those capital sums are required or the level of income sought, and the amount of risk you can tolerate. Ultimately, investing is a trade-off between risk and return.

Smoother investment journey

Not only does asset allocation naturally spread risk, but it can also help you to boost your returns while maintaining, or even lowering, the level of risk of your portfolio. Your investments reflect who you are. To maximise returns, every investor will have their own individual attitude towards risk.

Determining what portion of your portfolio should be invested into each asset class is called 'asset allocation' and is the process of dividing your investment/s between different assets. Portfolios can incorporate a wide range of different assets, such as cash, bonds, equities (shares in companies) and property – all of which have their own characteristics,.

Spreading risk through diversification

The idea behind allocating your money among different assets is to spread risk through diversification – the idea of not putting all your eggs in one basket. It is important to understand the characteristics of the different types of assets and the implications of how a portfolio will perform in different conditions.

Investments can go down as well as up, and these ups and downs can depend on the assets you're invested in and how the markets are performing. It's a natural part of investing. If we could look into the future, there would be no need to diversify our investments. We could merely choose a date when we needed our money back, then select the investment that would provide the highest return to that date.

Different kinds of investment

Moreover, the potential returns available from different kinds of investment, and the risks involved, change over time as a result of economic, political and regulatory developments, as well as a host of other factors. Diversification helps to address this uncertainty by combining a number of different investments.

When putting together a portfolio, there are a number of asset classes, or types of investments, that can be combined in different ways. The starting point is cash – and the aim of employing the other asset classes is to achieve a better return than could be achieved by leaving all of the investment on deposit.

Think about risk and return

Cash

- The most common types of cash investments are bank and building society savings accounts and money market funds (investment vehicles which invest in securities such as short-term bonds to enable institutions and larger personal investors to invest cash for the short term).
- Money held in the bank is arguably more secure than any of the other asset classes, but it is also likely to provide the poorest return over the long term. Indeed, with inflation currently above the level of interest provided by many accounts, the real value of cash held on deposit is falling.

Your money could be eroded by the effects of inflation and tax. For example, if your account pays 5% but inflation is running at 2%, you are only making 3% in real terms. If your savings are taxed, that return will be reduced even further.

Bonds

Bonds are effectively IOUs issued by governments or companies. In return for your initial investment, the issuer pays a pre-agreed regular return (the 'coupon') for a fixed term, at the end of which it agrees to return your initial investment. Depending on the financial strength of the issuer, bonds can be very low or relatively high risk, and the level of interest paid varies accordingly, with higher-risk issuers needing to offer more attractive coupons to attract investment.

As long as the issuer is still solvent at the time the bond matures, investors get back the initial value of the bond. However, during the life of the bond, its price will fluctuate to take account of a number of factors, including:

- **Interest rates** – as cash is an alternative lower-risk investment, the value of government bonds is particularly affected by changes in interest rates. Rising base rates will tend to lead to lower government bond prices, and vice versa
- **Inflation expectations** – the coupons paid by the majority of bonds do not change over time. Therefore, high inflation

> Understanding investment risk and determining what level of risk you feel comfortable with before you invest is an important part of the investment decision process.

reduces the real value of future coupon payments, making bonds less attractive and driving their prices lower

- **Credit quality** – the ability of the issuer to pay regular coupons and redeem the bonds at maturity is a key consideration for bond investors. Higher-risk bonds such as corporate bonds are susceptible to changes in the perceived credit worthiness of the issuer

Equities

Equities, or shares in companies, are regarded as riskier investments than bonds, but they also tend to produce higher returns over the long term. They are riskier because, in the event of a company getting into financial difficulty, bond holders rank ahead of equity holders when the remaining cash is distributed.

However, their superior long-term returns come from the fact that, unlike a bond which matures at the same price at which it was issued, share prices can rise dramatically as a company grows.

Returns from equities are made up of changes in the share price and, in some cases, dividends paid by the company to its investors. Share prices fluctuate constantly as a result of factors such as:

- **Company profits** – by buying shares, you are effectively investing in the future profitability of a company, so the operating outlook for the business is of paramount importance. Higher profits are likely to lead to a higher share price and/or increased dividends, whereas sustained losses could place the dividend or even the long-term viability of the business in jeopardy
- **Economic background** – companies perform best in an environment of healthy economic growth, modest inflation and low interest rates. A poor outlook for growth could suggest waning demand for the company's products or services. High inflation could impact companies in the form of increased input prices, although in some cases companies may be able to pass this on to consumers. Rising interest rates could put strain on companies that have borrowed heavily to grow the business
- **Investor sentiment** – as higher-risk assets, equities are susceptible to changes in investor sentiment. Deterioration in risk appetite normally sees share prices fall, while a turn to positive sentiment can see equity markets rise sharply

Property

In investment terms, property normally means commercial property – offices, warehouses, retail units and the like. Unlike the assets we have mentioned so far, properties are unique – only one fund can own a particular office building or shop.

The performance of these assets can sometimes be dominated by changes in capital values. These unusually dramatic moves in capital value illustrate another of property's key characteristics, namely its relative illiquidity compared to equities or bonds. Buying equities or bonds is normally a relatively quick and inexpensive process, but property investing involves considerable valuation and legal involvement.

The more normal state of affairs is for rental income to be the main driver of commercial property returns. Owners of property can enhance the income potential and capital value of their assets by undertaking refurbishment work or other improvements. Indeed, without such work, property can quickly become uncompetitive and run down. When managed properly, the relatively stable nature of property's income return is key to its appeal for investors. ■

> “Diversification can help you smooth out the returns while still achieving growth, and reduce the overall risk in your portfolio.”

DIVERSIFICATION

Spreading your money across different investment types and sectors

If we could see into the future, there would be no need to diversify our investments. We could merely choose a date when we needed our money back, then select the investment that would provide the highest return to that date.

It might be a company share, or a bond, or gold, or any other kind of asset. The problem is that we do not have the gift of foresight. It's a basic rule of investing that to improve your chance of a better return you have to accept more risk. But you can manage and improve the balance between risk and return by spreading your money across different investment types and sectors whose prices don't necessarily move in the same direction – this is called diversifying.

Reducing the overall risk in your portfolio

Diversification can help you smooth out the returns while still achieving growth, and reduce the overall risk in your portfolio. It helps to address this uncertainty by combining a number of different investments. It can't guarantee that your investments won't suffer if there is a market correction, but it can improve the chances that you won't lose money, or that if you do, it won't be as much as if you weren't diversified.

In order to maximise the performance potential of a diversified portfolio, managers actively change the mix of assets they hold to reflect the prevailing market conditions. These changes can be made at a number of levels, including the overall asset mix, the target markets within each asset class, and the risk profile of underlying funds within markets.

Environment of positive or recovering economic growth

As a rule, an environment of positive or recovering economic growth and healthy risk appetite would be likely to prompt an increased weighting in equities and a lower exposure to bonds. Within these baskets of assets, the manager might also move into more aggressive portfolios when markets are doing well and more cautious ones when conditions are more difficult. Geographical factors such as local economic growth, interest rates and the political background will also affect the weighting between markets within equities and bonds.

In the underlying portfolios, managers will normally adopt a more defensive positioning when risk appetite is low. For example, in equities they might have higher weightings in large companies operating in parts of the market that are less reliant on robust economic growth. Conversely, when risk appetite is abundant, underlying portfolios will tend to raise their exposure to more economically sensitive parts of the market and to smaller companies.

Knowledge is power

Investors face a number of risks over their lifetime, but longevity, sequencing and inflation risks are three key risks that are particularly pertinent to retirees. When looking at investments, it is important to bear these risks in mind.

Longevity risk: the risk of outliving your investments

Sequencing risk: the risk of market corrections (such as the Global Financial Crisis) just before or after retiring, which is generally the point of maximum wealth.

Inflation risk: purchasing power of retirement income could reduce if there is not sufficient capital growth. This risk is gradual, though – it is not a one-off like sequencing risk.

Market risk: the risk of general movement in financial markets over time. This risk can be reduced through portfolio diversification.

Behavioural bias risk: the risk that investors allow their emotions to drive investment decisions. For example, selling out of growth assets after a fall is often the worst thing to do. A long-term view of investing should be taken. ■

TRUST IN YOUR INVESTMENTS

Taking a more diverse approach to asset allocation

Investment trusts are a well-established way of investing. Many investors prefer to invest in a fund rather than by picking individual stocks, shares or other assets. Funds allow you to diversify your portfolio easily, as well as giving you the chance to benefit from the expertise of fund managers.

They are set up as listed companies issuing shares that can be traded on the London Stock Exchange. Like any company, they issue a fixed number of shares – hence the term 'closed-ended' – to raise capital that the manager allocates to investments.

Right to vote on issues

When you invest in an investment trust, you become a shareholder in that company. This gives you the right to vote on issues such as the appointment of directors or changes to the investment policy. If shareholders in the trust want to sell shares, their decisions don't impact directly on the value of the manager's pot, enabling a relatively long-term view in investment decisions.

Investment trusts usually have smaller operating costs and lower charges than other types of funds, for example, OEICs (Open-Ended Investment Companies) or unit trusts. Unit trusts and OEICS have an open-ended structure, which means the fund manager simply creates more units when more people want to own that fund, and vice versa.

Less liquid asset classes

Investment trusts enable investors to invest in a more diverse array of assets, including less liquid asset classes such as private equity, commercial property and infrastructure. This liquidity issue is important. If an investor in a trust wants their money back, they simply sell the shares.

Trading at a premium

Investment trusts have two valuations. One is the share price, which is the price you will pay to buy the investment or what you will receive if you sell it (disregarding spreads and trading costs).

The other is the Net Asset Value (NAV), which is the value of the underlying investments. If the trust is trading at higher level than its NAV, it is said to be 'trading at a premium', and if lower it is 'trading at a discount'.

Gearing, or borrowing, is something open-ended fund managers are not allowed to do. Borrowing to invest more at opportune times can lift returns per share by more than the cost of the loan per share. But if the market falls, investors in geared trusts may lose more per share than those in ungeared trusts.

Profits for 'smoothing' purposes

In the current low interest rate environment, funds that pay a regular income are very attractive. Unlike open-ended funds, investment trusts are allowed to keep back 15% of their profits for 'smoothing' purposes. This means trusts can use the income they keep back to help them pay dividends in years that are less fruitful.■

UNINTENDED INVESTMENT CONSEQUENCES

Staying disciplined and sticking to your plan is key

The overall direction of developed stock markets is a relentless and continual rise in value over the very long term, punctuated by corrections. It's important not to let global uncertainties affect your financial planning for the years ahead. Individuals who stop their investment planning, particularly during market downturns, can often miss out on opportunities to invest at lower prices.

Such volatility is less of an issue if you take a longer-term view. It's important to stick to your strategy and keep moving ahead consistently by spreading risk and growing your wealth. But it's volatility in stock markets that make investors nervous. However, on the flip side, not all volatility is bad, for without volatility stock prices would never rise.

Focus on long-term horizons

Trying to second-guess the impact of events such as Brexit or a stock market correction rarely pays off. Instead, investors who focus on long-term horizons – at least five to ten years – have historically fared much better.

At the time of writing this guide, the UK Government had left the European Union (EU) at midnight on 31 January 2020 and is now in a transition period until 31 December 2020.

Foreign currency exposure

Political uncertainty and various other factors such as exchange and interest rates can all impact how investments perform. However, for some investors, the Brexit vote has up until now been good for their portfolio's performance, as some have benefited from foreign currency exposure.

During any period of change, it's important to be able to obtain professional financial advice and feel comfortable that your investments are robust enough to deal with any potential volatility and – which is key – that they include a diverse mix of assets.

Economic cycle performance

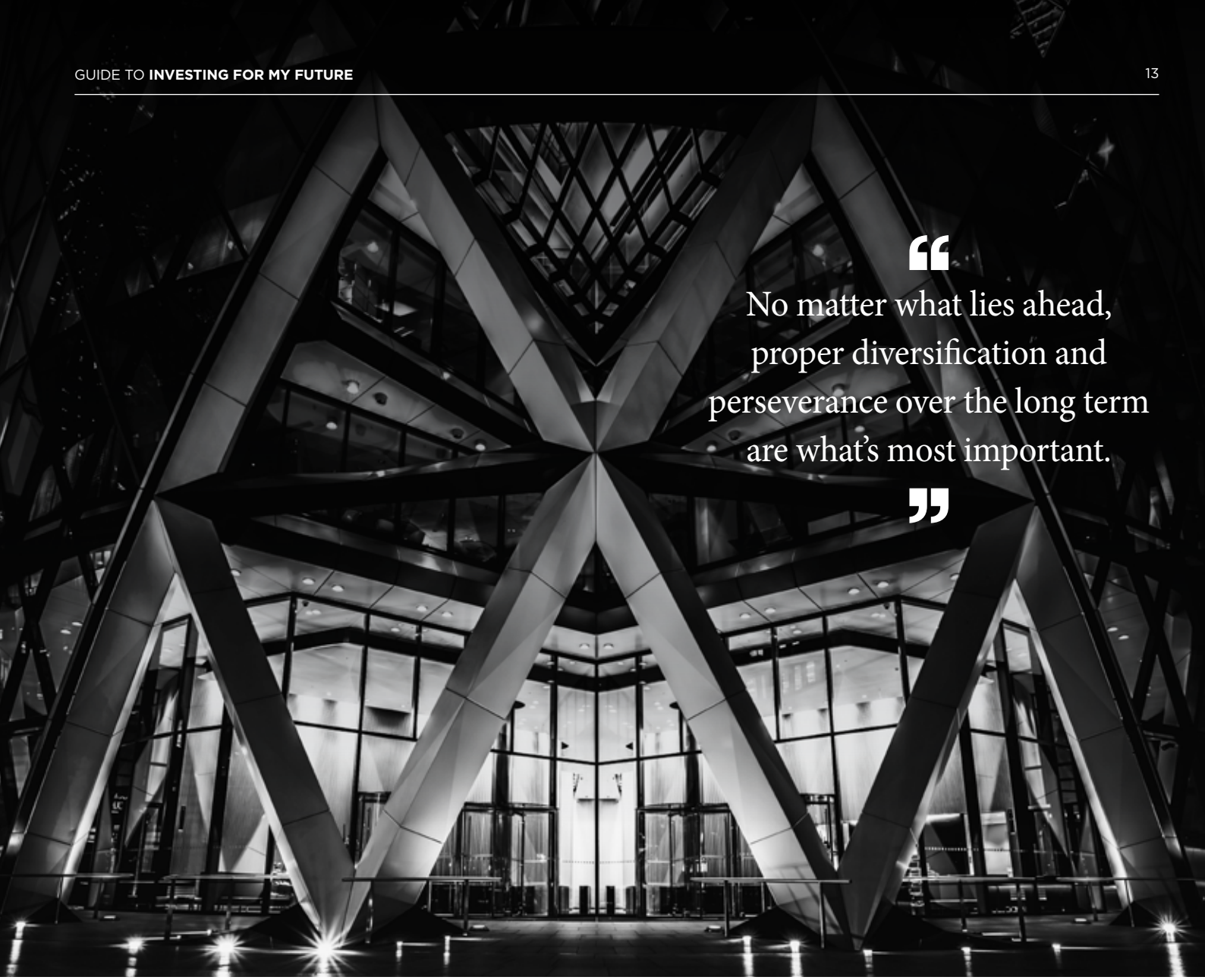
Among so much uncertainty surrounding the UK's departure from the EU, conventional pricing of company shares has been turned on its head. This is not to say that all UK stocks have fared badly. On the contrary, many large companies that derive most of their earnings from overseas have outperformed, as have those seen as defensive stocks that are widely expected to hold up well throughout the economic cycle.

It is often said that quality is not about any single metric, but a blend of characteristics that allows companies to deliver growing value for shareholders over time. A quality company should, among other things, be able to deliver sustainable growth with a healthy balance sheet and strong corporate governance.

Attractive valuations

Brexit, for all its unintended consequences, has opened up rare possibilities to buy stakes in quality companies at attractive valuations. By comparing share prices to company earnings, UK stocks overall have looked less expensive than their counterparts elsewhere in the world – especially in the US. The abandonment of logic in the face of short-term concerns over the UK economy has created particularly fertile hunting grounds for some long-term investors.

It also remains too early to understand fully how Brexit may affect the cost of imported goods years from now, as so much depends on trade agreements reached between the UK



and the EU, and other countries. If the pound's weakness persisted, the cost of other imported goods would also rise.

Embracing opportunities

But despite periodic and unavoidable corrections, stock markets tend to recover over time. The worst thing to do is sell out of the market. Long-term investors need to take a pragmatic view about volatility and the subsequent opportunities. Of course, it is tempting to think that cash is the best place for long-term savings, but if investors embrace opportunities and avoid panicking, then market corrections can become a friend.

It's important to remember that no matter how big a market correction, gains made during periods of recovery that follow generally outweigh any losses. No one can predict exactly what will happen in 2020 and beyond, but we can safely look to history and take some comfort from the knowledge that markets are resilient. Short-term bear markets may be painful, but bull markets are very rewarding for those who hold their nerve.

Protecting your investment portfolio

Media frenzy

Volatility, risk and market declines are a normal part of the investing cycle, but the media likes drama. Reports will use words that make these market fluctuations sound alarming, so be cautious about reacting to the unnerving 24/7 news cycle.

Stay strategic

If you have a well-diversified portfolio, then it's more important than ever to stay the course. You have a strategy in place that reflects your risk tolerance and time horizon, so stay committed. However, if you reacted and sold in a previous market decline or have not implemented a strategic asset allocation, then now is the time to have a discussion about your investment options.

Stay calm

The first thing to do when volatility is high is to stay calm. It can be easy to work yourself up into a panic when stocks are falling, but this won't help you. Making calm, rational decisions is one of the keys to long-term investing success. Remember – you haven't actually lost money until you sell. The chances are that stocks will recover, as they have historically done in the past.

Stay focused

No one knows how severe any market turbulence will be or what the market will do next. It could be over quickly or linger for a while. But no matter what lies ahead, proper diversification and perseverance over the long term are what's most important.

Taking a strategic approach

Sensible diversification – owning a mix of assets, including shares, bonds and alternative investments such as property – can help protect against uncertainties over the long term. When one area of a portfolio underperforms, another part should provide important protection – and it's never too early or too late to start taking this considered and strategic approach. ■

INCOME-GENERATING INVESTMENTS

Time to widen your search for income?

If low interest rates continue, it really matters where you invest your money. Investing for income means choosing assets that are able to provide you with a regular income. This is in contrast to investing for growth, which focuses on how much your assets could gain in value.

People are living longer. Simple demographics mean that supplementary income is no longer a luxury, it's a necessity. With historic ultra-low interest rates on savings, many investors over the past decade have turned to income-paying funds as an alternative to cash-based savings.

Varying income

Changing life plans and priorities mean we now encounter varying income needs and goals throughout our life – and when investing, certain innate behavioural traits will influence our decision-making.

Increasingly, some income seekers are looking beyond cash and government bonds to capitalise on the more attractive income opportunities that exist across global markets. Investing in higher yielding assets – such as dividend-paying stocks, corporate bonds and emerging market debt – can provide an attractive income, even with interest rates so low.

Investment strategy

Our reasons for seeking income tend to shift through life. Shorter-term goals like supporting a business start-up or funding children's education may be a priority in earlier years, before making way for a longer-term focus on boosting retirement income and providing an adequate cushion for later life. The key is working out how much income you need at each stage, and then finding an appropriate investment strategy to help you meet your goals.

It's essential to work out what you need to achieve and set clear objectives. The most obvious option to generate a monthly income is to buy funds that do just that. Some funds explicitly set out to provide investors with a monthly income, while others – such as many property funds – pay out dividends monthly, too.

Balanced portfolio

With time on your side, there are steps you can take to reduce risk, particularly in the final years before you need the money as your focus shifts from capital growth to capital protection. In order to achieve your financial goals, you can build a balanced portfolio incorporating a variety of different investment types (including cash and funds that invest in everything from corporate bonds to FTSE 100 companies, smaller companies, and companies based in numerous countries across the world) or you can simply pick one fund that is itself a balanced portfolio and offers you access to a broad spread of investments through one single plan.

However, if you are seeking income from your investment straight away, you may need to ensure your investments immediately generate the sum you need, so it's worth factoring this into any decision-making. It may well be that your decision does not involve whether or not you should invest in the stock market, but which particular stock market investment will help you generate the income you need.

Diversifying risk

There are various ways in which capital can be used to generate income. Each has its pros and cons, and for most people the ideal solution, where possible, is to spread money among several different types of investment, providing a balance and diversifying risk.

With any income-generating investments, always remember to ensure you have a suitably diversified portfolio. You should never just rely on one asset class or investment, as if this investment suddenly falls in value, you stand to lose more than if you had put your money into a range of different investments.

> "With time on your side, there are steps you can take to reduce risk, particularly in the final years before you need the money as your focus shifts from capital growth to capital protection."

Banks and building societies

Savings accounts have traditionally been a clear favourite for many people who rely on the interest payments as a supplementary income. Deposits are seen as a secure option because the monetary value of savings does not go down, and there is protection under the Financial Services Compensation Scheme for deposits up to £85,000 in any one institution should they not be able to meet their commitments.

However, interest rates fluctuate, so the income from savings accounts cannot be relied upon to remain stable. Not only do the returns depend upon the general level of interest rates (which has only fallen over the last decade), but banks and building societies are also able to apply their own discretion as to the interest they pay on their accounts. Rates are often inflated by introductory bonuses which then fall away, typically after a year. Inflation can also erode the value of cash on deposit.

Fixed income securities/bonds

A bond is a loan that the bond purchaser, or bondholder, makes to the bond issuer. Governments and corporations issue bonds when they need to raise money. An investor who buys a bond is lending money to the government or corporation.

Like a loan, a bond pays interest periodically and repays the principal at a stated time, known as the 'maturity date'. Certain government securities are regarded as the most secure, though corporate bonds can pay higher rates of interest depending on the deemed creditworthiness of the issuing companies. Over the long term, shares have tended to provide a greater total return, but bonds are generally regarded as less risky. In the event of bankruptcy, a bondholder will get paid before a shareholder.

Equities

By investing in equities, savers can back companies which have potential to pay out significant dividends – a share in the profits – to shareholders. There are many such companies which have historically provided not only reasonable dividends, but a track record of growing profits and consequently improving those dividend payments over time.

It is also possible to grow your original capital if the share price increases in value over the time you are invested, although it may go down as well as up along the way. Investments in equities can be volatile. Their values may fluctuate quite dramatically in response to the results of individual companies, as well as general market conditions.

Property

In recent years, there has been a growing demand for rented property, as the cost of housing has risen. Many investors have profited from the buy-to-let market, buying residential property that they then let out in order to generate a rental income. However, property is not as liquid an investment as some others. There is also the risk of periods without income between lets and the ongoing costs of maintaining the properties.

More significantly, the taxation burden on UK buy-to-let investors and the properties themselves increased in 2016 following a government clamp down. There was a sharp increase in stamp duty payable by homeowners purchasing a second home, as well as an increase in the level of taxation faced by landlords buying to let. ■

INDIVIDUAL SAVINGS ACCOUNTS

Transforming your investment outcomes

Investing through a tax-efficient wrapper, such as an Individual Savings Account (ISA), can give a significant boost to an overall investment portfolio, but it should be blended with an appropriate investment strategy to give the best outcome.

Build up your savings in an ISA and it remains tax-efficient for life, no matter how large the lump sum becomes. Each tax year, we are each given an annual ISA allowance. The current ISA limit for 2019/20 is £20,000.

It is a 'use it or lose it' allowance, meaning that if you don't use all or part of it in one tax year, you cannot take that allowance over to the next year. Utilising your ISA allowance to invest tax-efficiently could lead to significant savings in Capital Gains Tax and even improve your potential returns.

Get the most from your ISA allowance

We've answered some questions we get asked about how best to use the ISA allowance to help make the most of its tax-efficient opportunities.

Frequently Asked Questions

Q: What is an ISA?

A: An ISA is a 'tax-efficient wrapper' designed to go around an investment. These include Cash ISAs and Stocks & Shares ISAs. A Cash ISA is like a normal deposit account, except that you pay no tax on the interest you earn. Stock & Shares ISAs allow you to invest in equities, bonds or commercial property without paying personal tax on your proceeds.

Q: Can I have more than one ISA?

A: You have a total tax-efficient allowance of £20,000 for this tax year. This means that the sum of money you invest across all your ISAs this tax year (cash or stocks and shares) cannot exceed £20,000. However, it's important to bear in mind that you have the flexibility to split your tax-free allowance across as many ISAs and ISA types as you wish. For example, you may invest £10,000 in a Stocks & Shares ISA and the remaining £10,000 in a Cash ISA. This is a useful option for those of you who want to use your investment for different purposes and over varying periods of time.

Q: When will I be able to access the money I save in an ISA?

A: Some ISAs do tie your money up for a significant period of time. However, others are pretty flexible. If you're after flexibility, variable rate Cash ISAs don't tend to have a minimum commitment. This means you can keep your money in one for as long or as short a time as you like. They also allow you to take out some of the money from your ISA and put it back in without affecting its tax-efficient status.

> 'Put your 2019/20 ISA allowance of £20,000 into an ISA by 5 April and don't pay tax on the money your ISA makes'

On the other hand, fixed-rate Cash ISAs will typically require you to tie your money up for a set amount of time. If you decide to cut the term short, you usually have to pay a penalty. But ISAs that tie your money up for longer do tend to have higher interest rates.

Stocks & Shares ISAs don't usually have a minimum commitment, which means you can take your money out at any point. That said, your money has to be converted back into cash before it can be withdrawn.

Q: Could I take advantage of a Lifetime ISA?

A: You must be 18 or over but under 40 to open a Lifetime ISA. You can use a Lifetime ISA to buy your first home or save for later life. You can put in up to £4,000 each year, until you're 50. The Government will add a 25% bonus to your savings, up to a maximum of £1,000 per year.

Q: Is tax payable on ISA dividend income?

A: No tax is payable on dividend income. You don't pay tax on any dividends paid inside your ISA. Outside of an ISA, you currently receive a £2,000 dividend income allowance.

Q: Is Capital Gains Tax (CGT) payable on my ISA investment gains?

A: You don't have to pay any CGT on profits. You make a profit when you sell an investment for more than you purchased it for. If you invest outside an ISA, excluding residential property, any profits made above the annual CGT allowance for individuals of £12,000 in the 2019/20 tax year would be subject to CGT. For basic-rate taxpayers, CGT is 10% or more. For higher and additional-rate taxpayers, CGT is 20%. This is on gains from chargeable assets (other than residential property).

Q: I already have ISAs with several different providers. Can I consolidate them?

A: Yes, you can – and you won't lose the tax-efficient 'wrapper' status. Many previously attractive savings accounts cease to have a good rate of interest, and naturally some Stocks & Shares ISAs don't perform as well as investors would have hoped. Consolidating your ISAs may also substantially reduce your paperwork. We'll be happy to talk you through the advantages and disadvantages of doing it.

Q: Can I transfer my existing ISA?

A: Yes, you can transfer an existing ISA from one provider to another at any time. If you want to transfer money you've invested in an ISA during the current tax year, you must transfer all of it. For money you invested in previous years, you can choose to transfer all or part of your savings.

Q: Do I still need a personal pension plan if I have an ISA?

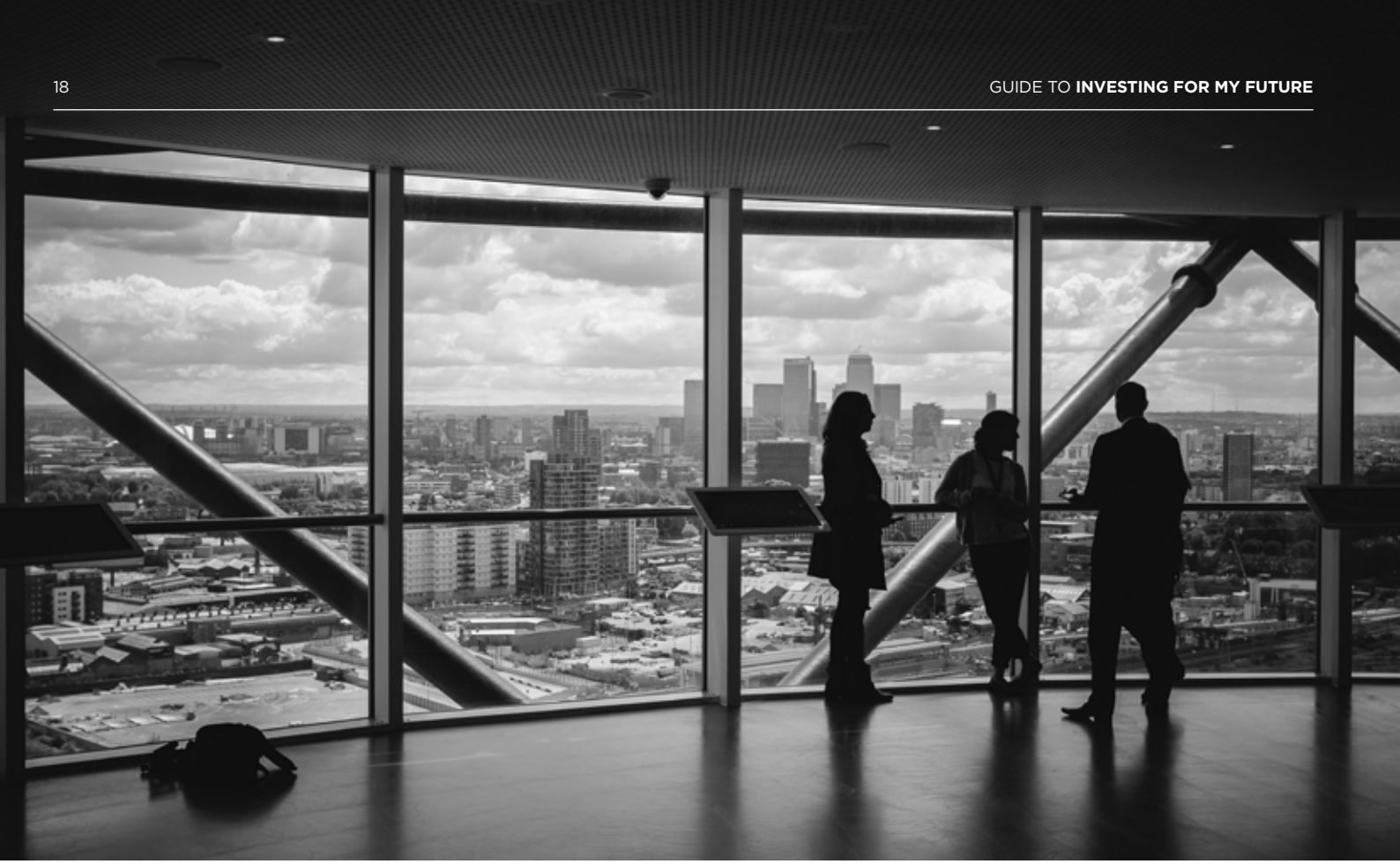
A: ISAs and personal pension plans are entirely separate, and both can – and most likely will – form part of your financial planning requirements. They both have tax-efficient benefits. An investment-based ISA such as a Stocks & Shares ISA could potentially grow your savings as much as a pension plan in the long term. However, personal pensions have benefits that ISAs don't have.

For example, the yearly tax-free pension allowance is higher than the yearly ISA allowance. Also, besides tax-efficient interest, you also receive tax back on all your contributions. This is paid at the highest rate of tax you pay, up to a maximum of 45%. If you're in a workplace pension scheme, your employer will also contribute to your pension plan. From 6 April 2019, the minimum employer contribution is now at least 3%.

But the earliest you can take out your pension is age 55. This means there's no temptation to dip in early. An ISA can be a good way to supplement your personal pension planning. The yearly tax-free pension allowance is in addition to your annual ISA allowance. By using both allowances as much as possible, you'll maximise your tax savings.

Q: What happens to my ISA if die prematurely?

A: The rules on ISA death benefits allow for an extra ISA allowance to the deceased's spouse or registered civil partner. ■



2019/20 ISA ALLOWANCE – USE IT OR LOSE IT

Maximise your wealth creation – don't miss the deadline

Whatever you're putting money aside for, there's likely to be a role for Individual Saving Accounts, or 'ISAs'. An ISA is a way of holding savings or investments without paying personal tax on interest received or on the growth of your investment.

Whether you're a novice or an experienced saver, we can help you get the most from your 2019/20 ISA allowance.

Tax year deadline is 5 April 2020

Each year, you have an ISA allowance which, if fully utilised, can have a big impact over time. ISA allowances can't be rolled over to the next tax year. If you don't use your 2019/20 ISA allowance by 5 April 2020, it'll be gone for good. For the 2019/20 tax year, the ISA allowance is £20,000.

You can split the ISA allowance across different types of ISA, but you can only add money to one ISA of each type in a tax year.

What are your ISA options?

Cash ISA – a type of savings account, where any interest received is tax-free.
Stocks & Shares ISA – a 'wrapper' for investments, where any investment growth is tax-efficient.
Innovative Finance ISA – a 'wrapper' specifically for peer-to-peer investments, where any interest received is tax-efficient.
Help to Buy ISA – a regular savings Cash ISA, where the Government will add up to £3,000 if you have contributed £12,000 yourself (these closed to new savers on 30 November 2019).
Lifetime ISA – a type of Cash or Stocks & Shares ISA available to the under 40s since 6 April 2017, designed to help people save for their first home or their retirement. Any interest received or investment growth is tax-efficient. Savings of up to £4,000 per year will be matched by a contribution of up to £1,000 from the Government; any savings above that amount will not receive any additional bonus. You can continue paying into a Lifetime ISA until you are 50.
Junior ISA – a type of Cash ISA where parents can save up to £4,368 per year tax-efficiently for the child. The child gains access to the money at the age of 16, and the account becomes a standard cash ISA at the age of 18
Inheritance ISA – a Cash ISA specifically for widows, widowers or bereaved civil partners, where the deceased's ISA can be transferred across into the surviving partner's name, in addition to their own annual allowance. ■

COLLECTIVE INVESTMENTS

Pooling money in one or more types of asset class

Collective investment schemes – also known as 'pooled investment funds' – 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.

Investing this way can be easier and less risky than buying shares in individual companies direct, and there are lots of funds to choose from.

There is 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 collective investment schemes

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 investment.

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 (2019/20).

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 (2019/20).

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)

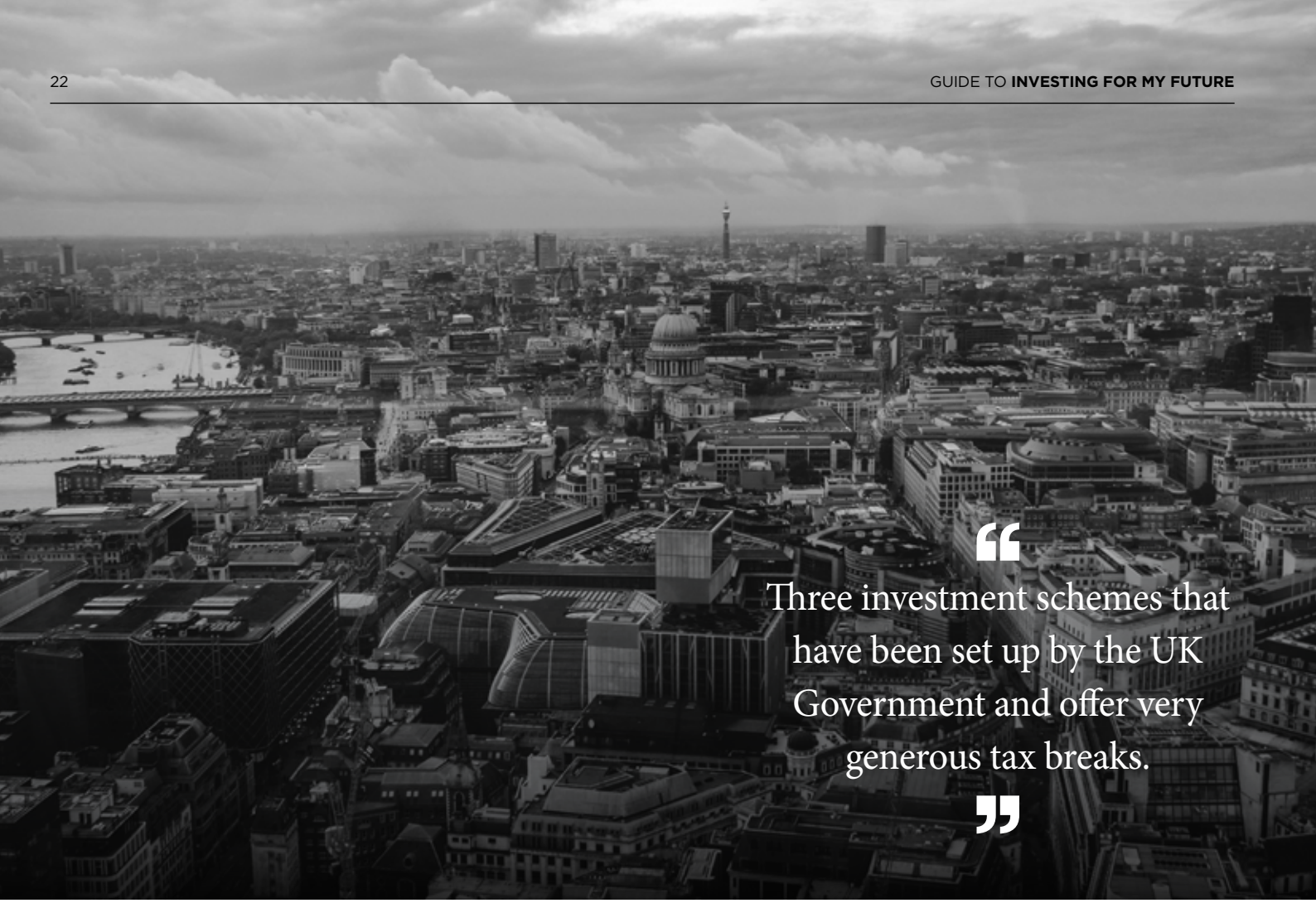
If your fund has invested in corporate bonds, gilts or cash, it should pay interest, and that interest will be treated differently to dividend income.

You are entitled to a personal savings allowance (2019/20). 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
- 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. ■

> “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.”



“Three investment schemes that have been set up by the UK Government and offer very generous tax breaks.”

GOVERNMENT APPROVED PROGRAMMES

Pre-qualified companies or investment vehicles

The term ‘tax-efficient investments’ refers to investment opportunities through which investors will receive tax benefits.

More specifically, these types of investment use government approved programmes to give investors tax relief on the investments they make into pre-qualified companies or investment vehicles.

The types of tax relief investors receive in return range from Capital Gains relief through to loss relief and Inheritance Tax relief.

Three investment schemes that have been set up by the UK Government and offer very generous tax breaks:

The Enterprise Investment Scheme (EIS)

This scheme is designed to encourage investment into early-stage companies that are not listed on a stock exchange. It offers investors a range of tax breaks, including Income Tax relief of 30%, no Capital Gains Tax on gains realised on the disposal of EIS investments provided the investments are held for three years, Capital Gains Tax deferrals if proceeds are invested in qualifying EIS investments, and Inheritance Tax relief if the investments are held for two years.

The Seed Enterprise Investment Scheme (SEIS)

This scheme is designed to promote investment into start-up companies that are raising their first £150,000 in external equity capital. Like the EIS, it offers a range of generous tax breaks, including Income Tax relief of 50%, no Capital Gains Tax on gains realised on the disposal of SEIS investments provided the shares are held for three years, reinvestment tax relief, and Inheritance Tax relief if investments are held for two years.

Venture Capital Trusts (VCTs)

VCTs are investment companies that are listed on the London Stock Exchange and invest in smaller companies that meet certain criteria. VCTs offer investors a range of tax breaks including 30% Income Tax relief, tax-free dividends and tax-free growth.

While all of these schemes offer generous tax breaks, it’s important to be aware that due to the high-risk nature of investing in small, early-stage companies, they will not be suitable for everyone. Only those who can afford to take the risk should consider these tax-efficient investment schemes.

Only experienced investors who are comfortable with high levels of risk should consider these schemes. ■

BEWARE OF INVESTMENT SCAMMERS

Warning signs which you can use to avoid falling victim

Every year thousands of people lose millions of pounds due to investment scams. The internet and advances in digital communications mean these kinds of scams are becoming more common and harder to identify. Thankfully there are some warning signs you can use to avoid falling victim to scammers.

Investment scams aim to get unsuspecting people to hand over money. On the face of it, they can seem perfectly legitimate, appearing knowledgeable with websites, testimonials and marketing material.

The most infamous kind of investment scam is a Ponzi Scheme, where money is collected from new investors to pay previous investors. Eventually the money owed is greater than the money being collected and the scheme collapses, leaving all the investors out of pocket.

Today, due to the internet and digital communications, investment scams can be much more complex. Some of these scams are so convincing, even professional investors have fallen victim to them.

Since the pensions freedoms were introduced in April 2015, older people are particularly vulnerable to investment scams because they can access cash lump sums from pension pots. All investment scams have one thing in common. They claim to be able to offer high levels of return for very little risk.

Don't feel pressured

Make sure you are aware of the warning signs that might indicate an investment opportunity is a scam:

- Unsolicited approaches by phone call, text message, email or a person knocking on your door.
- When a firm doesn't allow you to call it back.
- Where you're forced to make a quick decision, or are pressured into doing so.
- Contact details you are given, or found on their website, are only mobile phone numbers or a PO box address.
- You are being offered a high return on your investment, but are told it's low risk.

Follow simple rules

To avoid being caught out by a scam, make sure you follow these simple rules:

- Reject any unsolicited calls, emails, text messages or visitors to your door. Legitimate investment companies will not cold call, or contact you out of the blue.
- Check the FCA register of regulated companies, or the FCA warning list.
- If you are thinking about an investment opportunity, seek professional financial advice from an FCA regulated firm.

If you've been targeted

If you think you've been targeted by an investment scam, report it to the FCA Scam Smart website.

If you have lost money to a suspected investment fraud, you should report it to Action Fraud on 0300 123 2040 or online at www.ActionFraud.police.uk

Beware of being targeted in the future, particularly if you've lost money to a scam. Fraudulent companies might take advantage of this and offer to help you get some or all of your money back. ■

WILL I ENJOY THE MOMENTS THAT MATTER?

Life can be unpredictable – but by making the right saving and investment choices now, you can make sure you will be able to enjoy the moments that matter.

To discuss your goals and aims, or if you require further information, please contact us – we look forward to hearing from you.

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