INVESTING

Get your money working for you

LLOYDS BANK

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The case for investing

The potential of the financial markets

Getting started

In the summer of 2007, the Bank of England base rate peaked at 5.75%. Since then interest rates have remained low.

Interest rates have been at historically low levels since March 2009 when they were cut to 0.5%. While record low rates have been good news for borrowers, they have been bad news for savers, especially those who have failed to shop around for the best interest rates on their money or consider other investment options.

The real value of £100 reduced by the effects of inflation

Number of years	2% inflation	3% inflation
Day 1 real value	£100.00	£100.00
1 year	£98.04	£97.09
5 years	£90.57	£86.26
10 years	£82.03	£74.41
20 years	£67.30	£55.37
30 years	£55.21	£41.20
40 years	£45.29	£30.66

Source: Chase de Vere

It has become increasingly common for cash accounts to pay interest rates as low as 0.1%. The impact has been most acutely felt by those, such as retirees, who rely on savings to meet their regular outgoings. While the face value of cash savings may not fall in absolute terms and is protected by the Financial Services Compensation Scheme up to £85,000, it is likely to fall in real terms given that the rate of inflation is greater than the interest rates available on most cash accounts.

It is crucial that savers and investors take account of the effects of inflation: it can quickly erode the value of your savings, reducing your purchasing power.

It is unsurprising, then, that more and more savers are looking at other options such as investment, in search of real returns and the potential for growth.

There is a link between investment risk and the potential for return: low levels of uncertainty or risk are associated with low potential returns, whereas high levels of uncertainty or risk are associated with high potential returns.

Assessing your needs

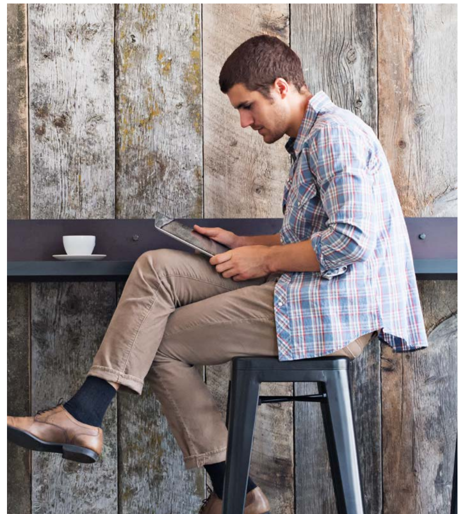
Before you start investing it is prudent to have a cash cushion, especially to guard against unforeseen expenses. A good starting point for assessing your financial needs can be found at **www.moneyadviceservice.org.uk/en/articles/beginners-guide-to-managing-your-money.**

Your rainy-day fund – generally speaking, aim for three months' income – should be held in an easy access savings or high interest current account.

Cash can also be useful in enabling investors to pick up other assets when they fall in price, but it is rarely recommended as part of a long-term investment portfolio.

First set aside enough funds to cover short-term emergencies and pay off any major debts. This is important because interest earned on savings could be lower than interest paid on credit cards or loans. Then study your finances to see how much you can potentially invest each month or as a lump sum.

Remember you need to ensure you have enough money set aside every month to cover basic living expenses such as food, housing and utilities as well as long-term expenses such as life insurance.



Setting your goals

The first step on your investment journey is to determine your goals – what you are aiming to achieve with your money. The longer the period over which you plan, the greater the risk you may be prepared to take, as you have time on your side to help ride out the peaks and troughs of financial markets.

If you are saving to fund a wedding in a year's time, for example, you may be better to remain in cash. However, if you are in your 20s, 30s, 40s or even 50s and are saving for retirement in your 60s or 70s you may like to invest.

Past performance is not a guide to future performance. The value of investments can go down as well as up and you may get back less than you invested

In broad terms, those with a medium- to long-term investment goal – five years or more – could consider stocks and shares given the historically higher returns offered by stock markets and to protect their savings against the impact of inflation.

Over the past ten years, a period that included the financial crisis and stock market crash of 2007, shares (also known as 'equities') have given a real average annual return of 2.3% per year and corporate bonds 1.8%, while cash has lost 1.1%, according to the Barclays Capital Equity Gilt Study 2016. According to the same study over 50 years, shares have returned an annualised 5.6% per year, while cash savings have eked out 1.4%.

Over 10 years shares have returned a real average annual return of

2.3%

*Over the 10 years to 2016.
Source: Barclays Capital Equity Gilt Study

Assessing your risk profile

Getting the balance right

The second step is to figure out what type of investor you are. This should determine the long-term trade-off between risk and return in your portfolio.

Your investment timeframe 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.

How you feel about taking investment risk – what financial advisers describe as your 'attitude to risk' or 'risk tolerance' – is likely to remain more constant over time.

For some people, safety is their prime concern: the thought of losing money, even over the short term, gives them sleepless nights so they pass up the opportunity for greater returns in exchange for peace of mind. Others are willing to take higher risks for the potential of higher returns.

The combination of risk tolerance and risk capacity determine your risk profile. If you are uncomfortable with the possibility of losing money and need to ensure you have cash available to pay for short-term goals, your risk profile will be low and you will probably only want to consider relatively safe investments. In this scenario, your risk profile might be described as 'cautious'.

However, if you are willing to take high risks in pursuit of higher potential returns, have the composure to ignore short-term market volatility and are mostly investing for longer-term goals, your risk profile will be relatively high and your money could be most exposed to shares and other higher-risk investments. You might be termed a 'balanced' or 'adventurous' investor, depending on where you sit on the risk spectrum.

Five tips for managing risk

Regardless of your risk profile, there are ways in which you can mitigate the risk of investing. Let's look at some of these:

1. Allocate your assets correctly

Nobody can consistently predict which sectors will perform the best, so don't try to time the market: the best approach to generate a real return and effectively manage risk is to ensure your portfolio is well diversified.

There are a number of so-called 'asset classes' including shares, bonds, property and cash. You can spread your risk by allocating your money across this list and ensuring the make up of your portfolio is appropriate for your risk tolerance and risk capacity.

2. Drip feed into markets

Regular investors benefit from 'pound cost averaging': regularly drip feeding money into the markets mitigates the risk of markets taking a tumble just after you have invested a large lump sum.

It means that you buy fewer shares when prices are high and more when prices are low; buying low and selling high is the key to successful investing.

Some share dealing services significantly cut the cost per deal for those who invest regularly.

Many investment funds allow you to make regular contributions from as little as £50 a month. More on funds later.

3. Keep your balance

Different asset classes will inevitably perform at different rates and your portfolio could quickly get out of kilter.

Take profits each year from sectors that have outperformed and reinvest in areas that are underweight in relative terms. Not only will you boost performance by regularly crystallising profits, but you will also ensure you are not taking more (or less) risk than you originally intended.

4. Ignore the noise

Investors often react in an emotional way: when the market goes up they buy and when it goes down they sell.

At any given time, in a well-diversified portfolio, you should expect some investments to be performing well and others to be doing badly.

Focus on your goals, adopt a long-term investment strategy and stick with it. That means not getting swayed by short-term 'noise', performance or market sentiment.

Building blocks of your portfolio

Getting the balance right

There are several building blocks that you could use to construct your portfolio. Let's look at some of these investment options:

Individual shares and bonds

One option is to build your own portfolio by investing in a range of individual shares and bonds.

Many share dealing services give access to shares listed on the London Stock Exchange, AIM (Alternative Investment Market) and foreign companies listed on major overseas markets. These might include main exchanges in New York, Frankfurt, Milan, Paris, Amsterdam and Brussels, as well as specialist indices, like the NASDAQ technology sector index.

Some also provide access to UK government gilts and corporate bonds. By buying these assets you are effectively lending money to the government or a company in return for a regular interest payment or coupon.

Deciding which shares or bonds to buy requires careful research and specialist knowledge of the different industries in which they operate. This means making time to research and monitor companies.

Those with a share dealing account often get access to a research centre, giving them up-to-date company news and market information.

Funds

If you have neither the time nor inclination to research individual holdings, consider investing in funds. These are pooled investments whereby the fund manager puts your money together with other investors' money.

In this way, they enable you to spread your capital over a much wider range of holdings than most investors could achieve by buying them individually. Funds also allow you to pool the costs of professional fund management with other investors.

The fund manager makes all the decisions about which assets to buy and sell, and the timing of these trades.

When you invest, you buy units or shares in the fund: the more you invest, the more you buy.

Funds are priced daily and investors get a valuation based on the number of units or shares they hold multiplied by the share price.

More information on a fund can be obtained on its fund fact sheet, typically published every month.

▪ Unit trusts and OEICs

The first main subset of investment funds is unit trusts and open-ended investment companies (OEICs). There are hundreds of them available to UK investors from several investment managers, offering a diverse range of funds specialising in worldwide investments or any number of different geographical locations or industry sectors.

Some invest in a single asset class – say, shares – while others hold more than one type of asset and are often known as 'multi asset' funds.

Funds can have a very broad global remit or can be categorised into country and regional funds, and sub-divided further into funds that invest only in certain industry sectors.

Each fund will have its own investment objectives and will detail which type of assets and markets it invests in, allowing investors to identify whether a fund is suited to their risk profile and goals. Some funds aim for capital growth, while others target income, for example.

Unit trusts and OEICs are 'open-ended' funds as the number of units in issue fluctuates in response to demand from buyers and sellers. If you want to buy into one, the manager can simply create new units with the money you've provided.

▪ Investment trusts

The investment trust universe is much smaller, but it still offers a wide variety of investment options.

The biggest difference between these and unit trusts and OEICs is that investment trusts are 'closed-ended' funds, because they have a finite number of shares in circulation.

This stable pool of capital means that investment trust managers will never be forced to sell underlying assets to meet redemptions: every selling shareholder must be first matched with a buyer, through the stock market, before a transaction can take place. It is for this reason that investment trusts are well suited to assets which are harder to buy and sell, like property.

However, the greater complexity of these funds can dissuade investors. Investment trust shares can trade at more than their assets are worth (called trading at a 'premium') or less (trading at a 'discount'). Their managers can use 'gearing' – borrowing money to invest alongside shareholders' capital. This can augment

profits in rising markets, but can also increase losses in falling markets.

▪ Exchange-traded funds

Unit trusts, OEICs and investment trusts are actively-managed funds: fund managers actively buy and sell the constituents of their portfolios based upon their investment process and research. The hope is that they will outperform the market against which they are measuring their performance.

Exchange-traded funds (ETFs), on the other hand, track an index of shares (like the FTSE 100), bonds or commodities – anything from precious metals like gold and silver to cattle, water and timber.

The prices of ETFs change throughout the day as they are bought and sold.

▪ Investment style: active or passive?

Passive funds, like ETFs, give low-cost access to a basket of assets. They are simply intended to match the performance of those assets and will therefore never outperform the index they follow. The performance will be slightly worse after investment costs and 'tracking error' (differences in the performance of the fund and the underlying assets) are considered.

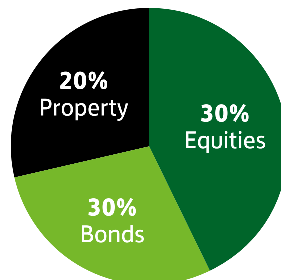
Active funds are 'actively' managed by an expert making stock selections and could therefore perform better than the market. Some active funds do outperform, but certainly not all. The costs associated with active fund management are higher.

Tracker funds simply buy constituents of an index, while active managers can work to avoid the risks they want to avoid and take on the risks that make the most sense for investors.

The UK stock market, for example, is heavily concentrated in oil and financials – two sectors that many investors would have wanted to avoid in recent years.

Clearly, both investment styles have their pros and cons, but it doesn't need to be a binary choice. Many financial advisers advocate holding active funds in sectors where the fund manager should be able to outperform, such as in smaller companies or emerging markets, and passive funds in highly efficient markets where outperformance has proven less likely, such as large cap UK and US equities.

HYPOTHETICAL MODEL PORTFOLIO



Source: Shares Magazine

Tax wrappers

Protect your returns

When investing, it is always best to do so as tax efficiently as possibly – keeping as much of your money in your hands and out of the taxman's. Individual savings accounts (ISAs) and pensions are chief among ways of doing this. Let's take a closer look:

ISAs

Utilising your tax-free ISA allowance should be the first port of call for UK taxpayers looking to shelter their money from the taxman and limit the impact of inflation.

The allowance for 2017/18 is £20,000. Proceeds (both capital and income) roll up free of tax.

You can either save in cash or invest in a range of assets, including a single investment fund, more than one fund or individual shares and bonds. You can transfer your ISA holdings both ways between a cash ISA and an investment ISA to suit your circumstances.

Every tax year, the total allowance can be paid into a cash ISA, a stocks and shares ISA, an innovative finance ISA or a combination of the three.

From April 2017, those aged 18 to 40 will also be able to put up to £4,000 of their allowance into a lifetime ISA. Any savings put into this account before your 50th birthday will receive an added 25% bonus from the government, provided you either put the money towards a deposit on a first home or your retirement from age 60.

SIPPs

Pensions are the most tax-efficient way of saving for retirement. While traditional pensions typically restrict investment choice to a limited list of funds, usually run by the pension company's own fund managers, self-invested personal pensions (SIPPs) let you choose your own investments from the full range of investments approved by HM Revenue & Customs.

Like all pensions, SIPPs attract tax relief on contributions at your highest marginal rate (20% for basic rate taxpayers, 40% for higher rate taxpayers and 45% for additional rate taxpayers) and there is no capital gains tax or income tax to pay.

From age 55 (57 from 2028), you can start making withdrawals, normally up to 25% tax free and the rest taxed as income.

Pricing

So, how much does investing cost? Execution-only services, whereby investors can choose their investments online themselves, buying and selling at the click of a mouse (but do not receive advice on what to own), are typically the cheapest means of investing.

Some charge a flat fee, say £40 per year, while others charge a percentage of your investments, say 0.45% per annum on portfolios of up to £250,000 (less for more than this).

Consulting an intermediary, like a financial adviser – thus receiving advice – will cost more than this. Advisers typically levy 1% of an investment portfolio per annum or fees that average £150 per hour.

On top of this there is the cost of the underlying investments. Buying shares, bonds or units in an investment fund will cost the price of the asset and dealing commission. Stamp duty is also charged at 0.5% on individual UK company and investment trust shares.

Dealing commission is typically charged at a set amount per trade, with funds often being much cheaper to trade than individual stocks.

Funds also carry fees – the best figure to look at is the 'ongoing charges figure' as this, in theory, should reflect the total cost of you owning the fund.

Where can I find out more?

Build your investment knowledge

The Investment Association **(theinvestmentassociation.org)** is the representative body for unit trust and open-ended investment company managers, while the Association of Investment Companies **(theaic.co.uk)** represents investment trust managers – their websites are packed with information and statistics.

Tax rates and reliefs are subject to change and the value of any tax benefits will depend on your individual circumstances. For information on tax thresholds and exemptions to go the 'money and tax' section of the UK government website **(gov.uk)**.

For information on the state pension or to get an entitlement forecast check out the 'working, jobs and pensions' section at gov.uk.

It might be prudent to consult an independent financial adviser about your investment needs and risk profile. Find an independent financial adviser in your area through Unbiased **(unbiased.co.uk)**.

Glossary of key terms

Asset class

There are four main asset classes that you can use to build your portfolio: shares, bonds, property and cash.

AIM or Alternative Investment Market

AIM or Alternative Investment Market
The London Stock Exchange's market aimed at smaller growing companies.

Bonds

Corporate bonds are effectively IOUs issued by companies to investors, who receive a fixed rate of interest over a set period in return. They are considered higher risk than government bonds (see 'gilts'), due to the greater risk of a company defaulting on its debt than a government.

Earnings per share

A widely followed profit measure. Calculated as net profit divided by total number of shares.

Fund fact sheet

Fund managers publish information fact sheets on the funds they manage, typically once a month. These can often be sourced through their websites or investment analysis services like **trustnet.com**.

Fund manager

Fund managers, also known as investment managers, are investment professionals who manage investors' money on their behalf.

Gilts

Gilts, also known as government bonds or gilt-edged securities, are issued to support government spending. UK gilts are issued by HM Treasury and listed on the London Stock Exchange.

Inflation

Inflation refers to an increase in the general level of prices for goods and services. It is measured as an annual percentage increase. As inflation rises, every pound you own buys a smaller percentage of a good or service.

Glossary of key terms

ISA

An Individual Savings Account is a tax free wrapper which enables you to shelter a certain amount of cash and stocks and shares from capital gains and income tax.

Liquidity

How easy it is to buy or sell an investment.

Main Market

The primary equity market of the London Stock Exchange.

OEIC (Open Ended Investment Company)

A UK fund structured to invest in companies or other assets. Investors can freely buy and sell shares in the fund which grows or shrinks accordingly.

Ongoing charges figure

This should reflect the total cost of owning an investment fund and should be found on a fund factsheet.

Risk profile

This is determined by your risk tolerance (how comfortable you are with the prospect of losing money) and risk capacity (how much risk you can take based on your age and investment objectives).

Shares

Shares, also known as equities, give the right to share in the ownership of a company. If a company is very profitable, its shares are likely to rise in value as more investors will want to buy them. On the other hand, if the company goes under, shareholders risk losing all the money they have invested.

Stamp duty

Payable on the purchase of UK shares at 0.5%.

Tax wrapper

There are several tax wrappers available in the UK, through which you can hold a range of assets in tax-efficiently.

Find out more

Go to lloydsbank.com

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If you have a hearing or speech impairment you can contact us using the Next Generation Text (NGT) Service or via Textphone on 0345 300 2281 (lines are open 24 hours a day, 7 days a week).

If you're Deaf and a BSL user, you can use the SignVideo service available at lloydsbank.com/accessibility/signvideo.asp

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