A guide to savings and investments

What Investment

Saga

Welcome

Many millions of people in the UK choose investing to give their money the opportunity to grow. Despite the worldwide financial turmoil of recent years, stock markets have historically generated greater wealth than standard bank accounts for those making the most of their opportunities. Many smart investors are still doing well in the continuing uncertain climate, while the most savvy can even turn it to their favour.

Starting out investing can seem like a daunting prospect, but once you're familiar with the products available and the terminology involved, it can be quite straightforward. By gaining further information and knowledge along the way, you can build up your expertise along with a valuable portfolio of investments.

Today, you can buy and sell shares in individual companies, invest in different types of shares to create a diverse portfolio or enter into collective schemes called funds. What's more, it's never been easier to buy, sell and carry out research, thanks to the modern miracle of the internet.

Over the coming pages, we show you how to assess your existing financial position, set your goals and develop a strong investment portfolio. We'll also discuss the concept of risk and show you how to avoid some of the common pitfalls that can affect many investors starting out.

The publishers of this guide

Saga Personal Finance has produced this guide in association with *What Investment* magazine, a leading investment publication established in 1982. *What Investment* helps investors monitor individual funds, find out which assets offer the highest potential returns, and – most importantly – enables them to make better investment decisions.

What Investment is published by Vitesse Media plc, a fast-growing media company that is quoted on the AIM (Alternative Investment Market) sector of the London Stock Exchange. An online version of the magazine, *whatinvestment.co.uk*, was launched in 2000.

Before you begin…

It's vital to remember that the value of stocks and shares can go down as well as up and you may not get back the money you put in. If you are unsure if investing is right for you, it's best to contact an independent financial adviser.

Also, because the value of stocks and shares can vary, you don't want to be forced to sell at the wrong moment just because you urgently need money. It's best to keep some emergency cash in an instant access savings account that offers interest, with no penalties for immediate withdrawal.

The essentials of saving…

The moment you salvage all your cash from the back of the sofa and place it in an account paying interest, your savings become a form of investment. However, there is an important distinction between saving and investing.

Savings are the pool of money that form the basis of your initial investment lump sum. They represent your 'emergency cash', usually held in an account that has little or no risk attached – such as a building society or bank deposit account. You can access it easily but rates of return are usually low and inflation can undermine the value of the interest received. For example, if you place your money in a cash deposit account that pays 2% when inflation stands at 5%, a year later you will have made a 3% loss on the value of your money.

In the short term, inflation doesn't necessarily increase the price of everything (house prices can fall, for example), but consider its cumulative effect – 3% this year, 3% next – even if inflation stays close to the government's target, in 20 years' time your money would be worth about half as much as it is now.

… and the basics of investing

Of course, there is a place for savings. A well thought-out selection of investments should include a pool of savings that can be accessed in times of emergency or on a rainy day, but the rest of your money could be employed towards longer-term goals. That's where investing in the stock markets comes in.

Anyone who watches television news will know that stock markets go up and down, influenced by all kinds of factors. For example, they rose in line with the development of the internet during the 1990s, crashed following the credit crunch of 2008 and rocked around after the Japanese tsunami of March 2011. On a more day-to-day basis, they are influenced by good or bad economic data or simply swept along by vagaries and trends.

Despite this, over the last thirty years one thing has remained fairly constant – stock markets have reflected the fact that national economies tend to develop and dynamic companies tend to generate profits. Historically, investing your money in the right place at the right time has generated greater returns than a standard savings account. That's why investors continue to place so much money in the stock market, and try to profit from its ups and downs by buying and selling at the right time.

However, the unpredictability of the markets means that investing in them entails a certain degree of risk. You may have to wait a long time for your money to grow – and you might not even get back the money you put in. So it's very important to only invest money you can afford to lose.

Planning a portfolio

Building a good, diverse portfolio of investments is an important part of making your money work for you. Before you begin, there are a number of questions you should answer to help ensure you make the right decisions for your money.

Essential things to consider

Everybody has different financial requirements – some people want to derive readily accessible income from their money, others want to fund their future plans or retirement. One popular goal is to save for a child's future, whether it be their marriage, education or a house deposit.

So it's very important to decide what you want to achieve, especially between immediate access to your money or leaving it committed for a longer time. You must also consider your attitude to risk, and the everyday realities of investing in and owning shares.

For example, are you likely to panic if your investments lose value in the short term, or would you be happy to sit on the loss in the hope of an eventual upturn? Might you need to access your money at short notice and be upset to find that, at that particular moment, you have less than you invested? Do you have the time and patience to methodically research new investments and move your money around – particularly if your initial choices aren't doing as well as you'd hoped?

Answering these questions can make it easier to choose where and what you would like to invest in.

Cash savings accounts

Having enough cash readily available, but still generating a return, is a vital part of any investment portfolio. Because cash deposit accounts have the lowest risk, they are ideal for cautious customers – although you should be aware that some accounts incur penalties if you withdraw your money early. And as we discussed earlier, inflation can erode the value of your savings too.

You can choose between easy-access accounts and ones where you need to give some notice before withdrawing your money. Some offer a fixed rate of interest, so you know exactly what you will receive, whereas others offer a variable rate that usually tracks the main Bank of England Base Rate.

The latest rates can be found on comparison websites, but be aware that the highest returns usually require you to keep your money locked in for a specific time – usually between one and five years. It's important to always have some money immediately available for emergencies.

Saving within an ISA

Normally when you save money in a deposit account, any interest you receive is liable to tax. However, a Cash ISA (Individual Savings Account) is a special type of account where the interest is paid tax-free. It makes sense to choose this option if you want to save money in a low risk way, which is why the amount held in UK Cash ISAs at the end of the 2014/15 tax year was more than £200 billion.

There are two kinds of ISA - a Cash ISA and a Stocks and Shares ISA. During the 2016/17 tax year, the ISA allowance is £15,240. You can invest the full amount into a Stocks and Shares ISA, a Cash ISA or any combination of the two. You can also move your annual allowance between a Cash ISA and Stocks and Shares ISA. Plus, you can withdraw money from a Cash ISA or cash held within a Stocks and Shares ISA and replace it later without this counting towards your annual ISA allowance limit. Once all the withdrawn money has been replaced, any additional investment will then be counted towards your allowance. Check with your ISA provider for withdrawal terms and conditions.

To complement your 2016/17 allowance, you could consider transferring money from any ISAs you have taken out in previous years. If you have one that is languishing, perhaps because its initial rate has fallen, try to find one that provides a better return and allows you to transfer the money across. Think twice before moving money from an ISA into a normal bank account, though, because it will lose its tax-free status and a higher interest rate is unlikely to compensate for this.

A Cash ISA does actually operate pretty much like a normal savings account, except that tax is not deducted from the interest you receive, but always check you are happy with any terms and conditions such as penalties for withdrawals.

A Stocks and Shares ISA means your money is invested in the stock market, so you shift from everyday saving to investing and hence your money is at greater risk. You can choose a Stocks and Shares ISA that is managed for you by the bank or financial organisation that provides it, or use one as a tax-free 'wrapper' for your own stock market investments up to the ISA limit. You then enter the realm of making your own investment decisions.

Individual investments

Inside or outside an ISA, there is a wide range of investments and products available for investors. A common individual approach is to buy shares (which are also known as equities) in one or more companies that you feel will be successful in the future. Over 3,000 companies are listed on the London Stock Exchange, the organisation that ultimately facilitates the buying and selling of their shares. In return, they must all abide by its various rules and regulations.

By buying shares in a company, you become a shareholder and effectively own part of that company. If the company proves successful, the value of your shares should theoretically increase. What's more, successful companies normally pay their shareholders a dividend, perhaps up to twice a year. The size of this monetary 'thank you' may reflect the company's profits, but it might still be paid even if the share value has not increased.

Of course, your investment may reduce in value if the company fares badly, or be lost altogether if it goes bankrupt. For this reason, the majority of investors choose established, wealth-generating companies such as those listed on the London FTSE index. The All-Share version of this actually consists of some 700 companies, while the FTSE 100 constitutes some of the biggest and best known in the UK. However, some investors think that smaller companies lower down the index have more potential to grow, plus their shares are usually cheaper to buy – but that doesn't mean they will turn out to be profitable.

Collective investments

Perhaps the simplest way to invest is to join other people in a collective investment known as a fund, and this is a popular route for many investors. Normally managed by experts within dedicated fund management companies, funds can invest in a far wider range of companies, assets and markets than would be practical or affordable for the average individual. Theoretically, expert management should result in better returns and risk management too, but that's certainly not always the case.

Through a fund management company, you can target everything from established UK companies to emerging overseas markets, plus niche areas such as solar energy, precious metals and technology.

There is a large amount of information available on the internet to help you research fund management companies, the historical performance of funds, the record of individual managers and much more. One of the most popular is www.morningstar.com which also tracks and publishes daily share prices.

In general, though, funds form the core of most investor's portfolios and – for the average private individual – there are four main types:

1. Unit trusts

One of the most common types of fund, unit trusts invest in companies that are listed on the stock market. However, trusts are not listed on the stock market themselves.

A fund investment company manages each unit trust and investors buy into it via units. New units can be created to satisfy demand. When people want to sell their investment, the trust 'cancels' the units. There are two prices for the units: the offer price is what you pay to buy new units (which includes any charges from the investment house). The bid price is how much you get if you sell your units.

The price of these units is calculated from the fund's Net Asset Value (or NAV). The NAV is calculated by totting up the current market worth of all of the investments that the fund owns, then dividing it by the number of units issued. This normally happens on a daily basis.

The financial pages of most quality national newspapers print the daily price of the largest unit trusts, or the information can be found at www.morningstar.com.

2. Open Ended Investment Companies (OEICs)

In many ways, OEICs are like unit trusts and in some cases have replaced them. New shares can be issued each time money is invested, or cancelled in accordance with demand. They also can't be traded on a stock exchange. The main difference is that an OEIC is not set up legally as a 'trust'. Instead, the assets of the fund are held within a specially established company.

3. Investment trusts/closed-ended funds

Investment trusts are companies that have been set up for the sole purpose of investing in other company's shares. They can invest in any company across the world, whether listed on a stock exchange or not, and they are able to offer venture capital to new companies looking to expand. They have an independent board of directors and are run in the interests of their shareholders just like any other investment company.

Because they are listed companies, investment trusts have the option to borrow from banks in order to make additional investments. For example, they could put some money into an up and coming small business that might help it expand or advertise. Then all the shareholders would benefit from any extra returns.

Whereas unit trusts and open-ended investment companies can create new shares to meet demand, the number of shares issued by investment trusts is normally fixed (hence they are 'closed-ended' funds). The price of each share simply goes up and down in accordance with supply and demand. Consumer magazines such as What Investment publish details of these discounts and premiums in their listings every month.

4. Exchange-traded products

The above options are known as 'actively managed' funds because they are run by a group of experts who aim to outperform an index such as the FTSE. These experts try to make choices that will maximise returns for their investors.

Exchange-traded products – or ETPs – on the other hand, are computerised accounts that merely track an index. Hence, they are sometimes called Tracker Funds. They can come in the form of funds (ETFs), notes (ETNs), commodities (ETCs) or currencies, and they are able to trade on the stock exchange.

ETPs assume that an index such as the FTSE will ultimately increase in value and provide greater returns than a standard bank savings account – and historically this has proved the case. What's more, because ETPs aren't run by managers, their charges tend to be quite a bit lower than actively managed funds. This is attractive to some investors because many actively managed funds don't outperform the index either.

One important thing to be aware of is that different ETPs track indexes in different ways. For example, a 'leveraged' ETF is designed to exceed the performance of its associated index – so if the index rises by 3%, the ETF may rise by 6%. However, this kind of ETF will also fall further than the index. Products that promise high returns usually carry a high level of risk, so it's important to scrutinise any that interest you.

Asset classes and risk

Investors may be able to reduce the amount of risk in a portfolio by diversifying their investments between 'asset classes'. This basically refers to different categories of investment. Because different asset classes perform in different ways, depending on prevailing economic and market conditions, it is important to have a spread of funds in various classes to reduce overall risk across a portfolio.

The five most common assets in the average investor's portfolio are: cash, bonds, property, equities and overseas investments. The equities class ranges from shares in large cap (big companies with lots of capital) to small cap (riskier small companies with less capital). The following table shows the main assets classes and the level of risk that financial experts attach to them.

Within your own portfolio, the percentage split between the various asset classes will depend on your own attitude to risk and your assessment of the prevailing market. Here is a summary of the five main classes, some details of which we have mentioned earlier.

1. Cash

Cash savings accounts are a good way to protect your capital over short periods of time. Risk to your money is very low and you can access it in an emergency without having to break into longer-term investments. Rates of interest tend to be small, but can be increased if you commit for a period of time. However, the value of your money might be reduced by inflation.

2. Bonds

With a share you own part of a company, but with a bond you are effectively lending that company money. National governments also sometimes issue bonds in order to borrow money. A bond issued by the UK government is known as a Gilt.

In return for your investment, the bond issuer pays you a fixed amount of interest on an agreed date or dates. Sometimes referred to as 'fixed interest' securities, bonds are therefore useful if you are seeking a regular income. The longer the bond's redemption period, the higher your return might be.

Also, if general interest rates fall below the rate agreed on your bond, it could become an even better investment and sellable for a profit. Of course, if the reverse occurs you may wish you'd invested your money elsewhere – but at least you'll still receive the interest you are expecting. In fact, even if the issuer goes bankrupt and can no longer pay the interest, bondholders can expect a degree of financial compensation unavailable with normal stocks and shares.

High yield corporate bonds are considered the highest risk among bonds because their issuers are considered to be at a greater risk of not honouring their commitments. They therefore offer a higher yield in order to entice investors.

You can invest in bonds directly (via a stockbroker or through the London Stock Exchange's ORB system), or through funds that specialise in identifying the best bonds on the market.

3. Property

If you already own your home or have a mortgage, you will be familiar with the concept of investing in bricks and mortar. Some people purchase additional property in the hope that rental income will cover the mortgage and provide a long-term investment – perhaps reselling the property at a profit if prices escalate. They also like the idea of owning something tangible in return for their money.

It's important to remember that mortgage rates can increase whereas rental incomes may not, so this investment relies on securing good tenants and rent that stays in line with the mortgage payments. Also, bear in mind that physical property needs to be maintained and can be difficult to dispose of, especially during a downturn.

As well as purchasing actual property, it is also possible to select funds that invest in companies that develop it. This might involve commercial and industrial property too. These funds are known as Real Estate Investment Trusts or REITs. The value of your investment will reflect demand, rental income and wider economic wellbeing, but at least you will not be left with empty or unsellable bricks and mortar.

4. UK Equities

Equities are shares in companies and can be bought directly (via a stockbroker) or through an investment fund. They are a way to benefit from any profit the company generates, and take the form of an increase in the share price or a dividend pay out.

History shows that equities normally increase over the long term because company profits tend to go upwards. However, major events such as the credit crunch can affect the financial strength of companies and the resulting value of the shares. If a company goes bust, the shares become worthless and all your initial capital investment may be lost.

For this reason, equities present a higher potential risk than bonds – and a much higher risk than cash. However, the amount of risk is also determined by the size of the company – a large cap organisation listed on the FTSE 100 is potentially less risky than a small company holding far less capital – but an enthusiastic small company headed by someone with a good track record might be an attractive alternative.

It's also important to consider the business sectors in which companies operate. This enables you to invest in specific areas such as energy, utilities, environmental products, the media and so on. Overall, a good standard of research is key to safer investment within the equity asset class.

5. Overseas investments

In recent years, the emergence of large overseas economies such as India and China has tempted investors to choose funds that access this growth. In many areas, this has proved fruitful – especially if the particular country's banks weren't overly implicated in the 2008 credit crunch.

However, it's important to remember that overseas companies are not necessarily as well regulated as those in the UK. You can't always monitor their performance, rely on their declarations or expect a dividend pay out. On the other hand, some large overseas companies are probably less risky proposals than a small UK one! Either way, your chosen fund will almost certainly invest using the country's own currency and any profit might be undermined (or enhanced) by shifts in the exchange rate.

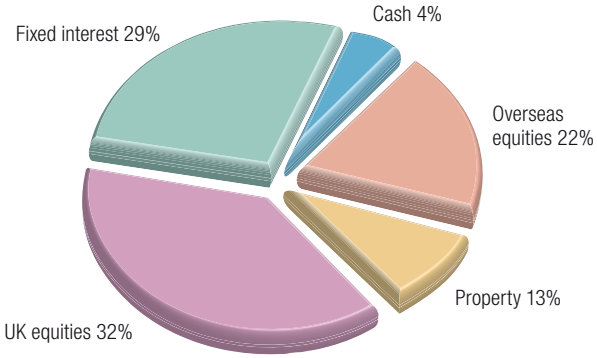
Diversifying your portfolio

Experts recommend that long-term investors spread their money across asset classes such as those in the previous pages. This is referred to as 'portfolio diversification'. In doing so, the aim is to reduce the risk of all your assets losing value at the same time.

The example chart below represents the typical mix of assets you might find in a portfolio suitable for an investor with a moderate attitude to risk and would be held for at least five years.

The mix of assets in your own portfolio would depend upon your own preferences, experience and assessment of the prevailing trading conditions.

ASSET CLASS MIXTURE



An introduction to share dealing

People opting for direct equity investment are increasingly using the internet to carry out their buying and selling. The development of sophisticated online facilities has led to an increase in investor trust with the cost of trading falling considerably. Saga Share Direct says that over 65% of its customers now prefer to complete their transactions online instead of over the phone.

Although private share ownership overall has dropped, the popularity of online dealing has increased. The internet is also helpful in analysing fund performance and identifying opportunities arising from weakness in the markets.

The appeal of online share dealing is that it is relatively cheap and you are in full control. You can choose from a wide variety of share dealing services and funds, plus you can trade as often or as little as you like.

With some dedicated share dealing services (called 'fund supermarkets'), you can do all your business in one place. They enable you to select from a wide choice of asset classes and shares, invest inside or outside an ISA and analyse your portfolio at a glance. Some larger fund supermarkets offer low or zero commission charges on each initial investment, too – although they might incur fees in other ways.

That's why you should clearly determine how much it will cost to use a share dealing service, especially in relation to the volume of trades you are likely to make over a 12-month period. For example, does the service make a flat rate charge each time you buy and sell or take a percentage of each trade's value? Do they require more money per trade if you only deal infrequently – or even penalise you for not dealing at all?

A novice trader can easily be tempted by the headline price of a service, but not enjoy access to the information and training tools offered by a more expensive provider.

Practising your art

For example, something a cheaper share dealing service might not offer is the facility to practice buying and selling using 'virtual' money. This useful feature not only enables you to learn how to use the service, but also reveals the outcomes of your investment choices – just as if you'd undertaken them in the real world. It's a great way for you to discover the ins and outs of trading, see what seems to work for you and hopefully learn from any mistakes.

Investment clubs

Joining a local group of investors is a great way to meet people who share your interest, learn from their experience and pool resources. You are also more likely to invest in a greater diversity of shares than you would have chosen yourself. Hopefully, any losses made on some investments will be compensated by gains on others, too. Visit www.proshareclubs.co.uk for lots of useful information and details of clubs in your area.

Gradually does it?

Some share dealing services allow you to invest in a company or fund via monthly instalments rather than committing all your money upfront. This can be useful if the value of your investment falls because you will have limited your exposure to it. Also, if you decide to continue with the investment, you will then be buying at the lower price. Of course, if the fund suddenly rises in value, you won't benefit as much because less money has been committed.

Ten tips for choosing a share dealing service

1. Go to investor forums on the internet and read the feedback on each company
2. Give consideration to the markets you want to trade in
3. Compare dealing costs and administration charges
4. Check the company is registered with the Financial Conduct Authority (FCA)
5. Check the company's disciplinary record on the FCA register
6. Consider whether you need investment advice and ask if it is offered
7. Analyse the dealing services available
8. Ask if the company has practice facilities
9. Consider what training and research tools are available
10. Evaluate how clear the company's response is to your questions.

Some final questions

How often should I look at my portfolio?

Markets can change very quickly, and so can your own objectives, so you should review your portfolio frequently. Look at your assets and rebalance them at least once a year, and perhaps more if the markets are volatile. This makes you analyse how well your investments are doing and see if they still reflect the wider economic world. It also helps you to sell when the price is high and buy new things when their price is low. You should always be aware that the value of your investments can fall as well as rise and you may get back less than you invested.

How can I avoid losing all my money if the economy shrinks?

Putting your money in a range of investments across a variety of different categories can help spread the risk of losing out. If one investment starts to suffer, perhaps another may compensate.

For example, if you invest your money in a company that builds houses and the property market collapses, you may lose money. But if you have also invested in a company that provides conservatories, you might see gains as people develop their existing property rather than moving house.

Of course, it is also possible to move your money from a struggling investment into one that is performing better – providing you do your research properly and remember that the value of all shares can go down as well as up, so the one you ditch could do better in a while.

What protection is there for investors?

Before choosing a fund investment company – even if you access its funds through an established share dealing service – you should ensure that it is included on the register administered by the Financial Conduct Authority (FCA). This shows that they are an authorised and regulated provider.

If your chosen registered provider goes out of business, The Financial Services Compensation Scheme covers you for up to £50,000 of investments (cash deposits are covered under a separate limit of £75,000). However, if you invest in a provider that isn't covered by the Financial Services Compensation Scheme and it ceases to trade, you could lose all the money held. Unfortunately, the scheme doesn't cover you for anything you lose as part of your share dealing!

What if I am unsure what to do?

Just remember that the value of shares can go down as well as up, so you may want to take expert, independent financial advice to help minimise the risk. Also, keep some cash available in case of emergencies, so you aren't forced to sell any shares when you would rather not.

Further information

The Consumer Financial Education Body
www.moneymadeclear.org.uk

Fund information
www.trustnet.com
www.morningstar.com

Online financial information
www.londonstockexchange.com
www.whatinvestment.co.uk

Investment clubs
www.proshareclubs.co.uk

Financial Conduct Authority
www.fca.org.uk

Financial Services Compensation Scheme
www.fscs.org.uk

More financial services *from Saga*

When making financial decisions, it's important to ensure you select the right products for your needs. Equally important is choosing a company you can trust.

At Saga, we deal exclusively with people aged 50 and over. We have helped hundreds of thousands of customers with their financial circumstances, so we understand the most common issues and have the appropriate answers. In many instances, we can tailor the solution to your individual requirements.

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- **Financial planning**
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CSW-AF0836