*Phone: 0117 900 9000 | Visit: www.hl.co.uk*

# A guide to investment risk & reward

For more information please contact us on 0117 900 9000 or visit our website www.hl.co.uk


Hargreaves Lansdown

One College Square South,
Anchor Road, Bristol, BS1 5HL
**www.hl.co.uk**

## Contents

p2 **Foreword**

p4 **Understanding risk**
p4 - Risk and reward
p5 - How much in each area?
p6 - The financial crisis of 2008
p6 - Measuring risk
p7 - Is there such a thing as a no risk investment?
p7 - Timescale
p8 - Income or growth?
p9 - Investment amount

p10 **Risk factors you can't control**

p12 **Finding the right balance**

p14 **Seven questions to help you assess your risk profile**

p15 **Different types of investments and their risks**
p15 - Chapter 1: Cash
p18 - Chapter 2: Fixed Interest
p22 - Chapter 3: Equities
p27 - Chapter 4: Property
p30 - Chapter 5: Alternative investment strategies

p34 **Methods of buying and holding investments**
p34 - ISAs
p35 - Investment bonds
p36 - Regular savings
p36 - Pensions - saving for retirement

p41 **Questions to ask**

p43 **Appendix: The Financial Services Compensation Scheme**

p44 **Useful telephone numbers**

# Foreword

**MARK DAMPIER**
**HEAD OF RESEARCH**

Many investors find the financial world a complex one. Sometimes they fail to understand the nature of the investments they hold, which can lead to disappointment, even shock, in the event of losses. Too few people are in a position to assess risk before they invest. This guide is written to help you understand the nature of risk and reward. This includes the risk to your capital from inflation and fraud, as well as market risk.

Investors are usually advised not to put all their eggs in one basket. In general this makes absolute sense - the idea being that if one of your investments is performing poorly, another one could be making up for it. In recent times, however, most investments have suffered a pretty torrid time, even those which are not usually correlated with each other.

During times of extreme financial stress, the rules which normally apply can break down if confidence in the system itself begins to weaken. Asset classes fall in value together as investors sell indiscriminately, preferring the relative security of cash. The more risky the asset, the more likely it will

fall in times such as this.

At the other end of the spectrum, the interaction of economies and markets can mean that perceived low risk assets like cash can turn out every bit the disaster that 'high risk' investments can. Those who held their money in gilts and cash in the 1970s and early 1980s will know the damage that extremes of inflation can inflict on their assets, just as a bear market can destroy the value of shares.

For this reason, we believe it continues to make sense to invest for the long term and spread investments across different regions and asset classes. Ultimately, on the subject of risk, I am afraid that the best person to select the level of risk with which you are comfortable is yourself. We can help by framing some of the questions and points to consider. We also explain the characteristics of the main products on offer and suggest some questions to ask before you invest.

Finally, I suggest that investors should keep this point in mind. It is not the return on your investment that should be your only concern; it is also the return of your investment.

***Everyone wants something for nothing - the gain without the pain and the reward without the risk.***

But when it comes to investments, risk and reward have a pretty close relationship.

The higher the potential return, the higher the accompanying risk - and the smaller the chances a person is prepared to take, the lower the gains they are likely to make.

Getting the risk/return balance right will depend on a number of factors, including investment goals and timescale, and whether income or growth is sought. Crucially, it will also be decided by how much volatility an investor is prepared to accept.

This guide aims to help you decide how much risk you are comfortable with - your risk "profile" in effect - and to show you how to match your investments to that profile.

# UNDERSTANDING RISK

Investment risk is a slippery beast to wrestle with, but most investors tend to view it as the likelihood of their investments suddenly plummeting in value. What they are concerned about is volatility - the tendency of an investment to vary in price. But if price falls were the only worry, investors could protect themselves by simply using cash deposit accounts.

Another, possibly greater, risk is that an investor's money will not grow fast enough to meet their needs. For those trying to build up as big a retirement pot as possible, or anyone saving for a specific goal such as a property purchase or school fees, this is a very real danger.

## Risk and Reward

The main types of financial asset - equities, fixed interest securities, property and cash - each have different characteristics, but only cash and some National Savings products offer capital security. The others all suffer from price volatility to a greater or lesser extent. But history shows that over the long term the most volatile type of asset, equities, has provided the best returns.

***Cash deposits*** such as bank or building society savings accounts offer capital security and a rate of interest, usually variable but in some cases fixed. Long-term returns have tended to be lower than those from the other asset classes, which means they are disproportionately affected by inflation. These low inflation-adjusted "real" returns mean that for long-term investors the risk that their money will not grow fast enough is high. However cash is generally the best home for short-term savings, and the essential first requirement of all investment planning is to build up an emergency fund. Every individual has a different set of calls on their capital, and the best person to assess the amount you need to hold on deposit is yourself.

***Fixed interest securities*** such as gilts and corporate bonds in their purest form are one of the only types of investment where investors know at the outset what their income and capital return will be. Between issue and the point at which they are redeemed, investors can buy and sell fixed interest securities just like any other investment and, like other investments, that value could fall as well as rise so you could get back less than you invest. These securities are essentially a loan to institutions who wish to raise finance. The term of the loan and repayment value is set at the outset, together with a predetermined rate of interest payable. Plainly, the security of the institution borrowing the money is of prime importance. There are few more secure than the UK government, which literally used to edge the loan certificates in gilt, giving rise to the term 'gilt edged securities'. Generally, the stronger the institution issuing the loan, the lower the return they need to offer to attract finance. Conversely, less creditworthy companies and governments need to pay more to attract finance and therefore offer higher returns.

During the life of the loan, the debt can be traded on the stock market. If the level of income looks attractive relative to current interest rates (also taking into account the level of risk), the price of the stock is likely to rise. Conversely, if the level of income looks unattractive, or concerns increase about the possibility of the issuer defaulting, the price should fall. This can give rise to pricing anomalies. Most investors participate in fixed interest through professionally managed funds, which aim to add value by exploiting pricing anomalies, and reduce risk by diversification.

However, when investing through a fund, the investor no longer has a predetermined redemption date and price.

The fixed interest sector covers a wide spectrum of risk and reward, from UK gilts to high yielding 'junk' bonds. 2008 demonstrated that companies rated as unlikely to default one month could be considered extremely high risk the next. In the event of any such default, fixed interest securities are not normally covered by the protection of the FSCS. Further explanation of fixed interest and the different ways to participate in this market are in the 'Different Investments and Their Risks' section which begins on page 15.

***Equity investments***, such as shares and the various types of fund that invest in them, allow individuals to share in the profits and growth of companies. In the past they have offered the best potential for capital growth and a growing income from dividends. However, they provide no security and are generally the most volatile of the four main types of asset.

The volatility of individual shares varies. For example, shares in a water company with a secure customer base and steady dividend record, may trade in a fairly narrow range. Shares in a technology company, with high product development costs and potential profits many years away, can move up and down dramatically. Likewise shares listed in emerging markets will usually be more volatile than UK shares because these economies are less mature and therefore perceived as more risky. In addition, changes in currency exchange rates will impact the return. Investing in a fund, or a spread of different shares will iron out some of the volatility of holding individual shares.

***Property*** is a physical asset; often forgotten when people assess their investment portfolios. Many will have a sizeable commitment through owning their own homes, and buy-to-let properties have also become popular in recent years. In 14 of the past 44 years property was the best performing asset (source: Barclays Capital Equity Gilt Study 2016 and Investment Property Databank - see page 12 for details) and it has provided good long-term returns. However, it is not a one way bet, as the table also shows. Private investors can gain exposure to commercial property through funds or Real Estate Investment Trusts (REITs), both of which are described more fully in the 'Different Investments and Their Risks' section which begins on page 15.

Commercial property is usually held to provide a reliable income, as tenants of commercial properties will generally continue paying the rent even if they themselves are making a loss. Realising any property investment depends on finding a buyer, which can present problems in a falling market, or when many investors wish to sell at the same time. Whilst property is usually affected at a later stage of the economic cycle than shares, in 2008 we witnessed extreme events which affected both at the same time.

Commercial property prices had been pushed higher and higher, as investors believed it was undervalued and sought to diversify their portfolios. In more normal circumstances this would have been perfectly valid behaviour. However, the sheer weight of demand from investors pushed prices well beyond normal valuations, and when equity markets started to fall, investors decided they wanted to be out of commercial property too. In effect, both asset classes, shares and commercial property, reached a peak at roughly the same time.

### How much in each area?

The table overleaf shows average annual total returns from cash, equities, gilts and corporate bonds over several long-term periods. Importantly,

| Long-term returns from different financial asset types - adjusted for inflation | | | | |
|---|---|---|---|---|
| Average Annual Return | | | | |
| **Last** | **10 years** | **20 years** | **50 years** | **116 years** |
| Cash | -1.1 | 0.9 | 1.4 | 0.8 |
| Gilts | 3.0 | 4.3 | 2.9 | 1.3 |
| Corp Bonds | 1.8 | | | |
| Equities | 2.3 | 3.7 | 5.6 | 5.0 |

*Figures show the "real" returns on top of inflation. They include capital gains and income without deduction of tax. Past performance is not a guide to future returns. Deposit accounts are accessible and provide capital guarantees unlike other investments. Figures for corporate bonds run back to 1999. Source: Barclays Equity Gilt Study 2016.*

these are "real" returns, showing the combined income and capital growth investors would have received after inflation. For instance, in a year where equities delivered a return of 15% and inflation was running at 5%, the real return would be 10%.

The table illustrates the relationship between risk and reward. The most volatile asset class, equities, has generated the highest returns over the very long term, whilst the least volatile, cash, has generated the lowest. Corporate and government bonds sit somewhere in between. It is this trade-off which often dictates how an investor chooses to allocate their capital between the various asset classes, along with other factors such as age, length of time to retirement or until capital is needed, and market conditions.

## The Financial Crisis of 2008

If anything focused investors' minds on risk it was the financial crisis of 2008. Queues like those seen outside Northern Rock had not been witnessed for more than 100 years in the UK. When investors start to doubt the actual fabric of a system based on confidence, the world finds itself in big trouble. Suddenly risk and reward came sharply into the investor's sphere of interest. Investors tend to always think that cash is safe, but the financial crisis clearly showed that there was a distinction to draw even between deposit takers. Following the best buy tables proved that the highest rate of interest on offer isn't necessarily the best if there is doubt over safety. Icelandic banks offered generous interest rates – but the price would have been huge had the UK government not decided to guarantee UK savers' money.

Without government intervention, savers would have lost everything over the limit of the Financial Services Compensation Scheme, then £50,000, but is it wise to rely solely on the government? The responsibility for savings and investments must ultimately lie with the individual. Consequently the lesson is to diversify, even with cash deposits, and use institutions that are well known and UK-regulated. After all, a foreign government will feel less pressure from voters to help depositors in another country.

Investors should always be suspicious of any investment which offers much higher yields or returns than they might expect for the type of investment. For cash, base rates can be used as a guide, perhaps coupled with the yield on 10 year gilts. This will give an indication of whether the rate on offer is ridiculously high and therefore signifies increased risk. Investors shouldn't be frightened to question how that rate is achieved, and if they don't understand the investment, they should avoid it.

## Measuring Risk

Risk has objective elements, but it is also dependent on the attitude of the individual. One person's idea of a less risky investment might be another person's idea of a higher risk investment. Volatility can be measured, but of the various methods, the only relatively accessible one is "standard deviation",

which shows how much the price of an investment varies from its average.

There have been several scandals in recent years, where people who believed they had bought a "low-risk" investment were shocked to discover it could fall in value. When financial advisers and commentators use the words low-risk, they generally mean an investment with a record of comparatively low volatility. But just because an investment doesn't usually experience big price fluctuations, doesn't mean it can't. Gilts, for example, are generally viewed as lower-risk, but in 1994 prices dropped by more than 10%.

### Is there such a thing as a no-risk investment?

Unfortunately not. Even capital guaranteed products can lose money in real terms, as over time capital will be eroded by inflation. In addition, with any product offering guarantees, investors should also question who is providing the guarantees and what level of financial security they enjoy. Thousands of UK investors in products backed by Lehman Brothers found to their cost in 2008 that a guarantee is only as good as the institution which issues it.

National Savings index-linked certificates carry the lowest risk of loss, paying tax-free interest and guaranteeing to increase capital in line with inflation over a set term.

Backed by the UK government, the only risk of loss lies in the unlikely event of government bankruptcy, or in the penalties for early withdrawal. The certificates are popular, and issues tend to sell out. At the time of writing there are no issues on sale.

At the other end of the scale, extremely speculative investments like derivatives, with the chance of losing more than the original investment, are undeniably high-risk.

**At the end of this guide, we suggest some questions to ask before making an investment.**

In between definitions become harder to pin down, particularly as the risk of loss must be weighed against the risk of low returns. Which type of risk represents the biggest worry will vary from person to person, and will depend on their investment goals and constraints. The most important of these constraints is investment timescale.

### Timescale

The amount of time before access to savings is needed is crucial to judging the level of risk taken with them. The longer the timeframe, the more the danger of poor returns outweighs the risk of loss. By contrast, those needing access to their money within a few years are likely to attach heavy importance to capital security. Someone saving for fewer than five years should generally stay clear of shares, or any equity-linked investment, as they run a higher risk of getting back less than they invest.

Since 1899 shares have provided a higher return than cash over 10-year periods 91% of the time, but please remember past performance is not a guide to future returns. (Source, Barclays Equity Gilt Study 2016).

Property is also a medium to long-term investment, particularly for those buying actual bricks and mortar. They not only face the risk of a fall in property prices just before they need to cash in, but also the danger that they will not be able to find a buyer when they want one. There are also high acquisition and disposal costs involved with investments in an individual property.

The risks of fixed interest securities for short-term investors depend on their redemption date and price. Bond-holders know to the penny the interest they will get between purchase and redemption. However, both income and capital payments rely on the issuer not defaulting. They are therefore not guaranteed.

Short-term investors who need to ensure capital security could opt for short-dated gilts (those with less than five years to go) with a redemption date just before they'll need the cash. At the time of writing, however, comparable returns were available from fixed-rate deposit accounts.

All investors buying investment funds or other packaged products should check the small print to see if they might suffer exit penalties or loss of interest by cashing in before a certain point. With-profits bonds, for example, often impose surrender penalties in the first five years, while fixed rate deposit accounts may cut interest in the event of early withdrawal.

For long-term investors, capital security tends to be outweighed by the need to grow their investments as much as possible. This typically means a sizeable amount in equities, ideally spread over a range of different markets, sectors and shares.

The danger of price falls is always there, but the longer the timescale, the more likely it is that these will be offset by previous, or subsequent gains. Over periods of ten years or more, for example, the chances of a unit trust falling in value are reduced, whether it invests in shares, bonds or property.

Bear in mind that investment timescale will decrease over time. Those investing for their retirement, for example, should consider gradually moving to a more cautious standpoint in the final years before the money is needed.

The long term is merely a series of short terms added together, so the closer the event for which the money is needed, the bigger the threat posed by volatility.

### Income or Growth?

This is an important question and when considering the answer be careful not to ignore the concept of total return. Total return looks to combine income with capital growth to achieve the best overall return.

One example of this is equity income funds, where investors saving for retirement could reinvest the income until the day they retire and then elect to have it paid to them instead, producing an income without the costs of completely overhauling their portfolio.

Index-linked investments, such as certain gilts and National Savings certificates (at the time of writing the latter are not available, though they may be reintroduced at some stage), can protect against inflation eroding capital and income, but in today's low-inflation world investors need to compare the

total return to that available from an ordinary gilt or savings account.

Wealthier investors, who can cope with a little fluctuation in their income and capital, could look to include corporate bonds, property and dividend paying shares. Bonds and property traditionally pay higher yields than equity income shares, but equities have provided the greatest opportunity for capital growth and growth of income. A balance between the different asset types should provide the best chance for a reasonable and growing income.

Income-paying equity, bond and property funds can be a good investment for those investing for capital growth too, as it is simple to arrange for income to be reinvested.

### Investment Amount

The amount a person can afford to invest has a bearing on the amount of risk they take. A wealthy person with a large sum to invest can probably afford to take more risk than someone with just a small amount to stash away. However, the wealthier they are, the less need they have to take risk.

Even if an investment is for the long term, it is still necessary to ensure the short term is covered, for example by putting aside a capital sum in an easy access savings account, sufficient to cover both anticipated spending over the next few years, and any emergencies that might arise. It should be enough to provide a cushion in the event of unemployment, as well as an extra sum for covering domestic or medical emergencies.

This means the cash part of any portfolio should always come first. Until a sufficient cash buffer is built up, investing in more volatile investments or those with early exit penalties runs the risk of being forced to sell in a hurry, and getting back less than the original investment.

Even once a cash buffer is in place, the amount of risk taken is dictated by the investment amount. Someone with a few thousand pounds to invest probably shouldn't be buying individual shares, for example, as they won't be able to afford the spread of investments necessary to reduce volatility to the market average. A better bet could be collective investment funds such as unit trusts, which typically invest in at least 40 to 50 stocks.

Investors who don't have a lump sum, but can put away a regular amount each month, should consider unit trusts, OEICs and investment trusts, many of which will accept regular savings from £25 a month. This can reduce the risk from volatility through "pound-cost averaging". In other words as the fund's value moves up and down, less is paid for each unit or investment trust share in some months and more in others, giving a long-term average purchase price. This should iron out short-term ups and downs, resulting in - hopefully - a gradually increasing fund.

## Risk factors you can't control

Planning investments according to risk profile can help reduce unnecessary risk, but they will still be subject to a whole host of influences outside the investor's control.

### Inflation

Inflation poses a serious risk, as it erodes both capital and income. In the 1970s, inflation ran at an average of 13% (reaching a horrifying 25% in 1975). Even with low inflation, defending capital and the spending power of returns should be a priority.

Inflation hits lower returns disproportionately hard. Over the past 44 years (1972 to 2015) equities have enjoyed average returns of 11.3% a year, while cash managed 6.5% - great by today's low interest standards. After taking inflation into account, equities' real average annual return was cut by just over a half to 5.1%. But cash returns were much harder hit, falling to 0.6%, a tenth of their nominal return.

**How inflation erodes your buying power**

| What £1,000 will be worth in real terms after... | Average Inflation | | | |
|---|---|---|---|---|
| | **2.5%** | **5.0%** | **7.5%** | **10.0%** |
| 5 years | 884 | 784 | 697 | 621 |
| 10 years | 781 | 614 | 485 | 386 |
| 15 years | 690 | 481 | 338 | 239 |
| 20 years | 610 | 377 | 235 | 149 |
| 30 years | 477 | 231 | 114 | 57 |
| 40 years | 372 | 142 | 55 | 22 |

Many investors have not got used to a low-interest rate environment, and as a result often take on more risk than they should in their attempt to replicate the double-digit returns paid on savings accounts ten or more years ago. Investors comparing the 0.3% paid on a typical building society savings account in 2015 with the 12.9% they would have got in 1981, (source Barclays Equity Gilt Study 2016) might feel hard done by. Yet in real terms the returns were very similar. Inflation in 2015 was around 1.2%, but was running at 12% in 1981, meaning real returns in both years were fairly close to zero.

### Exchange Rates

Investing in foreign shares, bonds or property, either directly or within a fund, carries the added risk of currency fluctuation. If the pound strengthens against the currency in question, the investments will buy fewer pounds, meaning any gain could be reduced. On the other hand, a weaker pound would enhance foreign returns in sterling terms. Some funds are now hedged to offset this risk.

### Interest Rates

If interest rates rise it's clearly good news for cash savers on variable rate accounts. But it's bad news for other types of asset, as it makes their yields less attractive by comparison. Investors holding shares in companies with high-levels of debt, such as many manufacturing firms, could be hit hard, as could buy-to-let property investors with variable rate mortgages. Corporate bond and gilt investors could also be adversely affected by rising interest rates.

### Political Change

A new government, in the UK or elsewhere, can mean big changes for a country's economy, which can affect all types of investment as a result of interest rates and inflation rising or falling. In addition government reforms on investment rules and tax allowances can dramatically alter the relative attractiveness of certain products.

## Visit **www.hl.co.uk** or call **0117 900 9000** for further information

### Industrial Change

Over time stock market sectors rise and fall in importance. Worldwide, technology, media and telecoms companies are much more important than they were a decade ago, for instance, and the UK service industries have overtaken manufacturing in importance. Broad-based investment funds can follow these changes more easily than sector-specific funds, and also tend to be less volatile.

### War, Terrorist Acts & Natural Disasters

Earthquakes and floods can cause severe disruption to the economies and markets of the countries affected. But the threat of war or terrorist attacks can hit stock markets around the world.

### Greed & Fear

Fundamental factors like company prospects are usually the main drivers of share prices. However, market sentiment always plays some part in share prices too. Occasionally, however, investors' greed pushes share prices up to unsustainable levels. The bursting of that bubble induces a hefty dose of fear which pushes them right back down. Cautious investors may consider taking profits to reduce the impact of such bubbles.

### Fraud or Default

This should be less of a problem than it used to be, as a result of tighter regulation by financial watchdogs and the fact that most investment products sold in the UK are covered by the Financial Services Compensation Scheme (details at the end of this guide). Those investing in direct shares (including investment trusts) or bonds, however, are not covered by the scheme, and what happened to Enron and Northern Rock highlighted the dangers in this area. When a company goes into liquidation, bond-holders have the first rights to any money owed to them after the banks, while shareholders are last in line. Sometimes there may be nothing there to pay even the bond-holders as in the case of Barings' collapse in 1995. Likewise the Madoff scandal which came to light in 2008 highlights the risk of investor fraud.

One type of fraud which is on the increase in the UK is unregulated brokers making unsolicited calls to investors, proposing they buy shares in a particular company. The shares are usually worthless or very difficult to sell, and the unscrupulous 'broker' simply pockets the cash. These are known as 'boiler-room' scams, because of the highly-pressurised sales techniques used by the caller. The golden rule is never to purchase an investment from a company which cold-calls - they have already broken the law by doing so - and always check that a broker is regulated by the FCA before doing business with them. You can check this on the FCA website - **www.fca.org.uk**.

## Finding the right balance

It's frustrating that there are so many risk factors that are impossible to control, but if they can't be eliminated altogether, it is still possible to reduce their effects by putting together a diversified spread of investments. The impact of picking the wrong asset type, the wrong region, or the wrong sector is significantly reduced if a portfolio covers a range of assets, regions, and sectors.

**Annual total return figures for the four main asset classes (not adjusted for inflation)**

| | Inflation (RPI) % | Gilts (15 yr) % | Cash (Building Society) % | Property (Commercial & Residential) % | Equities (All Shares) % |
|---|---|---|---|---|---|
| 1972 | 7.7 | -3.8 | 8.2 | 29.3 | 16.4 |
| 1973 | 10.6 | -8.9 | 9.7 | 28.4 | -28.1 |
| 1974 | 19.1 | -15.2 | 11.1 | -15.9 | -50.1 |
| 1975 | 24.9 | 36.8 | 11.0 | 11.4 | 149.3 |
| 1976 | 15.1 | 13.7 | 10.7 | 9.4 | 2.3 |
| 1977 | 12.1 | 44.8 | 10.7 | 26.4 | 48.6 |
| 1978 | 8.4 | -1.8 | 9.4 | 25.6 | 8.6 |
| 1979 | 17.2 | 4.1 | 12.2 | 22.8 | 11.5 |
| 1980 | 15.1 | 20.9 | 15.0 | 17.5 | 34.8 |
| 1981 | 12.0 | 1.8 | 12.9 | 15.0 | 13.6 |
| 1982 | 5.4 | 51.3 | 12.2 | 7.5 | 28.5 |
| 1983 | 5.3 | 15.9 | 9.6 | 7.6 | 28.8 |
| 1984 | 4.6 | 6.8 | 10.0 | 8.8 | 31.6 |
| 1985 | 5.7 | 11.0 | 10.8 | 8.3 | 20.2 |
| 1986 | 3.7 | 11.0 | 10.6 | 11.3 | 27.3 |
| 1987 | 3.7 | 16.3 | 9.7 | 26.0 | 8.7 |
| 1988 | 6.8 | 9.4 | 8.3 | 29.5 | 11.5 |
| 1989 | 7.7 | 5.9 | 10.7 | 15.4 | 35.5 |
| 1990 | 9.3 | 5.6 | 12.0 | -8.4 | -9.6 |
| 1991 | 4.5 | 18.9 | 9.3 | -3.1 | 20.8 |
| 1992 | 2.6 | 18.4 | 9.6 | -1.6 | 19.8 |
| 1993 | 1.9 | 28.8 | 4.1 | 20.2 | 27.5 |
| 1994 | 2.9 | -11.3 | 3.7 | 11.9 | -5.9 |
| 1995 | 3.2 | 19.0 | 3.9 | 3.6 | 23.0 |
| 1996 | 2.5 | 7.7 | 2.6 | 10.0 | 15.9 |
| 1997 | 3.6 | 19.4 | 3.1 | 16.8 | 23.6 |
| 1998 | 2.8 | 25.0 | 7.1 | 11.8 | 13.7 |
| 1999 | 1.8 | -3.5 | 5.1 | 14.5 | 23.8 |
| 2000 | 2.9 | 9.2 | 5.5 | 10.5 | -5.9 |
| 2001 | 0.7 | 1.3 | 4.7 | 6.8 | -13.2 |
| 2002 | 2.9 | 9.8 | 3.4 | 9.6 | -22.3 |
| 2003 | 2.8 | 1.6 | 3.3 | 10.9 | 20.2 |
| 2004 | 3.5 | 7.2 | 4.2 | 18.3 | 12.5 |
| 2005 | 2.2 | 8.4 | 4.0 | 19.1 | 21.6 |
| 2006 | 4.4 | -0.1 | 4.4 | 18.1 | 16.4 |
| 2007 | 4.0 | 5.2 | 4.8 | -3.4 | 5.1 |
| 2008 | 0.9 | 12.9 | 0.9 | -22.1 | -29.8 |
| 2009 | 2.4 | -1.0 | 0.3 | 3.5 | 29.0 |
| 2010 | 4.8 | 9.4 | 0.2 | 15.1 | 14.1 |
| 2011 | 4.8 | 21.4 | 0.2 | 7.8 | -3.4 |
| 2012 | 3.1 | 4.8 | 0.2 | 3.4 | 12.1 |
| 2013 | 2.7 | -7.2 | 0.2 | 10.7 | 20.5 |
| 2014 | 1.6 | 18.3 | 0.3 | 17.8 | 1.2 |
| 2015 | 1.2 | 0.5 | 0.3 | 13.1 | 1.1 |
| Years as best-performing asset | | 9 | 2 | 14 | 19 |
| Years as worst-performing asset | | 12 | 15 | 7 | 10 |
| Years as neither worst nor best | | 23 | 27 | 23 | 15 |
| Over 43 years £1,000 would have grown to... | | £53,097 | £16,016 | £90,155 | £110,127 |
| In real inflation adjusted terms | | £4,263 | £1,286 | £7,238 | £8,841 |
| Average annual return over 43 years | | 9.4% | 6.5% | 10.8% | 11.3% |
| Average annual inflation adjusted return | | 3.4% | 0.6% | 4.6% | 5.1% |

Source: Barclays Equity Gilt Study 2016 and Investment Property Databank. Past performance is not a guide to future returns. Deposit accounts are accessible and provide capital guarantees unlike other investments. NB: These figures do not take into account either income or capital gains taxes.

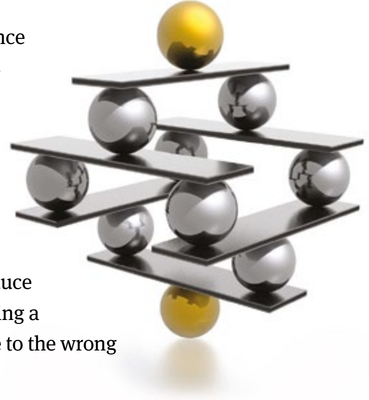
There is no rule saying a portfolio has to be balanced and diversified. Many investors stick doggedly to equities, while others are convinced that property is the only place to be. Taking such a view is fine, as long as the risks are understood. Those who invest only in one type of investment will only be right some of the time.

The table on the previous page shows how the four main asset classes have performed over time. A glance at the annual returns over the 44 years to 2015 shows that shares were top in 19 of them. That means that more than 50% of the time another asset, usually property or gilts, would have given investors a better return.

Over the full 44 years shares have provided the best cumulative total return, although there is no guarantee that over shorter periods the result would be the same. Trying to second guess the market and leaping from equities to bonds to cash and back is even more high risk.

Correctly guessing the best performing asset in each year to 2015, and switching investments accordingly between cash, equities, gilts and commercial property, could have turned £1,000 into an astonishing £10,511,034.

But picking the worst asset each year would have shrunk £1,000 to just £366, even worse when the effects of inflation are included. The spending power of that £366 equates to just £29 in 1972 terms.



Getting a balance of investments may be considered boring and pedestrian by some, but it could potentially reduce the risk of having a large exposure to the wrong asset class.

Some packaged investment products, such as life funds, and certain unit trusts and OEICs, spread risk across several asset classes and within those, across dozens of different investments. It is also important to try and get a spread across different providers in case a particular fund manager's performance goes off the boil, or if the life insurance firm behind a with-profits fund gets into difficulties - as Equitable Life did. A balance across different types of products will potentially cushion the blow of one type being subject to a change in tax law or other regulatory changes.

A spread of different funds can also provide access to different fund managers' investment styles, which can outperform at different stages of the economic cycle. Some fund supermarkets, such as our own Vantage account, provide a consolidated statement showing all a client's investments, and their split across different regions and sectors. These can prove invaluable in keeping tabs on a portfolio's balance.

**Trying to pick the winners - the cost of success ... and failure**

£1,000 invested between 1972 and 2015, with switches between asset classes each year

| | Total return | Real inflation - adjusted return |
|---|---|---|
| Get it right | £10,511,034 | £843,871 |
| Get it wrong | £366 | £29 |

Source: Hargreaves Lansdown/Barclays/IPD

# 7 QUESTIONS

## TO HELP YOU ASSESS YOUR RISK PROFILE

1. Do you already have sufficient easily accessible cash to cover anticipated spending over the next few years, as well as a buffer for emergencies?

2. Are you investing for income, or for capital growth?

3. If you are investing for capital growth, when will you need access to the money?

4. If you are investing for income, can you cope with fluctuations in your income and/or capital?

5. How much can you afford to invest, and is this a lump sum or a regular amount?

6. Can you cope with volatility? Do you think you can see your investments fall in price without panicking?

7. What investments do you already have, and do they add up to a balanced portfolio?

### *In summary*

There are two aspects to risk - the risk of your investment falling in value and the risk of your investments growing too slowly to meet your objectives. The structure of a portfolio should depend on how an investor wishes to balance these two factors. In the first of the next two sections we examine a range of investments and offer some ideas about how they could fit into a portfolio. In the second section we look at pensions and how they can help you save for retirement.

# DIFFERENT TYPES OF INVESTMENT AND THEIR RISKS

## CHAPTER 1: Cash

### DIRECT INVESTMENTS

This section examines the range of savings and investment products available, sorted into the four main asset classes: cash, property, fixed interest and equities. Within each asset class we describe the various ways to participate, the associated risks and what to look out for. These assets can be owned directly, held indirectly via funds and other pooled investments to diversify risk, or accessed via derivatives.

Volatile market conditions during the first decade of the 21st century have led to increased usage of alternative investment strategies, particularly in absolute return funds, which are a relatively new breed of fund aiming to generate a positive return in all market conditions, including falling markets, by using sophisticated investment techniques.

There are also a number of ways of holding both direct and indirect investments, for example holding funds within an ISA, pension, or investment bond, and a number of ways of purchasing investments, for example by regular savings.

This section describes how risks and returns can be affected by these different methods and strategies. Please note tax rules can change and the benefits of any tax allowances will depend on your personal circumstances. The value of investments can fall as well as rise, so you could get back less than you invest. The information below is designed to help you make your own investment decisions, it is not personal advice. If you are unsure of the suitability of any investment for your personal circumstances please seek advice.

#### ■ Bank and building society deposits

Banks and building society accounts vary, so there are a number of things to look out for. Most people will focus on obtaining the best interest rate on their savings, but the events of 2008 and 2009 have also highlighted the importance of security.

Cash deposits offer full security of capital - savings cannot fall in value, but this only applies if the institution holding then remains solvent. Should it fail to do so, the Financial Services Compensation Scheme (see Appendix for details) guarantees up to the sterling equivalent of €100,000, currently set at £75,000 per individual per UK institution. Many savers therefore spread deposits between institutions to take advantage of the security offered by the scheme. It is important to check that each institution is a member of the scheme, and also ensure that it has a separate FCA registration – some banks are owned by the same parent company and you would therefore only be covered for one sum of £75,000, even though they trade under different brands.

The UK government has agreed to reimburse savers in full where they have lost money in a number of cases, for example the UK-based subsidiaries of the collapsed Icelandic banks, but it is important to remember that there are no guarantees this will happen in future.

Shopping around for interest rates is a must, as some accounts offer very poor rates. Rates will generally vary according to how the account is operated, with online and postal accounts often paying more interest than branch-based accounts. Timeframe also affects the rate - banks and building societies are prepared to offer more interest to those who are prepared to tie their money up for longer, either by fixed-terms or notice periods. Fixed-term deposits are usually available for up to five years, and rates can appear

attractive. However, it is important to check whether it is possible to access savings early, and whether there are any penalties or loss of interest for early withdrawals. It is important to consider what might happen to interest rates elsewhere during the fixed term. Notice accounts normally offer extra interest in return for an agreement that a number of days' notice (often 90) will be given in advance of a withdrawal.

It is also necessary to check rates regularly, as many fail to stay competitive once they've attracted customers. Some eye-catching rates include bonuses which only last for the first six months, for example.

Banks and building societies also offer Cash ISAs (see page 34), which pay tax-free interest, though again it is necessary to look for a competitive interest rate.

**RISK ASSESSMENT** - Capital guaranteed not to fall in value, so only risk of loss is bank or building society collapse, or early-exit penalties from fixed-rate deals.

**TAXATION** - A tax-free personal savings allowance applies to £1,000 of a basic rate taxpayer's savings income and £500 of a higher rate taxpayer's savings income each year. Beyond that, interest is taxed depending on the rate of income tax you pay. Interest on cash in ISAs is tax-free and doesn't count towards the personal savings allowance.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

Check FCA registration at **www.fca.org.uk**.

## Offshore Accounts

Offshore accounts operate in much the same way as UK-based accounts. UK residents must still declare this interest on their tax return, but this can be useful for those who live or work abroad, or for tax-planning reasons. Until recently, offshore savings accounts often offered higher rates of interest than their onshore equivalents, but this is seldom the case now.

Offshore accounts hit the headlines with the collapse of the Icelandic banks. Whilst savers with the UK-based subsidiaries were covered by the Financial Services Compensation Scheme (FSCS) and also bailed-out by the UK government, those who held accounts with the offshore-based subsidiaries were not so lucky. Offshore accounts are often based in the Isle of Man, the Channel Islands, or Ireland, and so savers are reliant on the compensation schemes offered within these countries. In many cases these don't offer the same protections as the FSCS, so savers need to take this risk into account and ask themselves whether the governments and taxpayers of those countries would be willing and able to bail out UK depositors in the event of a collapse.

**RISK ASSESSMENT** - Capital guaranteed not to fall in value, so only risk of loss is institution collapse or default. However, this could be higher than for UK banks.

**TAXATION** - Interest usually paid gross, UK taxpayers must declare via their tax return.

**WHERE TO CHECK PROTECTION** - Check with institution where it is regulated, then with authorities in relevant country as to protection.

## National Savings

National Savings & Investments is a savings organisation owned and backed by the UK government, so there is virtually no risk of loss through fraud or default. However returns are generally lower than the best equivalent bank and building society accounts.

Their product range includes a Cash ISA, tax-free Savings Certificates, Premium Bonds, Income Bonds and 65+ Guaranteed Growth Bonds. Savings Certificates are either index-linked or fixed rate,

and are tax-free. The index-linked certificates give inflation proofing over a defined period, and pay a small amount of interest on top. The fixed interest certificates, pay a much lower rate of interest than some equivalent taxable bonds, which make them unattractive to non-taxpayers and basic-rate taxpayers, but could appeal to higher-rate taxpayers.

Premium Bonds provide no guarantee of a return over and above the initial investment, but do offer the chance to win tax-free prizes of between £25 and £1m.

You can check the interest rates on offer and product availability at **www.nsandi.com**.

**RISK ASSESSMENT** - Virtually no risk of loss.

**TAXATION** - Depends on product. Cash ISA, Savings Certificates and Premium Bonds are tax-free; interest from all other products is taxed as savings interest.

**FURTHER INFORMATION** - Visit **www.nsandi.com** for latest product details.

**WHERE TO CHECK PROTECTION** - National Savings and Investments are fully backed by the UK government.

## COLLECTIVE INVESTMENTS

**At the end of this guide, we suggest some questions to ask before making an investment.**

### Money Market Funds

Money market funds are collective investments where investors' money is pooled and invested solely in cash or cash equivalents. Cash equivalents are short-term instruments which usually behave very similarly to cash, for example Treasury Bills, which are a three month loan to the government for a fixed rate of return.

The idea behind money market funds is that a professional manager will provide enhanced and diversified returns for investors. However, investors do not enjoy the capital security, transparency and protections available to direct holders of cash. Furthermore, in times of low interest rates, management fees can make a significant dent in returns. Many investors were caught out in 2008 when it transpired that AIG had chased 'enhanced' yields by investing in longer-term instruments which were riskier than they appeared. When investors tried to redeem their holdings in great numbers at a time when there was little demand in the market for these securities, this caused a 'fire sale' and substantial loss of value. Likewise, increased demand from clients to withdraw from the Standard Life money market fund highlighted variations in accounting rules for these funds. To their credit Standard Life footed the bill so investors did not suffer losses.

Nonetheless, these funds offer greater diversification than a deposit account, as they are exposed to more than one institution: the fund manager of a money market fund typically takes around 50 positions in deposit accounts and other cash-like securities. Onshore funds are protected by the FSCS up to £50,000. Protection for offshore funds will vary according to where they are regulated.

**RISK ASSESSMENT** - In normal times, professional management can enhance returns and improve diversification, but lack of transparency and liquidity can cause risks during periods of low investor confidence.

**TAXATION** - Returns are taxed as savings interest.

**FURTHER INFORMATION** - Information on some of the funds available can be found in the Fund Prices & Research section of the HL website, **www.hl.co.uk**. See the Key Features for details of an individual fund.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

# CHAPTER 2: Fixed Interest

## DIRECT INVESTMENTS

### Government Bonds

Governments which need to borrow money can do so by issuing bonds. These usually pay a fixed level of interest each year throughout their life, and the amount originally borrowed is repaid on the maturity date. In other words, if a bond is held to redemption investors know exactly what return to expect, and it is guaranteed by the issuing government. They are usually issued by way of an auction, and once issued are traded on the stock exchange like shares. If bought 'above par' (that is to say, at a price above their redemption value), an investor will suffer a capital loss if they hold the bond to redemption. Conversely if bought 'below par' and held to redemption a capital gain will be made.

The main risk with government bonds is the likelihood that a government might default on, or 'restructure' its debt. This can be more of a threat with emerging market bonds, than UK government bonds, also known as gilts. That said, in 2013 the UK government lost its AAA credit rating, suggesting that the possibility of default is not as remote as once was the case.

Because the government is unlikely to default, gilts don't have to pay such high returns to attract investors and generally pay a lower income than corporate bonds (which are loan stock issued by companies). Some gilts are index-linked, which means their nominal value, and therefore investors' capital and interest, rises in line with inflation. As with other inflation-proof products, however, these tend to offer a lower initial income.

Whilst gilts are much less volatile than shares, this is not to say you cannot lose money. Between issue and the point at which they are redeemed, investors can buy and sell gilts just like any other investment and, like other investments, their value can fall as well as rise and you could get back less than you invest. The two main factors which influence their price are interest rates and inflation. Interest rates represent the 'risk-free' return available elsewhere, so a rise in interest rates makes gilts relatively less attractive and vice versa. Inflation erodes the value of both the interest and redemption payments from gilts, and therefore a rise in inflation (or expected inflation) will cause gilt prices to fall. Long-dated gilts are defined as those with 15 years or more to run, and are generally thought to be more sensitive to changes in interest rates and inflation, as investors are exposed

to the higher/lower returns for a longer period. Short-dated gilts are defined as those with fewer than seven years until redemption.

The name of a UK gilt contains some important information:

For example

This indicates that the gilt pays interest (or a 'coupon') of £8 per year for every £100 of nominal stock held

This indicates that the gilt is a loan to the treasury

This indicates that the gilt will be redeemed by the government in 2020

There is no protection scheme in place for government bonds – their security is entirely dependent on the government which has issued them.

**RISK ASSESSMENT** - If backed by the UK government, extremely dependable income and – if bought at or below par and held until redemption – capital security. Capital losses or gains are possible if bought after issue or sold before redemption. Foreign bonds add the risk of exchange rate movements, and depending on the financial strength of the country, can carry a higher risk of default.

**TAXATION** - Interest from gilts is generally paid gross, and is liable for income tax. Any capital gains are free of tax, but capital losses cannot be offset against gains made elsewhere for CGT purposes.

**FURTHER INFORMATION** - The Debt Management Office (DMO) is the government body responsible for issuing gilts – visit **www.dmo.gov.uk** for further information. The Financial Times publishes a list of gilts in issue along with current prices and yields each week.

**WHERE TO CHECK PROTECTION** - Not covered by the Financial Services Compensation Scheme.

## ■ Corporate Bonds

Similar in nature to government bonds, these fixed interest securities are issued by companies wanting to raise money. They are issued at a nominal or "par" value, and the issuing company promises to repay this on a set redemption date and to pay a fixed rate of interest on the nominal value in the meantime. Returns are therefore known if held for the full term and the company honours its obligations.

Once in issue, bonds can be bought and sold on the stock market, and prices will move up and down according to supply and demand. Investors buying and selling in the secondary market will be subject to price fluctuations and could get back less than they invest. Because the amount of interest paid stays the same throughout their life, bonds become proportionately more attractive when interest rates fall and less attractive when they rise. Broadly speaking, if general interest rates rise, bond yields look less attractive for the extra risk, so bond prices fall, bringing the bond yield up.

Bonds issued by companies with a good credit rating (i.e. those considered least likely to go bust) are described as "investment-grade", while those with a lower credit rating are "sub-investment grade" or "high-yield." Those with lower ratings have to pay more interest to attract investors and compensate them for the higher risk. They are more volatile than

investment grade bonds, but usually less so than comparable shares, and prices tend to be influenced more by the fortunes of the issuing company than by interest rates.

There is no protection scheme in place for corporate bonds – their security is entirely dependent on the company which has issued them.

**RISK ASSESSMENT** - Risk is determined by the creditworthiness of the issuer. Investment grade bonds have lower volatility and yields than riskier high-yield bonds. Assuming the underlying company doesn't go bankrupt, bonds offer a dependable and reasonable level of income. Capital gains and losses are possible if you are trading bonds, which means these are for medium to long-term investors. Corporate bonds are generally less volatile than shares, and usually bond holders will be paid before shareholders in the event of a company becoming insolvent. A company's credit rating can be checked with one of the credit rating agencies. The main ones are Moody's and Standard & Poors.

**TAXATION** - Capital gains on most individual bonds are not taxable and interest is paid gross. Taxpayers must pay any income tax due through their self-assessment return.

**WHERE TO CHECK PROTECTION** - Not covered by the Financial Services Compensation Scheme.

## PIBS (Permanent Interest Bearing Shares) and PSBs (Perpetual Subordinated Bonds)

PIBS are a kind of bond issued by building societies. They are similar to corporate bonds, but have no redemption date. Like corporate bonds they can be traded on the stock market but as they have no fixed redemption date, holders of PIBs or PSBs will normally need to sell their holding on the stock market to realise their investment. Their returns will be determined by the share price, which can be

influenced by supply and demand. PIBs and PSBs can fall as well as rise in value and therefore investors could get back less than they invest.

PIBS issued by demutualised building societies became 'Perpetual Subordinated Bonds'. Bradford & Bingley in 2009 became the first ever issuer to defer interest payments on this kind of investment. As with corporate bonds, no protection or compensation schemes exist.

**RISK ASSESSMENT** - As with corporate bonds, the creditworthiness of the issuer is the primary risk. A further risk is liquidity – there tend to be very few buyers and sellers for individual PIBS and PSBs, so they can be difficult to sell.

**TAXATION** - Capital gains on most PIBS and PSBs are not taxable and interest is paid gross. Taxpayers must pay any income tax due through their self-assessment return.

**WHERE TO CHECK PROTECTION** - Not covered by the Financial Services Compensation Scheme.

# COLLECTIVE INVESTMENTS

## Bond Funds

Unit trusts, OEICs (open-ended investment companies) and life funds pool investors' money, and it is then invested by a professional manager in a selection of assets.

There is an enormous variety of funds investing in fixed interest securities, all specialising in different areas of the market. There are funds which invest solely in gilts, those which invest only in corporate bonds, and funds which blend the two. Similarly, there are funds which concentrate on the UK, whilst others focus elsewhere. There are also funds which concentrate on particular types of bonds, for example high-yield corporate bonds or index-linked gilts.

UK corporate bond funds are split into three main sectors: Sterling Corporate Bond, Sterling High Yield, and Sterling Strategic Bond. Sterling Corporate Bond funds are required to hold a minimum of 80% investment-grade bonds and so prices are mainly affected by interest rate expectations. Sterling High Yield funds hold a minimum of 50% sub-investment grade bonds and so default risk has a greater impact on prices. With Sterling Strategic Bond funds the manager can invest across the entire fixed interest spectrum, and so both asset allocation and interest payments are likely to be more variable.

Investors in a bond fund forego the predetermined returns on offer to holders of individual bonds in exchange for greater diversification and the potential for a professional fund manager to enhance returns. An investment in a fund will be spread across a number of different bonds - this reduces risk as if one of the underlying companies goes bust this only represents part of your investment. A bond fund will fall in value as well as rise. The overall level of risk will depend on the manager's strategy and the inherent risk of the underlying investments.

Onshore funds are covered by the FSCS up to £50,000, but remember that this only covers default by the fund itself, and not losses made on the underlying investments.

**RISK ASSESSMENT -** Lower risk of total loss than direct bond investments owing to diversification. However, no ability to hold to redemption at a predetermined price and date so all investors are subject to price volatility.

**TAXATION -** Unit trusts and OEICs receive broadly the same tax treatment as the underlying investments they hold, so income from bond funds counts as interest for income tax purposes. Any appreciation in capital value is subject to capital gains tax. If accumulation units are held (where income is used by the fund manager to increase the unit price), any increase in value is split between income and capital gains. The split will be shown on the 'consolidated tax certificate', which is sent to unit holders once each year.

**FURTHER INFORMATION -** Information on many of the fixed interest funds available can be found in the Fund Prices & Research section of the HL website, **www.hl.co.uk**, including the manager's strategy, top ten holdings and the yield. See the Key Features or KIID for details of an individual fund. Fund yields may be quoted using a number of different methods – for a full explanation please download or request the HL Guide to Fund Prices, Savings and Yields from **www.hl.co.uk**.

**WHERE TO CHECK PROTECTION -** Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

# CHAPTER 3: Equities

## DIRECT INVESTMENTS

### Shares

Shares, or equities, represent partial ownership of a company, and therefore the right to share in any profits distributed as dividends. Shareholders, as owners of a company, usually have the right to vote on certain issues. Shares can either be bought directly from the company when it first offers shares to the public to raise money (known as an Initial Public Offering or IPO) or on the stock market once listed. Most shares will be described as 'ordinary' shares, though there are other types of share with different characteristics, for example preference shares (see below).

Shares have the potential to significantly grow in value, but are usually more volatile than other asset classes. Long-established companies and service companies normally distribute profits to shareholders as dividends, often twice yearly, whereas new companies and those in capital intensive industries usually reinvest profits to grow the business and therefore pay little or no dividend. The reason for buying the latter shares is that if a company grows, its shares normally increase in value.

Purchasing individual shares is intrinsically high risk, as the value of an investment is linked to the fortunes of one company (though of course, some companies are riskier than others). If the company goes bust, shareholders can lose their whole investment. For this reason, many ordinary investors choose to invest in shares through funds, which spread the risk across a number of companies – see page 24 for further details.

No protection or compensation schemes exist for direct investment in shares, though if shares are held with a broker, investors will be covered by the FSCS up to £50,000 in the event of the broker's default.

**RISK ASSESSMENT** - Risk levels vary according to the type of business. Some companies are less likely to go bust, although if they fall out of favour with the market, or the market falls in general, they can still fall dramatically in value. Smaller and newer companies carry much more risk. Dividends are not guaranteed and will vary from year to year. Investments in foreign shares will also be subject to currency risk.

**TAXATION** - Any gains resulting from share price appreciation are liable for capital gains tax, and UK Stamp Duty of 0.5% is levied on all share purchases. Dividends are liable for income tax. All taxpayers have a tax-free dividend allowance of £5,000 a year. After this dividends falling within the basic rate band are taxed at 7.5%, within the higher rate band at 32.5% and within the additional rate band at 38.1%. Dividends from shares held in ISAs are not subject to UK income tax and don't count towards the £5,000 allowance.

**FURTHER INFORMATION** - More information about both stock markets and individual shares can be found on the Share Research & Prices section of the HL website, **www.hl.co.uk**. The website of the London Stock Exchange, **www.londonstockexchange.com**, also contains useful information.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

### Preference Shares

These are a special type of share which aim to pay a fixed dividend each year. For this reason they behave like a cross between a share and a corporate bond. They tend to pay a higher yield than an equivalent bond; as if the company fails to make enough profit the dividends can be suspended. Preference shares may be convertible, which means shareholders have the option of converting them into ordinary shares.

‘Preference’ refers to two types of preferential treatment which investors receive over ordinary shareholders. Firstly, the issuing company cannot pay a dividend to ordinary shareholders without also paying the preference share dividend. Secondly, preference shares rank above ordinary shares when returning capital if a company is liquidated. However, preference shares do not usually carry voting rights.

**RISK ASSESSMENT** - Greater risk of loss than for an equivalent corporate bond, though potential rewards are also higher. Generally less volatile than ordinary shares, though neither income nor capital is guaranteed, and as such should still be considered as long-term higher risk investments.

## Warrants

A warrant represents the right, but not the obligation, to purchase a share in a company at a specified time and price (the ‘exercise price’). Warrants are traded on the stock market in their own right. Prices are linked to the price of the underlying share, but are much more volatile. If the share price is less than the exercise price at the exercise date, the warrants are worthless. Conversely, a profit is made if the share price climbs above the exercise price plus the price paid for the warrant itself. Because of this, warrant prices magnify sentiment on underlying ordinary shares. They can sharply rise and fall in value depending on supply and demand of both the underlying shares and the warrants. Your investment could therefore fall in value as well as rise and you could get back less than you invest.

Some companies and investment trusts (see page 25) issue warrants free of charge to shareholders or bondholders, usually as an incentive or a ‘sweetener’ when a company is restructured. Nothing is truly free, and extra returns might have been distributed via the ordinary shares had no warrants been created. That aside, if you receive warrants free, you have no downside risk.

**RISK ASSESSMENT** - The risk/reward level is extremely high for warrants. The potential profits are huge, but so is the chance that you could lose your entire investment in a short space of time.

A further risk is liquidity - there tend to be very few buyers and sellers for individual warrants, and they can be difficult to sell and can have very large bid/offer spreads. In accordance with FCA regulation investors wishing to purchase warrants will need to have completed a complex product risk warning notice prior to dealing.

## COLLECTIVE INVESTMENTS

### Equity Funds

Unit trusts, OEICs (Open Ended Investment Companies) and life funds are collective investments, which pool investors' money and invest it in a selection of assets.

Funds allow individuals to invest in a large portfolio of shares with many other investors. Units or shares are sold, each representing a small but equal fraction of a portfolio of typically 50 to 100 different holdings. Funds are popular because they offer ordinary investors access to professional fund management, and the benefits of diversification on lump sums of as little as £100, or regular savings of £25 per month.

The difference between unit trusts and OEICs is in their legal structure - unit trusts are established as trusts, and OEICs are incorporated as a company. They also often differ in the way their prices are calculated. In practice though they are very similar.

The unit or share price fluctuates to reflect the exact value of investments held, with prices usually changing daily. There are two main types of unit: income units where any dividend income generated by the underlying holdings is distributed to unit holders, and accumulation units where any income is 'rolled-up' in the price of the unit. Some funds offer both types of unit; others offer only one. There are thousands of unit trusts and OEICs available from dozens of fund management groups, investing in around 30 different fund sectors. There are several sectors dedicated to UK shares, including UK Smaller Companies, UK Equity Income and UK All Companies. There is also a vast number of funds specialising in one or more overseas markets, and a growing number which specialise in a particular industry. Some funds are not actively managed, instead aiming to track a particular index, for example the FTSE 100. These are known as tracker funds. The volatility and the risk of each fund will depend on the type of investments held within it, and also the manager's strategy. This is shown in the diagram to the right.

Onshore funds are covered by the FSCS up to £50,000, but remember that this only covers default by the fund itself, and not losses made on the underlying investments.

**RISK ASSESSMENT** - Lower risk than direct equity investments into the same area owing to diversification, but these are still long-term investments with no security of capital. Their exact position on the risk/return spectrum will depend on the underlying investments and the manager's strategy.

**TAXATION** - Unit trusts and OEICs receive the same tax treatment as the underlying investments they hold, so income from equity funds counts as dividends for income tax purposes. Any appreciation in capital value is subject to capital gains tax. If accumulation units are held (where income is used by the fund manager to increase the unit price), any increase in value is split between income and capital gains. The split will be shown on the 'consolidated tax certificate', which is sent to unit holders once each year.

**FURTHER INFORMATION** - Information on many of the equity funds available can be found in the Fund Prices & Research section of the HL website, **www.hl.co.uk**, including the manager's strategy, top ten holdings and the yield. See the Key Features or KIID for details of an individual fund. Fund yields may be quoted using a number of different methods – for a full explanation please download or request the HL Guide to Fund Prices, Savings and Yields from **www.hl.co.uk**.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

Check if a fund is FCA-regulated at **www.fca.org.uk**.

## RELATIVE VOLATILITY OF DIFFERENT UNIT TRUST/OEIC SECTORS

INCREASING VOLATILITY

China/Greater China
Global Emerging Markets
Japanese Smaller Companies
North American Sm Companies
Technology & Telecoms
Asia Pacific Excluding Japan
Japan
North America
Asia Pacific Including Japan
Europe Excluding UK
European Smaller Companies
Europe Including UK
Global
UK All Companies
UK Equity Income
Global Equity Income
Global Emerging Markets Bond
Specialist
UK Smaller Companies
UK Index Linked Gilt
Flexible Investment
UK Equity & Bond Income
Mixed Investment 40-85% Shares
UK Gilt
Unclassified
Pensions
Mixed Investment 20-60% Shares
£ Corporate Bond
Global Bonds
Property
Protected
£ High Yield
Mixed Investment 0-35% Shares
£ Strategic Bond
Targeted Absolute Return
Money Market
Short Term Money Market

Source: Lipper IM 31/03/13 to 31/03/16

### Investment Trusts

Investment trusts are another way of spreading the risk of stock market investment across a portfolio of shares. They are incorporated as companies in their own right, and their shares are traded on the stock exchange. Unlike unit trusts and OEICs which can create or cancel units according to demand, investment trusts are "closed-ended", with a finite number of shares in issue. The price of an investment trust is determined by the laws of supply and demand. Your investment could therefore fall in value as well as rise and you could get back less than you invest.

This increases volatility, as not only does the share price reflect the value of the underlying assets held by the trust, it is also driven by supply and demand. If an investment trust falls out of favour, its share price can fall to the point where it is at a discount to the value of the underlying assets. Conversely a trust which is popular with investors can trade at a premium to this "net asset value" (NAV). Unless a trust is wound up, at which point the value of the assets will be distributed, it is the share price rather than the NAV which will dictate how your investment performs, although the NAV will be one of the factors that determines share price movement. A wider than average discount can help to signal a buying opportunity, but it can also indicate concerns about future performance.

Another factor which can increase risk is that investment trusts are permitted to borrow in order to invest, "gearing" returns. Fund managers can use gearing if they feel share prices will rise. If they are right, they will make extra profits with the borrowed money. If share prices fall they make a loss and still have to pay off the debt.

Investment trusts cover most of the same sectors as unit trusts, but the most common types invest

can vary and investors should read the relevant prospectus before buying. If you are unsure of the suitability of an investment trust for your circumstances please seek advice.

in shares. Some investment trusts offer different share classes in order to meet certain investors' tax-planning needs, known as split capital investment trusts. Examples include income shares, which would pay an income (subject to income tax), but not make a capital gain, and zero dividend preference shares, which pay no income but have a redemption value at a predetermined winding-up date. The trust's ability to pay capital or income will depends on the performance of the underlying holdings. Split capital investment trust structures

**RISK ASSESSMENT** - The risk will vary according to the underlying holdings and investment strategy. However, the fact that the share price doesn't necessarily correspond to the NAV, plus investment trusts' ability to borrow means that risk is generally higher than for an equivalent unit trust. Investors must also consider liquidity as a risk. Just like purchasing shares in a normal company, investors have no protection should an investment trust become insolvent.

**TAXATION** - As for ordinary shares – dividends are subject to income tax and any gains from appreciation in the share price are subject to capital gains tax.

**FURTHER INFORMATION** - For general information visit The Association of Investment Companies' website **www.theaic.co.uk**. Information about an individual investment trust can be found in its prospectus.

## Venture Capital Trusts

A Venture Capital Trust (VCT) is a tax efficient form of investment trust that invests in small, entrepreneurial, high risk businesses (at least 70% must be invested in unquoted or AIM companies). Because they invest in very early stage companies, large tax incentives are available to encourage investment and provide some compensation for the extra risk. Some of these small companies could become FTSE 100 giants of tomorrow – others may go bust. A VCT will often invest in 20 to 25 different companies. VCT investors get up to 30p knocked off that year's tax bill for every £1 invested at launch, assuming that sufficient income tax has been paid. This is up to a maximum investment of £200,000 each tax year. All dividends and growth are tax free though dividends tend to make up the lion's share of returns. VCTs have to be held for a minimum of five years to retain the initial income tax rebate, and the market for the shares is often illiquid. Due to the early-stage nature of the investments a longer time horizon is often necessary. VCTs are sophisticated long-term investments only suitable for inclusion in significant portfolios. Don't forget, an investment shouldn't be made just for the tax break. Investors need to be happy with the underlying investments, the risks and the benefits prior to investing.

**RISK ASSESSMENT** - A very high risk investment in small fledgling companies. Potential returns are high, but so is the risk of loss. Should be considered a long-term investment, especially as must be held for a minimum of 5 years to qualify for the tax rebate. As the tax rebates only apply on the purchase of new VCT shares, there is low demand for the shares in the aftermarket. Liquidity poses a further risk, as it is often very difficult to find a buyer for the shares.

**TAXATION** - VCTs have a number of tax advantages. In addition to the income tax rebate of up to 30%, all dividends and growth are tax free.

**FURTHER INFORMATION** - More information can be found in the VCT section of the HL website, **www.hl.co.uk/vct**. You can also request or download our Guide to VCTs. Information regarding individual VCTs can also be found in their prospectuses, which must be read before investing.

### Enterprise Investment Schemes

Similar to VCTs in many ways, Enterprise Investment Schemes (EISs) invest in small unquoted businesses. They are one of the most tax incentivised investments available to UK investors, with tax relief potentially available from income tax, capital gains tax and inheritance tax, but they are also one of the highest risk, most sophisticated investments.

**RISK ASSESSMENT** - Often even higher risk than VCTs, these should be thought of as long-term investments and only suitable for inclusion in significant portfolios. As with VCTs, it can be virtually impossible to realise your investment when you want.

**TAXATION** - Unlike VCTs, dividends are subject to income tax. However, any growth is free of tax as long as the investment has been held for at least three years. There are also a number of other tax breaks available to EIS investors.

**FURTHER INFORMATION** - Information regarding individual EISs can be found in their prospectuses, which must be read before investing.

# CHAPTER 4: Property

## DIRECT INVESTMENTS

### Buy-to-Let

This is direct investment in residential property, with the aim of letting it to tenants. The potential return is the rental income, plus capital growth should the property increase in value. There are a few potential risks. A fall in rental demand could lead to reduced income and periods when the property is not occupied. A fall in property prices could lead to a capital loss, which can be further compounded by a lack of liquidity in a falling market - it can take some time to sell a property. Risk also will be increased if a mortgage is required: capital losses are compounded; negative equity might become an issue; interest rate rises might increase the cost of the repayments; the property is at risk if mortgage payments are not maintained. There is also the risk of unexpected maintenance costs.

If an individual only has one property, or has a number of properties of the same type or in the same

area, their portfolio is not diversified and they will be much harder hit if rental demand for that type of property or particular area drops.

Spreading investments around and thoroughly researching rents and demand for each area is wise. It is sensible to budget for the property being empty for two or three months a year and add a buffer for maintenance, insurance and interest rate rises.

No protection or compensation schemes exist for direct property investment.

**RISK ASSESSMENT** - Not a short-term investment, but chance for good total returns over the medium to long term. It is likely to take several months at least to realise an investment. Extra risk if borrowing to invest.

**TAXATION** - Property purchases are subject to stamp duty at a rate which depends on the purchase price. Buy-to-let properties worth more than £40,000 now attract a stamp duty surcharge of 3%. Rent is taxed as income, and it is permitted to deduct expenses (for example cost of repairing the property). Landlords can also claim tax relief on mortgage interest payments, though this is being restricted to 20% by 2020. Any gains made when selling the property will be liable for capital gains tax.

**FURTHER INFORMATION** - Visit the Residential Landlords Association's website: **www.rla.org.uk**

### Commercial Property

Direct investment in commercial property is not common for private investors, as the value of each property tends to be quite high. For that reason, most investors seeking exposure to this market do so via collective investments – see below. That said, those who have their own business might own the premises too, and therefore be invested in commercial property to an extent.

No protection or compensation schemes exist for direct property investment.

**RISK ASSESSMENT** - Again, a long-term investment and it is likely to take several months at least to realise an investment. Extra risk if borrowing to invest.

**TAXATION** - If the property is owned by an individual, it is taxed exactly as for residential property. If a company owns the property, the company will pay corporation tax.

## COLLECTIVE INVESTMENTS

### Property Funds

Unit trusts, OEICs (open-ended investment companies) and life funds pool investors' money, and a professional manager invests it in a portfolio of properties – usually commercial. They can also hold cash, and some hold shares of property companies.

The idea behind investing in such funds is to share in the rental income generated by the properties, and also the benefit of any appreciation in their value. Commercial property is an asset backed investment and can therefore provide long-term protection against inflation. In addition, tenants of commercial property must still pay the rent even if they themselves are making a loss. The income stream is therefore affected by different factors at different times from other assets and so commercial property can provide useful diversification.

**At the end of this guide, we suggest some important questions to ask before making an investment.**

The value of such funds can rise and fall with the value of the underlying properties, and funds can even suspend dealing because of illiquidity. Property can take some time to sell, particularly in a falling market. A key question to ask regarding commercial property is how the yield compares to gilts.

Onshore funds are covered by the FSCS up to £50,000, but remember that this only covers default by the fund itself, and not losses made on the underlying investments.

**RISK ASSESSMENT** - Lower risk than direct property investments owing to diversification. However, valuations inevitably include an element of subjectivity. If funds are hit by a stream of redemptions it can be difficult to sell a property to pay investors so liquidity is still a risk with funds able to suspend redemptions if they wish.

**TAXATION** - Distributions by the fund are subject to income tax, and any appreciation in value is subject to capital gains tax. If accumulation units are held (where income is used by the fund manager to increase the unit price), any increase in value is subject to a mixture between the two taxes depending on the level of income generated by the underlying properties. The split will be shown on your 'consolidated tax certificate'.

**FURTHER INFORMATION** - Information on many of the funds available can be found in the Fund Prices & Research section of the HL website, **www.hl.co.uk**. See the Key Features or KIID for details of an individual fund.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

### ■ REITs (Real Estate Investment Trusts)

REITs are a type of investment trust (a form of collective investment where a company is set up, investor's money is pooled and used to purchase investments, and the shares of which are then traded on the stock exchange – see page 25 for a full explanation). They were introduced in 2007 in order to provide a more tax-efficient way of investing in commercial property. Before they were introduced, investors in UK-listed property companies effectively paid tax twice, as the company paid corporation tax on profits before the investor paid income tax on the dividends. Provided they distribute 90% of their profits to shareholders as dividends, REITs do not have to pay corporation tax.

Shares in a REIT are traded on the stock exchange like a normal company. Their value is therefore determined by supply and demand (and general market sentiment), and could therefore be above or below the value of the underlying assets held in the fund. Investment trusts are permitted to borrow money – returns can therefore be 'geared'. This can increase returns when the manager makes gains, but can increase losses if the money borrowed is used to buy investments that fall in value.

**RISK ASSESSMENT** - Again, diversification brings benefits over direct property investment. Value, however, is determined by supply and demand in addition to the value of the underlying investments. They can fall in value – to zero if the REIT goes bust. Just like purchasing shares in a normal company, investors have no protection should this happen. Risk is further increased if the REIT borrows money, gearing returns

**TAXATION** - Dividends are subject to income tax and any appreciation in the share price is subject to capital gains tax. REITs are more tax-efficient than traditional property companies, as there is no double taxation – see above.

# CHAPTER 5: Alternative Investment Strategies

## Absolute Return Funds

Absolute return funds usually aim to deliver a positive return in both a falling and rising market. Each fund is different, but they can potentially invest in a wide range of asset classes, including shares, bonds, cash and property. They are increasingly being considered by investors looking to diversify their portfolio and lower the level of volatility within it.

They are also able to use derivatives to profit when a stock or index falls in value ('shorting'), and to shelter the fund's value against market falls. When used effectively, these tools should lead to better performance than traditional funds in a falling market, but are also likely to lead to reduced gains in a rising market. This is a similar strategy to that employed by 'hedge funds'. However, hedge funds are normally unregulated and only accessible to high net-worth individuals, whereas absolute return funds are accessible to all investors with much lower minimum investment levels and are fully regulated by the Financial Conduct Authority.

It is important to remember that whilst these funds aim to profit in all conditions, this is not guaranteed and they can go down in value as well as up. Ultimately it is the manager's investment decisions, and not the general movement of the market, that will determine returns. The sector contains a wide variety of funds, all of which have managers with contrasting methods and contain differing mixes of assets. As you might expect, this leads to large differences in performance between funds, so care needs to be taken in fund selection.

Onshore funds are covered by the FSCS up to £50,000, but remember that this only covers default by the fund itself, and not losses made on the underlying investments.

**RISK ASSESSMENT** - Capital and income can fluctuate, making these funds long-term investments. Risk will vary between funds depending on the manager's strategy. If managed well, losses should be limited if the market falls, but so might returns in a rising market. Holding any type of derivative introduces counterparty risk, which is the danger of the company underwriting the derivative running into financial difficulties. This may mean they are unable to honour the contract, potentially resulting in a loss.

**TAXATION** - Unit trusts and OEICs receive the same tax treatment as the underlying investments they hold. In practice the majority of returns from absolute return funds is likely to come from capital growth rather than income, and capital gains tax is likely to be the main concern.

**FURTHER INFORMATION** - More information on many of the funds available can be found in the Fund Prices & Research section of the HL website, **www.hl.co.uk**. See the Key Features or KIID for details of an individual fund.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

Check if a fund is FCA-regulated at **www.fca.org.uk**.

## Derivatives

Derivatives are financial contracts linked to the price movements of an underlying security or asset - anything from shares, stock market indices and bonds, to commodities such as oil, pork bellies or gold. Investors do not become the owner of the underlying asset but instead benefit or lose from movements in its price. Derivatives allow investors

to benefit from falling or rising prices.

Depending on the type, and more importantly how it is used, a derivative can either be high-risk, or useful in limiting risk. They are now increasingly being used by absolute return funds, which seek to offer a positive return in all market conditions. Below is a brief description of some of the most commonly used derivatives:

**(i) Contracts for Difference and Spread Betting** - Contracts for Difference (CFDs) are an agreement between the investor and the CFD provider to settle the difference between the opening price of a contract and the closing price. CFDs are available on shares, and also indices, currencies, sectors and commodities. Spread Betting is a popular type of CFD where all charges are built into the 'spread' between the buying and selling price of a contract.

CFDs and Spread Betting have some useful additional features over trading ordinary shares. Both are free from UK Stamp Duty, and Spread Betting is also free of capital gains tax (though tax laws are subject to change). CFDs and Spread Betting also enable investors to profit from falling prices by 'going short'. They are traded on 'margin', which means it is necesary only to deposit with the broker a small percentage (often 10%) of the overall size of the contract. Investors can therefore control a much larger position than if they purchased shares outright.

However, this is why they are regarded as significantly more risky – both losses and gains are magnified, and it is possible to lose more than the initial deposit. In order to manage risk, there is a range of trading tools such as stop losses, which automatically close a position to limit losses in the event of adverse price movements.

**(ii) Futures** - In simple terms, a future is an agreement to buy or sell a given quantity of a particular asset, at a specified future date, at a pre-agreed price. Futures are very high risk as the potential gains and losses are almost unlimited. Each contract will have standard terms, delivery dates and trading units. Contracts can be based on a number of different underlying assets, including shares and indices, but are also frequently used for agricultural commodities.

**(iii) Options** - Unlike futures, options give an investor the right, but not the obligation, to buy or sell an asset at a predetermined price within a set period. The right to buy is called a "call" option, while the right to sell is called a "put" option. If an investor thinks a share will fall, for example, they could buy a put option, giving them the right to sell at a fixed price in the future.

If the share falls below that price, the value of the option would rise. If it doesn't, the option expires worthless. Options are often less risky than futures, as losses are limited to the cost of the option, but there is still a real danger of losing the full investment. Options can be used to reduce (or 'hedge') the risk of holding a particular asset. For example, a holder of shares might also buy a put option to sell a similar number of shares - effectively taking out an insurance policy against loss, for the price of an option.

**(iv) Covered Warrants** - A covered warrant is a type of warrant (see page 23) that allows the holder to buy or sell a specific number of shares at a specific price and time. Instead of being issued by the company in whose shares you are trading, covered warrants are issued by a bank or a similar financial institution. Covered warrants also allow the warrant holder to buy or sell the underlying asset, whereas normal warrants allow the warrant holder only to buy. Covered warrants are traded on the London Stock Exchange rather than on a specialised derivatives exchange.

**RISK ASSESSMENT** - Derivatives can either be used to reduce risk assumed elsewhere, or as a risky speculative bet in themselves. They can be complicated, and in most cases it is possible to lose more than the entire original investment. As a result only very experienced investors should consider them. Derivatives products are highly-regulated, in the UK private investors will be covered by the Financial Services Compensation Scheme. Please note that this will only cover losses arising from the insolvency of a broker for example, and not losses made through trading. Holding any type of derivative introduces counterparty risk, which is the danger of the company underwriting the derivative running into financial difficulties. This may mean they are unable to honour the contract, potentially resulting in a loss.

**TAXATION** - Varies according to product. CFD trading and Spread Betting are both free of UK Stamp Duty, and Spread Betting is also free of capital gains tax. Gains from futures, options and covered warrants are subject to capital gains tax. In all cases tax rules are subject to change, can differ in a jurisdiction other than the UK and depend on your personal circumstances.

**FURTHER INFORMATION** - More information about CFDs and Spread Betting can be found at **www.hlmarkets.co.uk**; you can also download or request our Guide to CFDs or Guide to Financial Spread Betting which will help you to understand the risks involved. More information on futures and options is available from the London International Financial Futures Exchange (Liffe) at **www.euronext.com**. More information on covered warrants is available from **www.londonstockexchange.com**

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**.

## Exchange Traded Investments (ETIs)

Exchange Traded Investments is a term used to describe a collection of investments that includes Exchange Traded Funds (ETFs), Exchange Traded Commodities (ETCs) and Exchange Traded Notes (ETNs). They are vehicles which track the performance of a particular index, sector or commodity, and trade like shares on the stock market. ETIs are used by investors seeking precise exposure to certain areas of the market. If, for example, you are bullish on a particular sector, or perhaps a commodity such as wheat or gold, you can buy the relevant ETI and obtain immediate exposure to the price. Their passive nature means that they are low cost, although they do not offer the potential to outperform like an actively managed fund. Diversity is where some ETIs currently offer an advantage. Direct investment in commodities is an attraction of ETCs and the ability to profit from a fall in share or commodity prices is another way in which they can offer something different to a portfolio.

In terms of risk, the most basic ETIs, such as a FTSE 100 ETF, could be considered by many investors; however, specialist ETCs or ETNs that, for example, track the price of a single commodity have a much higher risk profile and should only be a consideration for more diverse, larger portfolios. ETFs tend to be structured as a fund, whereas ETNs and ETCs are different products. In addition the protections available under the Financial Services Compensation Scheme will not normally be available in connection with ETIs domiciled outside the UK.

ETIs that offer a magnified or leveraged return on a specific index or commodity are also available, and these should only be considered by experienced investors because they can be very volatile meaning you can make or lose a lot of money very quickly.

The ETI will not always physically hold the underlying assets, instead using derivatives such as options to gain exposure to price movements, and therefore there is a risk that a counterparty could default which could result in a loss not represented by the underlying index or asset. There are also a

number of reasons why an ETI might fail to accurately track the price of the underlying investment, and this represents a further risk to investors.

**RISK ASSESSMENT** - Risk is dependent on the risk of the underlying asset – some ETIs follow sectors or commodities that can be extremely volatile. ETIs are often provided by (and/or use derivative contracts provided by) an investment bank or similar institution. Investors are therefore also exposed to the risk of underlying institutions becoming insolvent, although they tend to be the very big banks. Holding any type of derivative introduces counterparty risk, which is the danger of the company underwriting the derivative running into financial difficulties. This may mean they are unable to honour the contract, potentially resulting in a loss.

**TAXATION** - The tax treatment of an exchange traded investment is subject to change, which could affect your investment in the future. In some cases, the returns from trading ETFs and ETCs may potentially be subject to income tax rather than capital gains tax. The ongoing tax liabilities are determined by both your individual circumstances and the continued status of the exchange traded investment.

**FURTHER INFORMATION** - More information about ETIs and their risks can be found on the relevant section of the HL website, **www.hl.co.uk/etf**.

**WHERE TO CHECK PROTECTION** - Find out about the Financial Services Compensation Scheme at **www.fscs.org.uk**. It might also be wise to check the financial strength of the ETI's provider. The risk is increased if the ETI is not domiciled in the UK as UK regulation and compensation mechanisms will not apply.

## Structured Products

Also known as Guaranteed Equity Bonds, Structured Products are fixed-term investments designed to provide returns linked to stock market performance combined with underlying assurances.

Despite assurances covering some or all of an investors' capital, the overall returns are uncertain, as they are linked to the performance of stock market indices. On maturity, a typical growth product might pay the growth over the term in the FTSE 100, plus the original investment back, but with the growth capped at a maximum of 50%. An income product might pay a fixed income of 5% during the term but only return all of the original capital if the linked stock market indices perform to specific levels set at the outset.

Structured products are offered by banks and building societies, insurers and specialist investment houses, and their tax treatment depends on type. Most use a complicated combination of money market instruments and derivatives to provide both the stock market exposure and the underlying guarantees. These instruments are expensive and as a result investors can expect reduced returns in a rising market – generally speaking, the greater the protection, the greater the restriction on returns.

Investors should also understand whether the product puts their capital at risk.

Importantly, the product assurances are only as good as the companies that provide them. In many cases investors do not know which company is providing the backing. During the credit crunch some investors

lost their money as their structured products were backed by organisations that became insolvent, for example Lehman Brothers.

These products are also inflexible; early surrender is usually only possible at a loss.

**TAXATION** - Depending on the product, gains will be subject to a mixture of income tax and capital gains tax.

**RISK ASSESSMENT** - Lower risk of loss than an index tracker, but potential returns are reduced too. Assurances are often provided by an investment bank or similar institution. While unlikely, investors are therefore also exposed to the risk of this institution becoming insolvent. Holding any type of derivative introduces counterparty risk, which is the danger of the company underwriting the derivative running into financial difficulties. This may mean they are unable to honour the contract, potentially resulting in a loss.

# METHODS OF BUYING AND HOLDING

The previous section of this guide explains how the risk of an investment can be affected by the way in which you participate, for example holding shares in a managed fund can reduce risk by diversification. This section examines how the way in which investments are held can also affect risk by introducing different factors like tax treatment or rules about access. For example, when investments are held in a pension, the benefits and restrictions of the pension wrapper can make a big difference. Tax relief on pension contributions can enhance returns or cushion falls, but restricted access to pension pots means investors below minimum retirement age cannot normally draw on this investment in case of emergencies. Remember tax rules can change over time and the benefits depend on your personal circumstances.

## 1. ISAs

The easiest way to think of an ISA is to consider it as a 'wrapper' which shelters savings and investments from tax. Within an ISA there is no capital gains tax and no UK tax on income; the value of these benefits will depend on individual circumstances. ISAs don't even need to be declared on a tax return. It is possible to place most types of investment within a Stocks & Shares ISA, and it often costs no more to do so than to hold the investments outside an ISA. Investments held within a Stocks & Shares ISA can fall in value as well as rise, therefore investors could lose money.

Used regularly, the annual ISA allowance offers the chance to create a substantial portfolio sheltered from the taxman, and their flexibility means they can be suitable for almost any investor. Cash ISAs can be used for tax-free interest on cash savings, or invest in shares, bonds, funds and many other investments through a Stocks & Shares ISA. Remember tax rules can change.

The tax benefits of an ISA are so attractive, the amount each person can save or invest in each tax year is limited. From 6 April 2016, each adult may invest up to £15,240 split as desired between Cash, Stocks & Shares and Innovative Finance ISAs (in which investors can hold peer-to-peer loans). The allowance will increase in 2017/18 to £20,000. Personal Equity Plans (PEPs) were the forerunners of ISAs, and became ISAs from April 2008.

**For more information, please request or download a copy of our Investors' Guide to ISAs by calling 0117 900 9000 or visiting www.hl.co.uk.**

## 2. Investment Bonds

These are lump-sum investments usually sold by life assurance companies. An element of life cover is provided but this is usually minimal, and therefore it is best to view them purely as investments. They are collective investments, where investors' money is pooled and used to purchase a portfolio of funds. They are normally designed to produce long-term capital growth although they can be used to generate an income.

It is permitted to draw out up to 5% of the original amount invested, each year, for up to 20 years, with any potential tax liability deferred until encashment. This feature is used to provide investors with income, although in practice this "income" is actually a return of capital.

There are two versions of investment bonds: onshore and offshore. Both work in a similar way although the tax treatment is slightly different. In both cases, investors are liable to income tax on the profits from an investment bond, not capital gains tax.

Onshore investment bonds have some tax automatically deducted. This is deemed to be an amount equivalent to the basic rate of tax, currently 20%. This can make onshore investment bonds undesirable for non-taxpayers, as this tax cannot be reclaimed. For withdrawals in excess of the 5% limit, or upon encashment, basic-rate taxpayers usually have no further tax liability as long as the profits, when added to their other taxable income, don't push them into the higher-rate tax band.

Higher-rate taxpayers may have to pay up to 20% more tax on the profits, unless they can time their encashment for a year when their income falls back to basic-rate level, perhaps after they retire. Additional-rate taxpayers may have to pay up to 25% more tax on the profits.

Offshore investment bonds are not subject to tax deducted automatically: tax is payable when profits are withdrawn or upon encashment. The rate of tax depends upon the investor's other taxable income in that tax year. Offshore investment bonds tend to have additional costs and are generally only suitable for investments of around £50,000 or over.

Onshore and offshore investment bonds differ from investments which are subject to capital gains tax (CGT), such as unit trusts, where no tax is paid on the profits until encashment, and even then profits within the capital gains tax allowance (£11,100 for 2016/17) are tax free. Please note tax rules are subject to change.

There are two main types of investment bond:

**1. With-profits bonds**

These invest in an insurer's with-profits fund, a large pool of money which typically contains investments from other bond investors, as well as those saving into with-profits endowments or pensions. With-profits funds hold a wide range of UK and overseas shares, fixed interest and property, and aim to provide steady returns by paying smoothed bonuses. They do this by holding back returns in good years, in the hope that they can continue to pay bonuses when the fund is not doing so well. Returns are paid as annual, or reversionary, bonuses, which once awarded cannot usually be taken away. There is, however, the risk that where markets have been poor for a sustained period a Market Value Reduction (MVR) may apply. The effect of an MVR is to reduce the surrender value of the encashment. This is designed to protect remaining investors when others choose to encash at a time where the actual value of the underlying investments is less than the current value of the investment bond.

Some with-profits bonds also pay terminal bonuses, which are not guaranteed and can be cut in the event of poor performance. With-profits bonds generally have no fixed returns and no fixed term although they are usually considered to be a minimum five-year investment. The level of risk will depend on the balance of investments within the fund and the financial strength of the life office.

Poor stock market performance has hit with-profits returns hard, and affected bonuses. Indeed around 10 years ago, some with-profits funds were so badly affected they were forced to close. We have not suggested new with-profits investments since June 2002 and believe that investors who hold with-profits bonds should review their investment and consider whether it is still appropriate for their needs. It is important to keep an eye on these policies, as situations can change.

**2. Unit-linked bonds**

Unit-linked bonds are collective investment funds similar to unit trusts. Like unit trusts their value can fluctuate from day to day, normally making them riskier than with-profits bonds. The range of investment choice varies from bond to bond.

The risks of investing in unit-linked bonds are similar to those for unit trusts, and will depend on the type of fund selected. There are hundreds of funds to choose from, in a variety of sectors. Distribution bonds have been a popular choice, invest in a mix of equity and fixed interest, and aim to provide a relatively high and growing income.

## 3. Regular Savings

Investing regularly has a number of advantages. Indeed most investors use regular savings to an extent, by contributing to their pension each month or using their ISA allowance annually. Most unit trusts and OEICs can be purchased monthly, from as little as £25 per month, whether in an ISA, pension, or just as a standalone investment. Remember inflation will reduce the spending power of capital over time.

There are a number of advantages to investing regularly. The fact that it makes investing so affordable is one major benefit. Small regular investments can soon mount up into a sizeable holding, and once established, investors become used to the payment leaving their account each month. Furthermore, investing regularly reduces the impact of market fluctuations – investing monthly ‘averages-out’ the price paid for units or shares, although there are no guarantees and you could get back less than you invest.

**For more information, please request or download a copy of our Guide to Regular Savings by calling 0117 900 9000 or visiting www.hl.co.uk.**

## 4. Pensions - Saving for retirement

Pensions deserve special consideration in terms of risk and reward because of the benefits and restrictions which apply to them, and the timespans involved.

The main benefit of using a pension to save for retirement is tax relief on contributions. For basic-rate taxpayers the government will top up every £80

net contribution to £100. Meanwhile higher-rate taxpayers get up to 40% tax relief and additional rate taxpayers up to 45%, meaning the net cost of a £100 contribution is effectively reduced to as little as £55. The amount of tax relief received depends on your personal circumstances. 20% tax relief is automatically added to eligible contributions. Any additional tax relief can be reclaimed through a tax return. Tax rules may change in the future.

The main restriction is that as pensions are designed for funding retirement, the benefits can normally only be taken from the age of 55 (57 from 2028). The amount you can contribute is also restricted. At retirement investors can usually take up to 25% of their pension pot tax free, with the rest used to provide taxable income. New rules introduced in April 2015 have given investors more options when they draw benefits – the pros and cons of these are discussed later in this section.

**Risk and reward when investing for retirement**

Like any other investment, there are two main types of risk which need to be considered when looking at future pension arrangements: the risk that one's pension will fall in value, and the risk that one's pension pot will not be sufficient to provide the desired level of income in retirement. How these two risks are balanced will depend on how long an individual has before they wish to retire.

For those who are nearing their retirement date and wish to purchase an annuity, the first type of risk will be more important to guard against – any sudden fall in the market could severely reduce the size of their pension (and the retirement income it will provide), and they won't have sufficient time for the market to recover. For this reason, many investors will choose to gradually reduce the amount of risk in their pension as they near retirement by switching out of share-based investments into less volatile investments such as cash, corporate bonds and gilts.

For those with longer to retirement, the priority should be to consider shortfall risk – i.e. the risk there won't be enough growth in the pension to provide a sufficient retirement income. Short-term market fluctuations shouldn't be of too much concern, as there is time for the market to possibly recover any losses. For this reason those with time on their side might want to consider those investments towards the upper end of the risk/reward spectrum, such as funds which invest in stock markets or individual shares themselves, rather than traditionally low-risk areas like cash or gilts. Inflation will reduce the value of money over time.

The key to reducing risk therefore, while still aiming for decent returns, is diversification, which can be achieved by holding a spread of investments. Diversity could be obtained from a single fund which invests in UK and overseas equities, fixed interest, property and cash. The alternative is to spread pension investments across a number of funds, each investing in a different area.

The choice of investments available varies dramatically between different types of pension. The main types are described below:

**Self Invested Personal Pensions (SIPPs)**

Arguably the biggest pension success story in recent years has been the rise of the SIPP. SIPPs are the most flexible type of personal pension plan for those who are happy to make their own investment decisions. They allow investors to hold unit trusts, OEICs and investment trusts, as well as ETFs, individual shares, bonds, gilts, cash and - with some SIPP providers - commercial property. SIPPs provide the widest choice of individual pension investments, and allow investors to spread their holdings across a diverse portfolio.

As SIPPs are a type of personal pension, the same tax benefits, contribution limits and retirement options apply.

Originally, the high charges levied by SIPP providers made them a niche product for “high net worth” investors, but greater demand has reduced costs and launched SIPPs into the mass market.

**Stakeholder pensions**

Introduced in April 2001, these are simple schemes, with restricted charges and no penalties for stopping contributions or switching to another scheme. They are available either as individual plans, or as group stakeholder pensions through an employer. Fund choice tends to be fairly restricted, but some do have a choice of between 15 and 30 funds covering most major sectors.

**Personal pensions**

Personal pensions sometimes have higher charges than stakeholder schemes, but offer a wider investment choice, with most offering dozens of funds.

**Company pensions**

Company (or occupational) pensions can be divided into two main types. Defined-benefit schemes offer a yearly pension in retirement, often based on your final salary. Those lucky enough to have such schemes need not worry about investment risk, as this is borne by their employer.

In the event that an employer becomes insolvent, with insufficient assets in its defined-benefit pension fund, the Pension Protection Fund should help towards any shortfall, provided the scheme is eligible for protection. This was established in April 2005 to protect and provide compensation to members of eligible defined-benefit schemes.

Defined-contribution schemes (also known as money-purchase schemes) involve building a pension pot by making contributions to the scheme and investing them.

**Automatic enrolment**

By 2017 all UK employers - no matter their size - will have to contribute to a pension on behalf of their eligible employees. Employees will have the choice to opt out, but it may not be a wise decision. If the choice on offer from a company pension is limited it is necessary to weigh up the lack of diversification against any extra benefits. These can be significant, such as employer’s contributions or lower charges. Many investors join their company scheme to benefit from the employer contribution and use a private pension such as a SIPP to top up their pension savings.

**Risk and reward when taking retirement benefits**

When taking benefits from a pension, it is normally possible to take up to 25% of the fund tax free, with any further income or withdrawals taxed as income. The most common way of taking a secure income from a personal pension is via an annuity. An annuity is paid for the rest of your life by an insurance company.

The first point to note is that it is imperative to shop around for an annuity – it is unlikely that the one offered by the company providing the pension will offer the highest income. It is also important to provide details of health and lifestyle, as these could boost income. Furthermore, there are a number of options when setting up an annuity. These are decided at the outset and, once set up, cannot normally be changed. In order to choose the most appropriate options, it is first necessary for an investor to decide the level of risk they are prepared to take with their income.

**Single or joint-life? Paid for a minimum term?**
For those who are married or have a partner, one of the decisions which needs to be made is whether they want their spouse or partner to receive an income if they die before them. This is known as a joint-life annuity. After death, the surviving spouse or partner will continue to receive an income for the rest of their life.

It is possible to arrange for the same income to continue to a surviving spouse or partner, or alternatively choose a reduced amount such as half or two thirds. A joint-life annuity may be less important if an individual's spouse has an adequate retirement income of their own.

Alternatively a single-life annuity can be chosen. Here the income is paid for the individual's lifetime only and does not continue to anyone else after their death. The income received each year will be higher than an equivalent joint-life annuity.

It is also possible to choose to have income paid for a minimum length of time (a guarantee period) or to include a 'money-back' option if you die before a certain age.

**Inflation protection**
There is a choice between level annuities, which pay the same income for life, index-linked annuities, which change each year in line with inflation, and escalating annuities, which increase by a set percentage each year. Of the three, level annuities have the highest starting income, but holders risk the buying power of their income being eroded over time by inflation.

Inflation-proof annuities offer a significantly lower income to start with (around 40% less for a 65 year-old at the time of writing), but move in line with inflation to maintain their original buying power. Escalating annuities, which are probably the best chance of keeping pace with average earnings increases, also start lower, and take many years to catch up. Based on annuity rates at the time of writing for a healthy 65 year old, the holder of a single life 3% escalating annuity will not reach the starting income of an equivalent level annuity for around 14 years, and would have to live for 25 years to be better off overall.

Essentially, buyers of conventional annuities have to weigh up the risk of their income being eroded by inflation with a level annuity against the alternative of an income which rises over time, but is relatively small to start with and therefore might never catch up.

It is vital to shop around and confirm full details about your health and lifestyle (and the health and lifestyle of your spouse or partner if you are considering a joint life annuity) when purchasing an annuity. The biggest risk is that a bad decision could mean a poor-value annuity for life.

**Drawdown - an income which depends on investment returns**
There is no legislative requirement to buy an annuity at all. One alternative is to keep control of your pension and use drawdown to draw an income, whilst keeping the pension fund invested. As well as keeping control, another potential advantage over annuities is that if an investor dies whilst in drawdown, their remaining pension fund can be passed on to their nominated beneficiaries, usually free of tax if the investor dies before the age of 75.

If the investor dies when 75 or older any withdrawals will be taxed as the beneficiaries' income (at 0%, 20%, 40% or 45%).

Drawdown can be attractive, but there are several

risks involved, so it won't be suitable for everyone. Lower-risk investments may struggle to keep pace with the income withdrawn, while higher-risk investments could mean that a pension fund falls in value. Your income is not secure; it can fall and rise along with your fund value, potentially leaving you short if your investments perform badly.

As a result drawdown is generally suggested only for those who have other significant means and are prepared to accept these risks. If you are uncertain about the suitability of drawdown for your circumstances we strongly suggest you seek advice.

A drawdown plan can also be used to take the tax-free lump sum entitlement from a pension, and defer drawing any income until later. This can be useful if capital is needed but there is no immediate requirement for income.

It is also possible to split your pension fund between the different options and to phase the purchase of an annuity, or the move in to drawdown.

**UFPLS (Uncrystallised Funds Pension Lump Sum) - Take lump sums when you need and leave your pension invested**

This option was introduced in April 2015. Investors who do not need their full tax-free cash yet, nor a regular income from their pension, can take periodic lump sums directly from a pension without having to go into drawdown.

Each time an UFPLS is taken, up to 25% of the lump sum will be tax free and the rest taxed as income.

What you do with your pension is an important decision. Therefore, we strongly recommend you understand your options and check your chosen option is suitable for your circumstances: take appropriate advice or guidance if you are at all unsure.

Pension Wise, the Government's pension guidance service, provides a free impartial service to help you understand your options at retirement. You can access the service online at **www.pensionwise.gov.uk**, by calling **0800 138 3944** or face to face.

This guide is not personal advice. We offer a range of information to help you plan your own finances and personal financial advice if requested.

**IMPORTANT INVESTMENT NOTES**

Unlike cash, stock market based investments are not guaranteed and can fall in value as well as rise, we therefore believe you should only invest for the long term (5+ years). Ultimately you could get back less than you invest. Any yields will vary over time so income is variable and not guaranteed. This guide is published solely to help clients to make their own investment decisions. It does not constitute a personal recommendation in any way whatsoever. Should you have any doubt as to the suitability of an investment for your circumstances you should contact our Financial Advisers for individual advice. Any tax rules referred to are those currently applying, but levels and the basis of, as well as reliefs from, taxation are subject to change. Any benefit to you will depend on your circumstances. Past performance is not a guide to future returns.

Before transferring an ISA, pension, or unit trust you should ascertain whether holdings will be liquidated and if exit or initial charges will be levied and then carefully consider whether you believe it will be beneficial for you over the period of the investment to proceed. When transferring pensions also ensure you will not lose valuable guarantees. If investments are liquidated you may suffer a loss of income or growth, should the market rise whilst the transfer remains pending.

Deposit accounts are accessible and provide capital guarantees unlike other investments. Deposit accounts, National Savings and buy-to-let investments are not regulated by the FCA. Information correct as at 6 April 2016.

# QUESTIONS TO ASK

## QUESTIONS TO ASK ON FUNDS

- ✓ Is the fund manager experienced, and if so what is their track record?
- ✓ What is the reputation of the fund management company (or its directors if new)? Is the company stable, and is it likely to retain its best fund managers?
- ✓ How specialised is the fund? More specialised funds often carry more risk and higher potential returns.
- ✓ What risks is the fund exposed to?
- ✓ Where is the underlying asset's price relative to historical levels?
- ✓ How has the fund performed over the longer term relative to the average fund in the sector?
- ✓ Is the sector or area of the market very fashionable at the moment? This is often a potential sign that the asset is overpriced.
- ✓ Are there any potential penalties for withdrawal?
- ✓ Are there any potential liquidity problems - i.e. how easy is it to sell your investment?
- ✓ What are the fund's charges, and how do they compare to its peers?
- ✓ If you have decided to invest, are you obtaining the maximum possible discount through your broker?

## QUESTIONS TO ASK ON BONDS

- ✓ What is the credit rating of the issuing company or government?
- ✓ Has the issuer ever failed to make an interest payment on a bond, or failed to repay a bond's capital value?
- ✓ What is the bond's yield taking into account the current price of the bond?
- ✓ Is the bond trading above or below its redemption value (i.e. if you hold the bond to maturity, will you make a capital gain or loss?)
- ✓ If the bond is trading a long way below par, why is this? Are there concerns about the strength of the company and the likelihood of it honouring future payments?

## QUESTIONS TO ASK ON SHARES

- ✓ Is the broker through whom you are buying the shares regulated by the FCA? If not, this could be a share scam and you run the risk of losing all your money.
- ✓ Do you have the time to conduct your own share research, and do you understand the business in which you are planning to invest? If not, should you consider investing in the stock market via a professionally-managed fund such as a unit trust?
- ✓ Are you investing for income or growth, and does the company fit the desired profile?
- ✓ What is the company's dividend history, and is current cash flow sufficient to maintain/grow the dividend?
- ✓ How volatile has the share price been historically, and are you comfortable with this?
- ✓ What are the costs of investing? Consider the bid/offer spread (difference between buying and selling price), dealing commission and Stamp Duty.
- ✓ Is liquidity an issue (i.e. can the shares be easily bought and sold)?

# *QUESTIONS* TO ASK

## *QUESTIONS* TO ASK ON ISAS

- ✓ Is the company which provides the ISA wrapper financially strong?
- ✓ Which type of ISA suits you best? If you are planning to invest in a Stocks & Shares ISA, are you comfortable with the risk that your investment can fall in value?
- ✓ Does your Stocks & Shares ISA provider offer a sufficiently wide choice of investments – funds from the whole market, plus shares, bonds etc.?
- ✓ Does the provider offer discounts on funds' initial charges, and annual rebates?
- ✓ Can you transfer your investments between ISA providers without punitive exit fees?
- ✓ Is it easy to switch investments within your ISA? Can you manage your investments by telephone, by post and online?
- ✓ What are the charges within the ISA? Is there an annual charge for providing the wrapper, and what are the costs to buy and sell funds and shares?
- ✓ Does the provider produce free research to help you manage your investments?

## *QUESTIONS* TO ASK ON PENSIONS

- ✓ Does your employer have a pension scheme, and if so, should you consider joining to take advantage of benefits such as employer contributions?
- ✓ How much do you need to contribute to your pension to help achieve your desired level of retirement income?
- ✓ Do your current pension arrangements give you the best chance of achieving your goals?
- ✓ Do your proposed pension arrangements offer you a balance of charges, investment choice, and ease of management which suits your needs?
- ✓ Should you consider transferring one or more of your pensions to a different provider?
- ✓ How much tax relief will you receive on your pension contributions?
- ✓ What is the most suitable way for you to take your retirement benefits?
- ✓ Do you need guidance from a pensions specialist?

# Appendix

**Compensation available in the event of fraud or default**

Most investment products sold in the UK are covered by the Financial Services Compensation Scheme (FSCS). This acts as a safety net to compensate consumers in the event of an "authorised company" being unable to pay claims against it. The Financial Conduct Authority's Consumer Helpline (0800 111 6768) should be able to tell you if the company you are thinking of dealing with is authorised to provide that particular product.

The amount of compensation you can claim depends on the type of investment and how you bought it.

**Deposit Protection**

This covers bank and building society products, such as savings accounts, Cash ISAs, current accounts, and guaranteed equity bonds.

Maximum compensation is the sterling equivalent of €100,000, currently set at £75,000 - if a deposit taking firm is unable to pay back deposits it owes to its members.

Because of this, you might decide to spread your deposits around different banks and building societies.

**Insurance Protection**

If a life insurer goes bankrupt, its customers will be covered by the FSCS's insurance protection, which will pay 90% of the value of a policy in liquidation with no upper limit. This protection covers pensions, endowments, with-profits bonds, unit linked bonds, guaranteed income bonds, high-income bonds, and annuities.

**Investment Protection**

This covers you in the event of an investment company going out of business and being unable to return your investment, and also provides compensation for loss arising from bad advice by a financial adviser who has gone out of business. Compensation for either type of loss is capped at a maximum £50,000.

The first kind of loss covers products such as unit trusts, OEICs, and other packaged investment products run by fund managers and other investment firms. It does not cover you in the event of an investment trust going into liquidation, however, as an investment trust is a share listed on the stock exchange. In the same way you would not qualify for FSCS compensation if a company you held shares or bonds in went bust.

However if your shares, investment trusts or bonds are held by a nominee company, and are therefore not in your name, they can be at risk if the nominee company goes bankrupt. In this event the FSCS would cover you as long as the nominee company is authorised, or the stockbroker running it accepts responsibility.

For directly held securities you should not lose out if your stockbroker goes out of business, as the shares or bonds will be held in your name.

The second kind of loss, arising from bad investment advice, is covered by the FSCS if the adviser has gone out of business, as long as the advice took place on or after 29 April 1988 and after the adviser became authorised to give investment advice. This protection covers bad advice on numerous products, including unit trusts, OEICs, investment trusts and other shares, bonds, gilts, pensions, endowments, investment bonds and so on.

Complaints about bad advice from a firm which is still trading should be taken up directly with the company in question. If you are not satisfied with its response you can pursue your claim with the Financial Ombudsman Service (0845 080 1800). If the firm in question is not authorised, or the product is not regulated, you may not have recourse to the ombudsman.

A Guide to

# Investment Risk & Reward

There are two aspects to investment risk - the risk of your investment falling in value and, perhaps more important for long-term investors, the risk that your investments will grow too slowly to meet your objectives. The aim of this guide is to help you balance your portfolio with these two factors in mind and is written for investors who make their own decisions as well as those who prefer the assistance of a personal adviser.

## USEFUL TELEPHONE NUMBERS

**For queries about**
ISAs, unit trusts, OEICs, index trackers, investment bonds, investment trusts and VCTs

Please call our Helpdesk on **0117 900 9000**

**To deal or enquire about**
Shares, bonds, gilts and covered warrants

Please call our Stockbrokers on **0117 980 9800**

**For queries about**
SIPPs and retirement options (including annuities, drawdown and lump sum withdrawals)

Please call our Pensions Helpdesk on **0117 980 9926**

**Hargreaves Lansdown, One College Square South,**
**Anchor Road, Bristol, BS1 5HL**
**www.hl.co.uk**
Hargreaves Lansdown Asset Management is authorised and regulated by the Financial Conduct Authority (FCA)