CHARLES STANLEY Direct

An Introduction to Direct Investing

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Like many things in life, spending a little time to educate yourself makes it possible to undertake new activities like taking control of your finances.

In fact, who could be better at managing your investments?

No-one else will have your best interests as close to their heart. Increasing numbers of people are following this path to become a DIY or Direct Investor. There are now an estimated 9.7 million UK individuals who manage all or most of their investments themselves. Direct Investing often has the advantage of being cheaper, so those with affairs that are relatively straightforward could save money on fees and charges.

Charles Stanley Direct was created to meet the needs of the modern self-directed or "DIY" investor. As an online investment platform we offer a wealth of information and the ability to buy and sell an exceptionally broad range of investments with ease. Managing and monitoring investments has never been simpler.

In this guide we explore the basics of investing so you can get to grips with the terminology and plan an investment portfolio. Armed with this information and a Charles Stanley Direct account you could be on your way to becoming a successful Direct Investor. For any words and phrases you are still unsure of it is also worth referring to our glossary, which can be found at www.cs-d.co.uk/Glossary

The decision to invest

History suggests the stock market remains the best way to grow wealth over the long term, easily outpacing interest paid on cash.

For instance, over the past 25 years an investment in the stock market (as measured by the FTSE All Share) would have turned £1,000 into £6,960, whereas a typical cash account would have grown the initial sum to just £1,516 (source: FE Analytics FTSE All Share, dividends reinvested, against Halifax Liquid Gold Account 31/08/1991 to 29/08/2016).

However, investing is only for those prepared to ride out the ups and downs. The first decision, therefore, is whether or not to start. This may sound odd, but for some people investing is not a priority at their stage in life.

If household finances are stretched and barely covering the basics putting aside money is clearly difficult and there is no room for error. The first priority should be to save up a cash reserve of say three to six months expenditure to act as a buffer to cover unexpected events.

Any debts should also be taken into account. Expensive short term debt such as personal loans, overdrafts and credit cards should be repaid as soon as possible and certainly before starting to invest – though pensions where your employer contributes are a possible exception.

Mortgage debt should also be kept under control and an appropriate repayment plan is needed. Once this is in place it is easier to be more comfortable with investing for the long term in more risky asset classes.

Remember too it is not necessary to go in at the deep end. It is possible to invest monthly into investment funds in order to build up an investment pot slowly over time.

Risk versus reward

Investing money means taking risk. To achieve a greater return than cash, all or some of your capital is potentially exposed to losses.

A basic rule is that if the level of risk is low, your return is also expected to be low, whereas if the level of risk is high there is greater potential to make a better return – but you could also lose money, and in extreme circumstances all of the investment amount.

Leaving money in cash is the lowest risk approach. It provides very little return (if any currently!) but it does have the important advantage of keeping capital secure. However, cash is unlikely to grow fast enough to keep up with inflation (the increase in the cost of living).

Essentially, the buying power of cash falls over time, making you feel poorer in the long term. This is why many people turn to other assets to help grow their capital in order to meet longer term objectives such as retirement.

The main asset classes

In addition to cash, the main types of asset – equities, fixed interest securities, property, commodities – each have different characteristics, but unlike cash all can fall as well as rise in value to a greater or lesser extent.

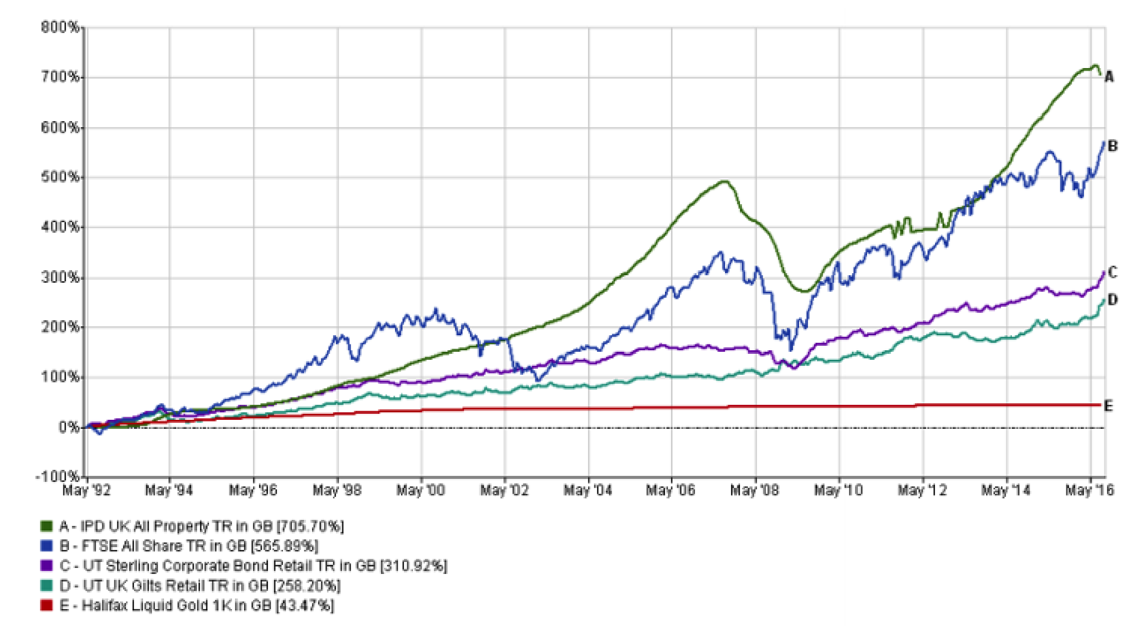
History shows that over the long term the stock market (representing shares in individual companies) is the most volatile asset class but has also provided the best returns.

Equities

Equities, also known as shares, represent a stake in a business. As a shareholder you participate in the growth of a business if it does well and often receive a share of the profits through dividend payments. Sharing in the profits and growth of companies can be lucrative but it can also be risky. Smaller, less financially-stable companies are clearly more prone to problems but no company is immune to the vagaries of an ever-changing marketplace – an neither capital nor income is guaranteed.

Nonetheless, the stock market has the potential to deliver a high return, as shown in the following chart.

Conventional wisdom suggests for terms of less than five years, cash is preferable, since over such short periods, stock market ups and downs mean there is a greater chance you might get back less than you invest. If you are willing and able to accept that your investment could fall substantially in value as well as rise investing in equities is worth considering.



25 years of returns from the major asset classes. Source: FE Analytics Account 31/08/1991 to 31/08/2016, income reinvested.

Fixed interest securities (bonds)

These are essentially loans to institutions who wish to raise finance. In the case of corporate bonds the borrower is a company, and for gilts the borrower is the UK government. When gilts or corporate bonds are issued the investor usually knows what their income and capital return will be. Typically they pay a fixed amount of income each year (known as a coupon) and repay the original capital at the end of the term – say 20 years.

The income varies according to the issuer of the debt. More risky companies have to pay a higher income to entice investors while low risk entities (such as many governments) can issue debt with low yields, perhaps in line with inflation or interest rate expectations, reflecting the minimal risk of default (non-payment of income or capital).

However, between issue and repayment investors can buy and sell fixed interest securities just like any other investment, so values fall as well as rise and you could get back less than you invest. Prices will change according to a number of factors including changing interest rates, inflation expectations and the creditworthiness (or "rating") of the underlying company or entity. You only achieve certainty with an individual bond by holding until maturity, and even then the issuer must be relied upon not to default.

There is also the risk that that the issuer of the bond runs into trouble – though this is clearly unlikely in the case of the UK government. In the event of bankruptcy bond holders are a creditor and could receive a proportion of remaining assets, if there are any, once the company is liquidated. This is an important distinction between equities and bonds as in the event of liquidation an equity holder would likely receive nothing at all. Therefore most bonds are considered lower risk than equities but have a lower potential upside. They generally attract investors looking to generate a consistent income ahead of cash but who don't want excessive volatility.

If you need to access your money quickly it is possible that, in exceptionally poor market conditions, it could be hard to sell holdings in corporate bonds and bond funds. This is because there is often low trading activity and bonds may become difficult to sell in sufficient quantities to fulfil redemptions.

Diversification

Balancing risk and return can take time and depends on a number of factors – investment goals, timescale and the requirement for income. It will clearly also be shaped by how much volatility (the frequency and amount of up and down movement) you are prepared to accept.

Diversifying a portfolio can help control risk and mixing together a variety of investments across different asset classes is likely to lead to a less bumpy ride overall – if one of the investments is performing poorly, another could be making up for it.

It is also wise for the first time investor to diversify within each asset class too. "Collective" investment funds such as unit trust and OEICs are designed to spread your investment – and risk – across dozens of different companies (or bonds or properties for those investing in those areas) and are either managed by a professional fund manager or designed simply to track a particular index.

In this way it is possible to own a diversified "share portfolio" for just a few hundred pounds. Some funds even spread the risk across several different asset classes as well.

Buying individual shares or other investments is a perfectly valid route too but generally best left to more experienced investors with larger portfolios and the time to dedicate to research and monitoring.

Other asset classes

There are a number of other "alternative" asset classes investors can use to diversify their portfolios still further. These include, "absolute return" funds, which aim to generate modest but positive returns each year.

There are also more esoteric investments such as fine wine, classic cars and antiques. The main thing to remember with these niche areas is that unless you are familiar with them think twice before investing. There could be costs that are difficult to quantify or risks you haven't thought of.

Types of fund

It is possible to buy an extensive range of different funds through Charles Stanley Direct. This makes building a portfolio easy and gives plenty of choice – although there are so many it can be difficult to know where to start!

There are around 30 different fund sectors, for instance several are dedicated to UK listed shares – UK All Companies, UK Equity Income and UK Smaller Companies. Then there are those dedicated to various overseas markets such as the US, Europe, Japan and emerging markets.

Others are even more specialist, targeting a single industry sector such as technology or agriculture. For bonds there are fewer sectors but they each represent important differences, such as separating out higher risk high yield bonds, or global bonds which typically add the risk of currency movements.

Most funds available are "actively" managed, that is to say they are run by a fund manager who decides when to buy and sell investments in the portfolio. "Passive" funds, or index trackers, are the alternative to this, they simply aim to track a particular index such as the FTSE 100. These tend to be cheaper, sometimes significantly so, but will never outperform the market they are designed to track in the longer term.

The Foundation Fundlist

If you already have some ideas on where to invest, but need some help choosing individual funds our Foundation Fundlist can help.

Our research team, with a combined 65 years of fund research experience, has created the list to highlight what we consider the best quality investments in each major sector. It incorporates actively managed unit trusts and investment trusts, which have been chosen on merit, rather than with any commercial bias, as well as passive investments or "trackers"selected for their low cost and ability to closely replicate the performance of a given index.

The actively-managed funds and investment trusts selected on the Foundation Fundlist are all managed by individuals or teams with excellent long-term records, who have exhibited the ability to generate outperformance in different market conditions. It is not a static list, though. We may often make changes when a major event occurs such as a fund manager leaving. We may also gain or lose conviction in a fund leading to additions or substitutions.

The Foundation Portfolios

If you are not sure where to invest but have a rough investment goal in mind – say growing your money ahead of inflation or providing income – our FoundationPortfolios could offer a more detailed starting point. The portfolios use a small number of our research team's preferred funds which, blended together, create a well-rounded portfolio for the given objective.

ISA, Pension or Investment Account?

Using Charles Stanley Direct it is possible to buy and hold investments in a number of ways. An Investment Account is the most straightforward – an account in your name where it is possible to hold a wide variety of shares, funds, gilts, bonds and more.

However, you should generally prioritise tax-efficient vehicles for investments; specifically Individual Savings Accounts (ISAs) and Self Invested Personal Pensions (SIPPs). These could save income and capital gains tax and boost returns in the long term. These can hold virtually the same range of investments so it doesn't mean narrowing down options. Just think of them as a "wrapper" around the portfolio.

Each year's ISA allowance can be used to shelter investments from capital gains and income tax. The allowance for the 2016/17 tax year is £15,240. Alternatively, if saving for retirement, you may wish to consider a SIPP which offers income tax relief on contributions of up to 45% although, of course, tax treatment depends on your individual circumstances and may be subject to change in the future. For most people a pension is the most tax-efficient means of saving for retirement but an ISA provides more flexibility to access money when needed.

Remember, it is also possible to transfer and consolidate existing investments, ISAs and pensions held elsewhere into Charles Stanley Direct – contact our helpdesk on 0131 550 1234 for more information on the transfer process.

Important information

This document is a marketing communication. The information does not constitute advice or a personal recommendation or take into account the particular investment objectives, financial situations or needs of individual investors. If you are unsure as to whether an investment or a pension is suitable for you, please seek professional financial advice.

Investors should be aware that past performance is not a reliable indicator of future results and that the value of investments and the income from them may fall as well as rise. The capital invested is therefore at risk and the amount realised may be less than the original sum invested. Investments should be considered for the medium/long term (5 years or longer).

Before you invest and for your own protection, please ensure you have read the available product literature carefully.

For funds that invest overseas, exchange rate variations may cause the value of your investment to rise or fall. Investments in certain funds, including emerging markets, specialist geographical areas, smaller companies and specialist sectors (such as technology & ethical stocks) tend to be more volatile. Where a fund's objective is to provide income and the income is paid out, there can be reduced potential for capital growth, especially over the medium to long term. The level of income payments can vary and where a bond fund's running yield is greater than the redemption yield, this may erode capital.

Some funds invest in higher risk fixed interest securities, known as sub-investment grade bonds. These bonds have a low credit rating and higher risk of default than investment grade bonds. This means that there is an increased risk that the value of your investment could fall.

The tax treatment of investments and pensions depends on individual circumstances and may be subject to change in future.

Fund switches in a Unit Trust / OEIC constitute a realisation for capital gains tax purposes.

Remember: take advice when you need it

Your financial situation will evolve and you may encounter more complex issues that need expert attention. Even if you start out a DIY investor we can introduce you to a Charles Stanley Investment Manager or Financial Planner at any time, whether on the telephone or at one of our local branches.

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