Investing: the basics

CHARLES STANLEY Direct

Like many things in life,

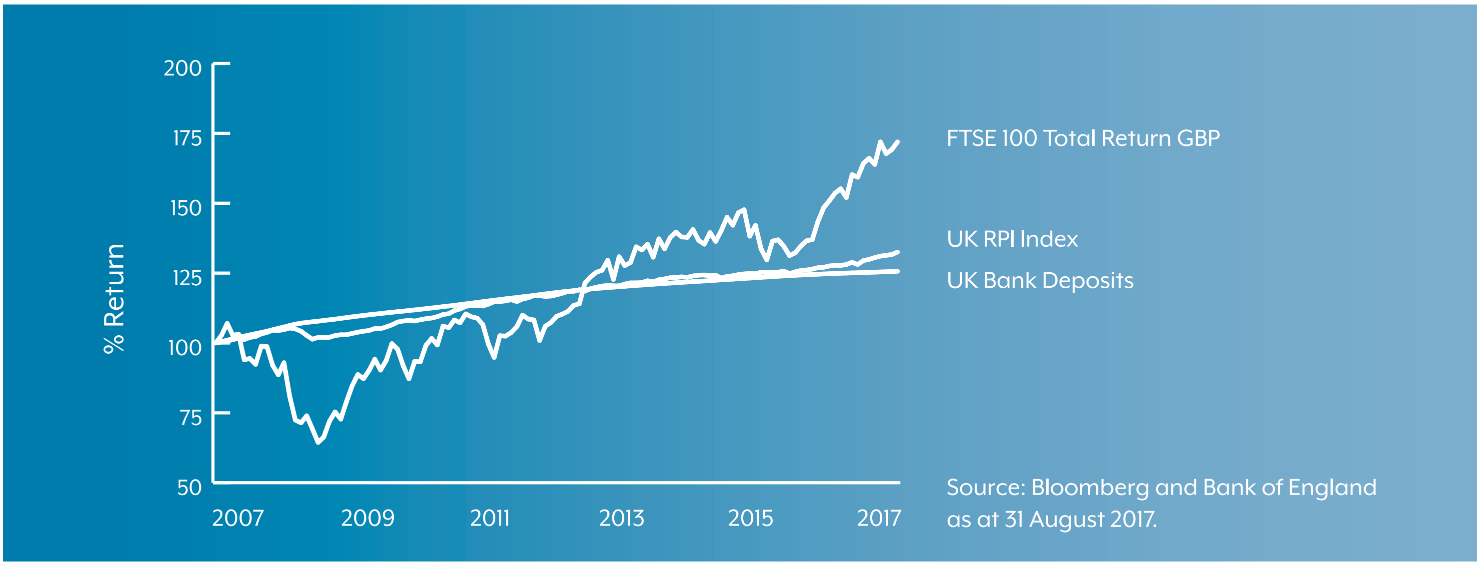
spending a little time to educate yourself makes it possible to take control of your finances. Charles Stanley Direct was created to meet the needs of today's 'DIY' investor who wishes to do this. As a leading online investment platform we offer the ability to buy and sell an exceptionally broad range of investments with ease.

While choosing, managing and monitoring investments has never been simpler, those new to investing should first get to grips with the basics. Here we cover the main factors we think you should consider.

For any words and phrases you are unsure of it is also worth referring to our glossary, which can be found at www.charles-stanley-direct.co.uk/Glossary

Should you be in any doubt about whether an investment is suitable you should seek regulated financial advice.

Why invest?



History suggests that owning assets, notably equities (in other words investing in the stock market), is a good way to grow wealth over the long-term, outpacing interest rates on secure investments such as cash. Investing money in these assets means taking risk though.

To achieve a greater return than cash, all or some of the capital is exposed to potential losses. A basic rule is that if the level of risk is low, the 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 there is also greater potential to lose money, especially over shorter periods.

Lower Risk
Lower Returns

Higher Risk
Higher Returns

When to invest

The first decision, therefore, is whether or not to start investing. If household finances are stretched, and putting aside money is difficult, the capacity to afford potential losses when investing is likely to be low. Instead, the priority should generally 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 before starting to invest – though pensions where an employer contributes are a possible exception. Mortgage debt should also be kept under control and an appropriate repayment plan should be in place. Once all this has been established it is easier to be more comfortable with investing for the long term.

Where to start

Make your own decisions

For investors who already have some ideas on where to invest but need some help choosing individual funds then our Foundation Fundlist can help. Our Research Team has created the list to highlight what we consider to be good-quality investments in each of the major sectors.

Buy a low-cost portfolio

For those not sure where to invest but with a rough investment goal in mind our Foundation Portfolios could offer a more detailed starting point. They are simple and economical 'starter' portfolios that blend together some of the Research Team's preferred funds to create a well-rounded portfolio for the given objective.

Buy an investment managed by us

Charles Stanley Multi Asset Portfolio funds are designed to meet different, broad investment needs and risk profiles. Each offers a diverse range of investments in a single fund, actively managed by Charles Stanley's investment experts. This means the investor does not need to monitor and change individual funds, shares or other assets in their portfolio.

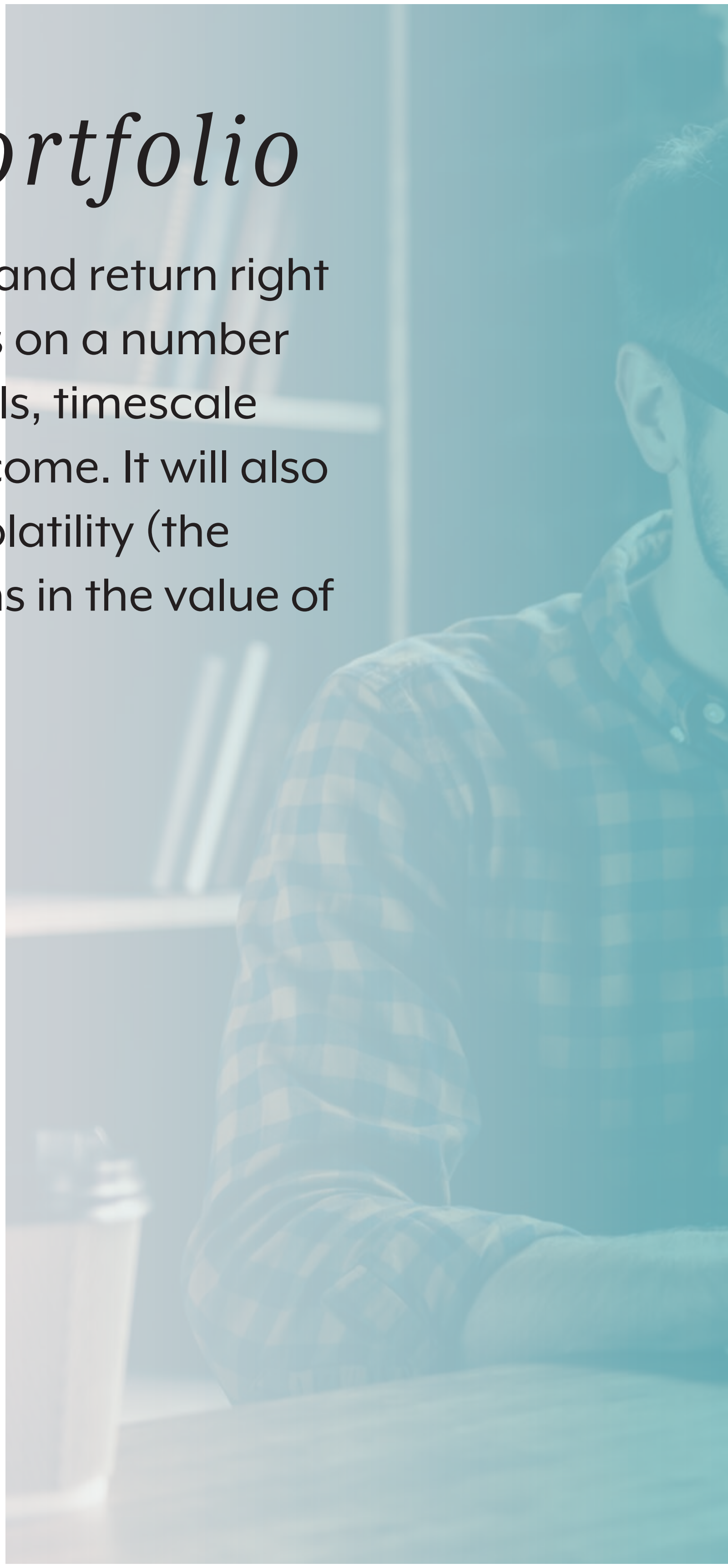
Remember, should you be in any doubt about whether an investment is suitable you should seek regulated financial advice.

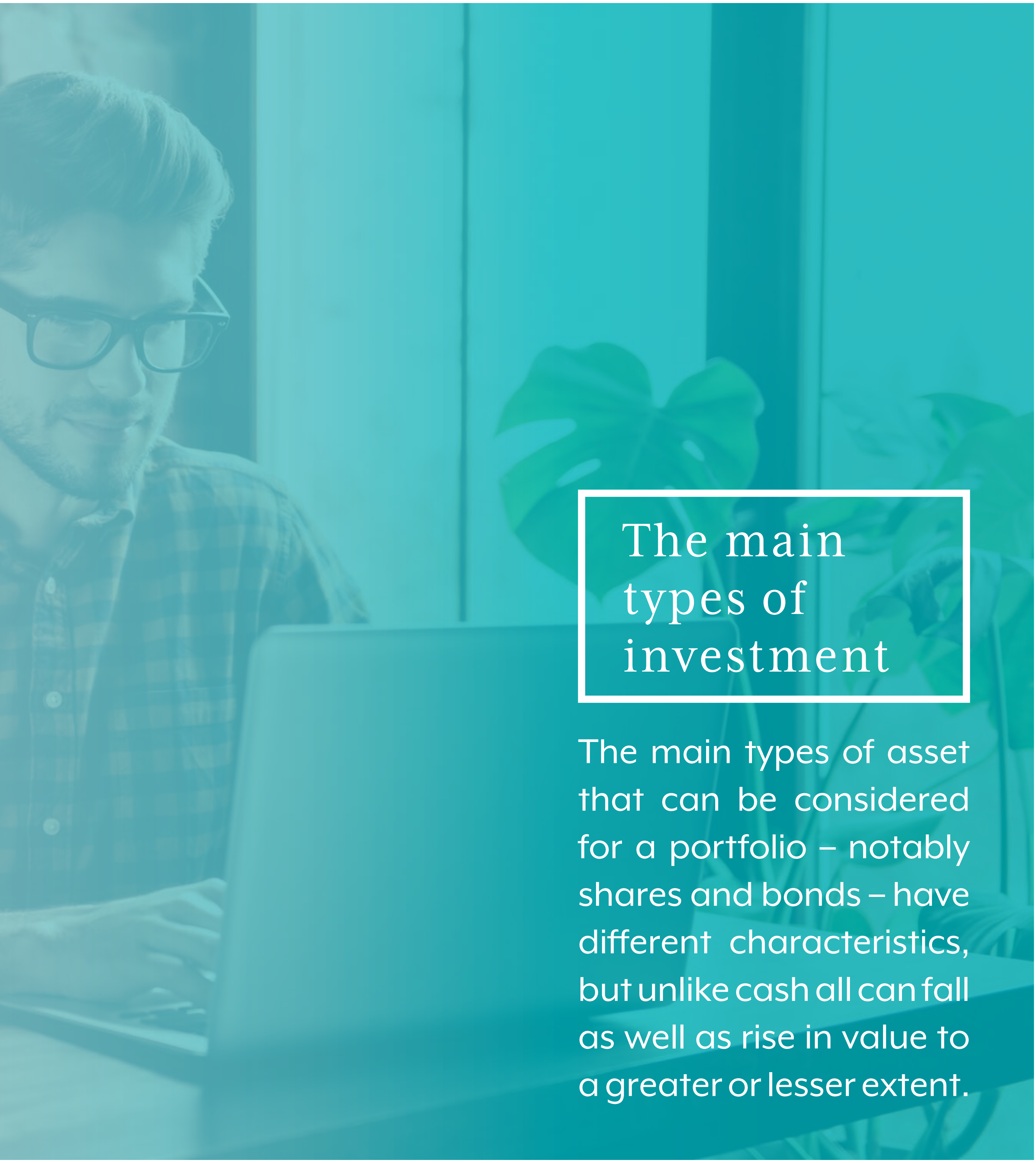
Building a portfolio

Getting the balance of risk and return right can take time and depends on a number of factors – investment goals, timescale and the requirement for income. It will also be shaped by how much volatility (the extent of the ups and downs in the value of investments) is acceptable.

Spreading investments between different investments and asset classes can lead to a less bumpy ride overall. If one of the investments is performing poorly, another one could be making up for it. Investors typically build portfolios of various shares and other assets so that they are not overly reliant on any one investment or asset class performing well – this is known as diversification.

'Collective' investments such as unit trust and Open-Ended Investment Companies (OEIC) funds are designed to do this in a convenient way. Each invests in dozens (or sometimes hundreds) of different companies (or bonds or properties for those investing in those areas). In this way it is possible to own a more diverse portfolio for just a few hundred pounds.





The main types of investment

The main types of asset that can be considered for a portfolio – notably shares and bonds – have different characteristics, but unlike cash all can fall as well as rise in value to a greater or lesser extent.

Shares

Buying shares (also known as equities) means owning a tiny slice of a business – Tesco, Shell or ITV for example. Shareholders participate in the growth of a business if it does well and often receive a portion of the profits through dividend payments. Income from dividends is sometimes overlooked but is a very important element of investing in the stock market.

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 - and neither capital nor income is guaranteed.

History shows that equity ownership over long periods leads to good returns, which is why people with a long time to invest often choose to put most of their portfolio in this type of investment. For those willing and able to accept that their investment could fall substantially in value, as well as rise, equities are worth considering.

Bonds

Bonds represent the borrowings of 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. Typically they pay a fixed amount of income each year and repay the original capital at the end of the term – e.g. 10 years.

More risky issuers of bonds tend to have to pay a higher level of income to attract investors while low risk ones (including many governments) can issue debt with low yields, perhaps in line with general inflation or interest rate expectations, reflecting that the risk of default (non-payment of income or capital) is minimal. However, between issue and repayment investors can buy and sell bonds just like any other investment, so values fall as well as rise and you could get back less than you invest.

There is also the risk that the issuer of the bond runs into trouble. 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 lower potential upside. They generally attract investors looking to generate a consistent income ahead of cash but who don't want excessive volatility. That said, values change according to a number of factors including interest rates and inflation expectations as well as any perceived change in the creditworthiness of the bond issuer.

Other asset classes

There are a number of other 'alternative' asset classes that investors can use to diversify their portfolios further. These include: targeted absolute return funds which aim to grind out modest but positive returns each year; property funds which focus on commercial properties such as shops, offices and warehouses; and commodities including precious metals such as gold and platinum.

Investment funds

While some more experienced investors like to buy individual shares, a convenient way to invest is through collective investments such as unit trust and OEIC funds. They offer diversification by investing in dozens of different companies – or bonds or properties for those investing in those areas.

There are around 30 different fund sectors and several are dedicated to UK 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 stocks in the portfolio. The alternative to this is 'passive' funds or trackers, which simply aim to provide performance similar to a particular index such as the FTSE 100. These tend to be cheaper, sometimes significantly so, but will not outperform the market they are designed to follow in the longer term.

It is possible to buy an extensive range of different funds through Charles Stanley Direct.

How to hold your investments - ISA, Pension or Investment Account?

Using Charles Stanley Direct it is possible to buy and hold funds 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, it is generally a good idea to prioritise tax-efficient vehicles for your 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 largely hold the same range of investments so it doesn't mean narrowing down options. Just think of them as a 'wrapper' around the portfolio. However, if an employer makes contributions to a particular pension scheme, it should be a priority to obtain these.

Each year's ISA allowance can be used to shelter up to £20,000 of investments from capital gains and income tax. Alternatively, those saving for retirement may wish to consider a SIPP, which offers income tax relief on contributions of up to the highest marginal rate although, of course, tax treatment depends on your individual circumstances and may be subject to change in the future. For many people a pension is the most tax-efficient means of saving for retirement but an ISA provides more flexibility to access money when needed.

It is possible to transfer and consolidate many existing investments, ISAs and pensions held elsewhere into Charles Stanley Direct.

www.cs-d.co.uk

Contact us to find out how we can help you:
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This guide does not constitute personal advice based on your circumstances and the contents should not be considered as a personal recommendation to deal. Investment decisions in funds and other collective investments should only be made after reading the Key Investor Information Document, Supplemental Information Document and/or Prospectus. If you are unsure of the suitability of any investment please seek professional advice.
Investors should be aware that past performance is not a reliable indicator of future results and that the price of shares and other investments, and the income derived from them, may fall as well as rise and the amount realised may be less than the original sum invested.

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