The basics of investing

WHAT TO KNOW BEFORE YOU START

Close Brothers
Asset Management

Introduction

When you invest for the first time, you are embarking on an important journey that should enable you to take control of your future and achieve your financial and lifestyle goals. Yet while investing is exciting, it can also seem daunting if you have had no prior experience.

As well as learning about risk, getting started as an investor means you will invariably come across financial terminology you may never have encountered before and making important choices – which may perhaps even seem overwhelming at first.

Remember, however, even the most experienced investors started somewhere. We're to here to help you every step of the way and have written this guide to provide clarity around the world of investing, to demystify some common phrases and terms, and to support you as you begin your investment journey with us.

Investing versus saving

People often use the terms ‘investing’ and ‘saving’ interchangeably. Yet they’re actually two very different disciplines.

SAVING

Saving is about setting aside cash sums on a regular basis, usually in a bank account. It is generally viewed as a short-term option for holding money because saved money is more accessible than invested money. Also, there is little to no risk of capital loss since saved money is sheltered from market volatility (when investments significantly rise or fall in value, usually in response to events).

If your bank or building society fails and can’t repay your money, the Financial Services Compensation Scheme will pay you compensation for deposits up to £85,000, provided your bank or building society is regulated by the Financial Conduct Authority.

THE EFFECT OF INFLATION

While saving cash is less risky than investing, it is not a completely risk-free way of holding money. Although it will not noticeably fall in value, cash does not generally keep up with rising prices – otherwise known as inflation.

What do we mean by that? Well, if the rate of inflation is higher than the interest rate you are receiving on your cash savings, prices are rising faster than your money is growing. This means that while you may have the same amount of money in your bank account, its purchasing power has decreased over time. So, if inflation stays steady at 2% for a year and your savings account pays you 0.5% over that same time period, you’re effectively losing 1.5% of its value each year. While a decrease of 1.5% may not seem like much, it can add up over time. Based on the above example, cash savings of £10,000 would lose £150 a year in spending power due to the combination of low interest rates and inflation. Multiply that amount over several years and you can begin to see the real cost of saving.

WHEN COULD SAVING BE RIGHT FOR YOU?

While saving is not risk-free, there are certain situations when it will be the best option for you. For example, you might:

- Want to achieve a short-term goal such as a holiday, a wedding or a house purchase.
- Need a fund of emergency money – perhaps for when your car or boiler breaks down.
- Be experiencing a change in circumstances that impacts your finances in the short term, such as a change in employment status.
- Feel worried by the risks of investing.

INVESTING

Investing is the process of allocating money (also known as 'capital') with the objective of receiving returns in the form of income, capital growth, or both.

You don't need a large sum of money to get started as an investor. You can invest as little – or as much – as you like.

Nevertheless, you should only invest funds you don't require for other purposes and you should be able to withstand any losses. If you have existing debts, such as credit cards or loans, you should consider paying these off before deciding to invest. Ideally, you should have between three and six months' worth of expenses set aside in case you encounter financial difficulties further down the line. Investing can help you to grow your money over the longer-term provided you are prepared to accept a higher level of risk than you would with savings. Investment returns have the potential to exceed those you can achieve by holding cash in a savings account, but investments are riskier.

WHY IS INVESTING RISKIER THAN SAVING?

- **You can lose money.** Unlike cash savings, investments can fall – as well as rise – in value. That means you could get back less than you invest.
- **The level of income is not guaranteed.** Market volatility may cause your returns to fluctuate. There may be periods when your investments perform poorly and your returns are negative.
- **You might not be able to access money easily.** While it can be simple to withdraw funds from cash savings, that isn't always the case with investments. Sometimes you may have to wait for a long time to access your money and you may have to pay fees to sell certain investments.

WHEN IS INVESTING RIGHT FOR ME?

While investment carries higher risk than saving, there are certain situations when it may be a better option for you. For example, you might:

- Want to pursue higher returns – and be willing to accept that you may lose money in pursuit of that objective.
- Have a long time horizon - so you can withstand short-term losses.
- Want to try and guard against the effects of inflation in the event that the interest rate on your savings account is below inflation.
- Be in a stable financial situation and have accumulated a cash reserve that you can draw on should your circumstances change.

What are your goals?

By now, you might be starting to think that investing is for you. So, what are the next steps? Before jumping in, we recommend you carefully consider the following questions:

WHAT DO I HOPE TO ACHIEVE FROM INVESTING?

Before you start, you should know why you're investing, how much you're investing, and how long you want to invest. Having defined investment goals allows you to plan more effectively and have an idea of what success looks like to you. When setting expectations, it's important to be realistic.

HOW MUCH RISK AM I WILLING TO TAKE?

Different investment opportunities come with different levels of risk. The level of risk you are prepared to take will be unique to you and your circumstances. If you're starting to invest for your retirement in your twenties or thirties, you may build a higher-risk portfolio because you will have a long-term horizon for maximising the growth of your pension pot. If you are investing for a retirement that is only a few years away, then you will have a shorter time horizon and may want to ensure your portfolio is less exposed to the higher-risk asset classes. This will help to minimise the risk of you suffering losses that you have less time to recover from.

HOW LONG AM I PREPARED TO PUT MY MONEY AWAY FOR?

The longer your investment time horizon, the longer your investments will have to grow. If you aren't willing to invest for at least five years, you might want to consider other options since investing should be seen as a long-term commitment.

Asset classes and investment types

Once you've decided you're ready to invest, you can start thinking about what you want to invest in. You will have a choice of investments across different asset classes.

An asset class is a group of investments that share similar characteristics and are subject to the same laws and regulations. Different asset classes tend to perform differently in changing market conditions. So, while one asset class may lose value in response to a particular market event, another asset class may perform strongly.

THE MAIN ASSET CLASSES ARE:

Shares
Shares – also known as 'equities' – are issued by companies that are publicly listed on stock exchanges. When you invest in shares, you become a shareholder who owns a share of the company. As a result, your returns are affected by increases or decreases in the company's value. In some cases, you may also get income in the form of dividends.

Bonds
Bonds are issued by companies and governments as a way of raising funds. Investors are essentially 'loaning' them money. Loans to governments are sometimes called 'gilts'. Returns come when the company or government pays interest on the loan amount. Interest is normally fixed and repaid over a specific time period.

Alternative Investments
Alternative investments are those that don't fall into the traditional asset classes i.e. shares, bonds and cash. Examples of alternative investments include commodities such as oil and gold.

Cash
Cash is seen as a lower-risk, lower-return option compared to shares or bonds. Within the context of an investment portfolio, allocating a portion of your investment to cash will allow you to take advantage of buying opportunities that arise during a period of market volatility.

OTHER INVESTMENT TYPES:

Funds
A fund is a collection of assets, which are chosen and managed by a professional fund manager, or investment provider in the case of passive funds. Funds typically contain different shares, bonds and alternative investments, but can also contain just a single asset class. They can be a good option if you're new to investing and would prefer a professional to make individual investment decisions on your behalf.

Investment Trusts
An investment trust is a company that invests in shares of other companies. As with funds, when you invest in an investment trust, you are pooling your money with other investors.

Where investment trusts differ from funds is that they are limited in size and listed on the stock market. Liquidity (the ability to quickly buy or sell an asset) can be an issue for investors who invest in investment trusts due to trusts having withdrawal restrictions.

Exchange-Traded Funds (ETFs)
ETFs are traded on the stock market in a similar way to investment trusts. ETFs include tracker funds, which track the performance of a market index. An index is a method to track the performance of a collection of assets. These could be broad market indexes designed to show overall market performance, such as the FTSE 100 or specific segments of the market.

Income, growth or a blend of both?

Investments are broadly divided into income assets and growth assets. When you plan your investments, you need to decide whether you want your investments to generate an income, grow in value, or achieve a combination of both.

GROWTH ASSETS

Growth assets are designed to grow your investment. They include shares, as well as commodities such as oil and gold. These assets are known as growth assets because they tend to generate the majority of their returns through increases in value.

As they have the potential to produce higher returns over the longer term, growth assets can help to protect against inflation. Nevertheless, they are also vulnerable to market volatility, which is why they are considered to be higher-risk investments.

INCOME ASSETS

The most common income assets are corporate and government bonds, which tend to provide more stable, but lower returns, than growth assets. They generate an income via fixed interest or dividend payments until their maturity date. At maturity, investors are repaid the initial amount they invested.

INCOME AND GROWTH

You could even consider a blend of both income and growth assets; how you split the two will depend on both your attitude to risk and your investment time horizon. If for example, you're approaching retirement and want to reduce your level of risk, you may want to reduce your exposure to growth assets and increase your exposure to more stable income assets. Funds are an example of an investment type that can incorporate both approaches to give a blend of the two.

Diversification

When you diversify your portfolio, you spread your investments between different asset classes. This is good practice because it reduces your exposure to market volatility. Since different asset classes respond differently to market influences, the positive performance of one investment could neutralise the negative performance of another.

If your portfolio is heavily exposed to a single asset class, it will be reliant on the performance of that asset class. Should the asset class underperform, you could incur significant losses.

As well as diversifying across asset classes, you should also consider diversifying across different geographies and sectors. Different stock markets around the world perform differently and respond to different events. If one economy is in recession, another may be booming. Industries such as technology and healthcare may be strong, while energy and financial industries are struggling.

What account type is right for me?

The type of investment account that you choose will depend on your financial planning objectives and whether you want to take advantage of available tax allowances and reliefs. Some of the accounts below have annual limits on how much you can invest, but it is possible to hold investments and cash in each of the three accounts simultaneously, apportioned according to your needs.

STOCKS AND SHARES ISA

Individual savings accounts (ISAs) are a great way to grow your money because they offer generous tax benefits. You pay no tax when you sell your investments in a stocks and shares ISA. You also pay no tax on any income that you earn from your investments. In the current tax year, you can invest up to £20,000 into your stocks and shares ISA – although this limit applies to all the ISA products that you hold, including cash and Lifetime ISAs. If you have parental responsibility for a child under 18, you may be able to open a Junior ISA (JISA) on your child's behalf. Unlike the aforementioned ISA types, saving into a Junior ISA won't affect your personal allowance. For the current tax year, you can invest up to £9,000 in a Junior ISA.

Your ISA limit resets at the start of each tax year, so you'll have a new allowance to use from 6 April annually.

SELF-INVESTED PERSONAL PENSION (SIPP)

A SIPP is a tax-efficient product that allows you to make your own investment decisions for your pension pot. You receive government tax relief on the money you put into your SIPP, up to a certain limit. The rate of relief you get depends on the level of income tax you pay.

INVESTMENT ACCOUNT

If you have used your full ISA and SIPP allowance, then an investment account is a great option for investing additional money and assets. Although it does not offer any tax benefits, there are no limits on the amount you can invest. Be aware, however, that any gains you make may be subject to tax.

Where do I start?

We have a range of tools and resources to help you get started on your investment journey with us:

IN-HOUSE RESEARCH

Take advantage of our investment expertise by viewing in-house research, analysis and insights. Our research is prepared by our investment team, who are constantly trading in the markets and managing the portfolios of thousands of investors across the UK.

Our fund factsheets provide detailed information about investment objectives, styles and track records.

DISCOVERY SHORTLIST

Chosen by our analysts, this shortlist of external funds is designed to assist investors in creating diversified, well-balanced portfolios. The Discovery Shortlist is based on in-depth research and analysis and our team meets with hundreds of fund managers each year to find out about their objectives, processes and strategy. You can read more about the shortlist here.

READY-MADE PORTFOLIOS

If you want to start investing but would prefer someone else do the hard work for you, our ready-made portfolios may be a good solution.

A ready-made portfolio is a combination of different investments, which are grouped together in one fund. Each ready-made portfolio is created by us and invests in a diverse mix of assets across a range of countries and sectors – helping to balance risk with the opportunity to invest in the right places. This approach provides a cost-effective way for you to have your investments managed. It also means that you benefit from having a professionally monitored and diverse portfolio, which reflects our best ideas and in-house investment views.

FINANCIAL ADVICE

If you're in a good position to invest, but don't feel comfortable doing it by yourself, it may be worth seeking the help of a financial adviser. Our qualified financial advisers can discuss your investment goals with you and work collaboratively with you to build a portfolio that is tailored towards your needs and aspirations.

Are you ready?

Investing can sometimes require patience and persistence. You should expect to experience highs and lows along the way, depending on how both markets and your individual investments perform.

Now that you've read through this overview, you may feel you understand enough to start investing. Make sure that you're comfortable with the basics of investing, and the associated risks, before you begin. We wish you the best on your investment journey.

Close Brothers Asset Management is a trading name of Close Asset Management Limited and Close Asset Management (UK) Limited. Both companies are part of the Close Brothers Group plc group of companies, are registered in England and Wales and are authorised and regulated by the Financial Conduct Authority. Registered office: 10 Crown Place, London EC2A 4FT. VAT registration number: 245 5013 86.

© Copyright Close Asset Management Limited 2021. All rights reserved.

CBAM6138. 18.03.2021.

Close Brothers
Asset Management