



A Guide to Savings & Investments



A Guide to Savings & Investments

Before deciding upon your investment options, you should have:

- considered your overall financial objectives
- prepared a budget to establish the amount of income you need (if any)
- calculated your current tax position
- ensured ready access to cash for everyday living expenses by setting aside some capital in a instant access account
- made a Will
- ensured that your family is financially protected in the event of your death or long term sickness

To help guide you through the maze of investment options, we have divided them into three categories:

- 1. Lower risk investments**
- 2. Managed investments**
- 3. Higher risk investments**

Lower Risk Investments

A) Deposit Accounts

- A vast range of accounts are available from building societies and banks.
- Can be treated as your cash reserve fund.
- Provide valuable security and flexibility as well as giving you regular payments of interest and easy access if you need to withdraw a cash amount.
- Interest rates are usually variable, therefore it is a good idea to review the competitiveness of the account from time to time.
- Remember to also consider Internet, postal and telephone accounts as some offer higher interest rates than the high street.
- Income tax will be deducted from the interest made on the account unless you are registered as a non-taxpayer.

B) National Savings

- Can have fixed or variable interest rates. The rates of interest paid vary in line with the changes in base rates.
- The main advantage of National Savings products is that they are safe, with government backing, and in many cases are offered free of tax or gross without tax being automatically deducted.
- May have particular appeal to non-taxpayers at one end of the scale and high rate taxpayers at the other.
- The period of investment varies considerably from instant savings accounts to five-year savings certificates and bonds.

C) Fixed Interest Investments

C1) Gilts

The government guarantees the final maturity value and rate of income paid by gilts. However, because they are quoted on the London Stock Exchange, their day-to-day values fluctuate.

- Any capital gains made are exempt from capital gains tax.
- Can offer a choice of regular known income, capital growth, or a combination of the two.
- Interest payments made by gilts are liable to income tax.

C2) Guaranteed Bonds

- Offered by insurance companies over periods normally ranging from one to five years.
- The rate of interest is fixed at the outset and will generally be attractive if interest rates are on a downward trend.
- Income can be paid on a regular basis or the money can be left to grow for the full term.
- If you are paying basic rate tax when the bond matures, there will be no income tax liability on the proceeds of the bond.
- The return of the original capital can be linked to the performance of a share market index. It is, therefore, possible to lose some of the original capital if the chosen share index declines in value.

C3) Annuities

- Offered by life assurance companies, they guarantee to pay you an income for life in return for the investment of a capital sum.
- The income is taxed on a favourable basis in that only the capital element is tax-free. The older you are, the higher the element viewed by the Revenue as return of capital rather than income which is, therefore, not liable to tax.
- A big drawback with annuities is the loss of capital. Usually there is no return of the investment once the annuity is purchased.
- Usually only suitable for those who require maximum income available at current rates and are not concerned to preserve their capital for their beneficiaries or for possibly more rewarding long-term investments.

Managed Investments

A) Unit trusts

- Unit trusts trade in shares, fixed interest securities and bonds on behalf of investors, who buy individual units that reflect the value of the assets purchased.
- Dealings within the fund are exempt from capital gains tax and the collective size of the fund means that a wide range of shares and other assets can be purchased to reduce risk.
- A choice of over 1,400 different funds to choose from a variety of different groups, including banks, insurance companies and investment companies.
- You are liable to tax on income paid by the funds, and also capital gains tax on the rise in the value of the units. However, most investors do not fully utilise their annual capital gains tax exemption.

B) Open Ended Investment Company (OEIC)

- Very similar to unit trusts in that monies from individual investors are "pooled" into a professionally managed fund with specific investment objectives. However, instead of operating under a trust deed, an OEIC has a company structure and issues shares instead of units. They also have a different pricing structure, with a single price quoted rather than the bid/offer system used by unit trusts.
- They offer greater freedom for switching within a range of sub-funds under one umbrella, which also has different share classes to appeal to private and institutional investors.

- They operate under similar regulations to unit trusts with the same protections for investors and the same favourable capital gains tax exemption for dealings within the fund.

C) Investment trusts

- An investment trust is a collective investment vehicle with the same favourable capital gains tax exemption treatment.
- Instead of units it offers shares, which are quoted on the London Stock Exchange. Like other quoted companies, it has a board of directors, elected by the shareholders, and it pays dividends out of its income after expenses. But unlike other quoted companies which manufacture products or provide services, investment trusts seek to make money by buying shares in other companies, even other investment trust companies, to generate profits from price movements.
- One big difference between unit and investment trusts is that investment trusts can borrow money to buy shares – known as gearing. Whilst this can mean extra profits from share transactions in strong share markets, it also involves the possibility of greater losses.
- A further risk is that the share price of an investment trust is not just based on the value of the underlying net assets, as with unit trusts and OEICs. As a quoted share, a whole range of outside influences including market sentiment can also influence the price of an investment trust. As a result, investment trust prices are often at a discount to the net value of the underlying assets, although on occasions, they move to a premium.
- Although historically investment trusts have provided a better average return than unit trusts, they tend to be more volatile and involve higher risk. Nevertheless, as a professionally managed collective investment vehicle, they can be less volatile than individual shares.

Past performance is not a guide to future performance

D) Investment bonds

- Single-premium investment bonds, offered by insurance companies, give investors the choice of a range of professionally managed funds and managed portfolios, with varying degrees of risk and potential reward. A big attraction of investment bonds is their flexibility.
- Active investors can switch easily and cheaply between the different individual funds under the bond "umbrella" to suit changing requirements and/or changing trends in the markets.
- More passive investors can choose funds such as With Profits, Managed and Distribution funds, which spread risk by investing in different sectors and geographical areas.
- With Profit bonds also 'smooth' returns by aiming to pay annual bonuses based on the past performance of the fund over a period of several years rather than being directly linked to short-term movements in the markets. Once the bonus is added it cannot be taken away. In addition a terminal bonus may be payable on encashment, this is not guaranteed but reflects the performance of the fund.

During adverse market conditions a reduction to the value of the investment (known as a Market Value Adjustment) may be applied to With Profit Funds, which could reduce the amount you get back on surrender.

- The main emphasis of investment bonds is normally on building up capital growth. However, investors can use investment bonds to provide income by way of capital withdrawals. Such withdrawals can usually be taken monthly, quarterly, half-yearly or annually.
- Because investment bonds are technically insurance policies, there is a special facility for investors to withdraw 5% annually off the original amount invested in a bond for a period of 20 years without any immediate liability to pay income tax or capital gains tax.
- This can be particularly attractive to higher-rate taxpayers who are able to defer any tax liability on the 5% withdrawals until final encashment when they may no longer be liable to pay higher-rate tax.

- There is no personal liability for basic rate taxpayers to pay income or capital gains tax on withdrawals because the bond pays tax internally. However higher-rate taxpayers may be liable to pay additional income tax if regular annual withdrawals exceed 5% of the original investment and when the bond is surrendered. At the same time non-taxpayers cannot reclaim the tax paid by the bond.

The levels and bases of, and reliefs from taxation are subject to change although it is unlikely that any changes would be applied retrospectively.

- You are free to surrender your investment bond whenever you like. However, investment bonds should normally be viewed as a medium to longer-term commitment, since there are initial or establishment charges to be met and early withdrawal penalties tend to apply for the first five or six years. It is also important to note that the value of your investment can fall, as well as rise, particularly in short periods of time.
- As an independent financial adviser, Lucra Limited reviews all the different investment bonds, issued by insurance companies, to assist clients in choosing the funds offering the best value, both in terms of charges and performance.

E) Endowment Policies

- Offered by insurance companies, endowment policies invest in a variety of assets from shares to fixed interest securities and commercial property. Policies are normally funded by payment of fixed monthly or annual premium. Regular premium policies held for 10 years can qualify for favourable tax treatment with the benefits being paid out tax-free.
- Endowment policies pay out a guaranteed minimum value, the sum assured, on the death of the named person. The insurer under a 'with profit' and/or low-cost endowment policy declare an annual bonus, which is added to the sum assured, and in the final year a terminal bonus may also be added.
- Endowments are only suitable for longer-term investment, say ten years minimum. Early surrender may result in your receiving less than you have paid in premiums. However, for those who wish to invest for a longer period and require a lower-risk investment than equities, the endowment policy may be an attractive option

F) Friendly Societies

- Friendly Societies offer qualifying policies and bonds similar to insurance companies. However, they have been granted an additional tax incentive. The Societies are not liable to pay the tax normally paid by life assurance funds on investments of up to £300 a year. They should, therefore, be able to provide more attractive returns over a period of 10 years or more, although they do not always benefit from the economies of size enjoyed by the bigger insurance companies. Nevertheless, Friendly Societies are a particularly attractive way to save modest amounts (e.g. the government's new Child Trust Fund payment), especially for children or grandchildren.

Higher Risk Investments

A) Shares

- Shares have traditionally provided a better total return (capital growth plus income yield) than alternative investments over a period of 5 years in spite of short-term fluctuations in the share markets.
- Normally bought to provide capital growth, but can also be a valuable source of raising income. Although dividends may not provide a high-income yield to start with, they grow in line with the rising capital value of the share.
- Investing in shares does involve an element of risk, especially over the short term. Prices of shares quoted on the stock markets can fluctuate considerably, both down and up.

- The timing of purchases and sales of individual shares, and the spread of risk, are important factors in maximising the value of a share portfolio.
- Many investors prefer 'pooled' or collective investments handled by professional fund managers. These managed funds offer many benefits including the wider spread of investment risk.

B) Share Schemes and Share Options

- There are several types of share schemes and share options available to employees. The two types are Save As You Earn (SAYE), linked share option schemes and Executive Share options. SAYE linked schemes impose limits on the value of shares which may be allocated to employees.
- Additionally, to qualify for Inland Revenue approval, the scheme must be available to all employees who have completed five years' service.
- Employees may save into a SAYE linked savings scheme, normally operated by a building society, up to a maximum of £250 per month. At the end of three, five or seven years, depending on the rules of a particular scheme, the employee may exercise the option to obtain shares at a predetermined price. There is no liability to Income tax on the grant of these options.
- Capital gains tax may be charged on the eventual disposal of the shares. Executive share options may also be established in a tax efficient manner. However, the maximum amounts involved are much more generous and there is no need to open up the schemes to all employees.

C) Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCTs)

- EIS and VCTs are two other tax-efficient plans primarily for investors wishing to defer payment of Capital Gains tax bills and prepared to take the risks involved of investing in new ventures. The tax concessions offered could be an incentive for some people to invest in high risk unquoted small companies. These schemes are suitable only for experienced investors and require specialist investment advice.

Savings & Investment Strategy

Whether you are looking to put money aside on a regular basis or you have a capital sum to invest, there are some key factors you should consider.

Availability - You should ensure that you have easy access to money adequate to cover your everyday expenses and possible emergencies.

Income - Income may be fixed or variable. You should calculate your income needs on a net (after tax) basis. Drawing up a budget is extremely helpful and we have included a form for you to use if required.

Inflation - To provide a source of future income and to protect the purchasing power of your money against the effects of inflation, you need to consider investments which will offer prospects of capital growth.

Flexibility - Your circumstances may change. Your investments will need to be capable of being adapted when necessary to meet different requirements.

Efficiency - Your investments should take account of your tax situation from year to year.

Safety - A certain degree of risk may be acceptable but it should be balanced by other more secure investments. It is vital to determine your specific needs before embarking on any savings or investment strategy.

Choosing the Right Investment Strategy

How do you choose between building societies and bank deposit accounts, unit trusts, investment bonds, national savings, and ISAs, when investing for your future? Each has its advantages and disadvantages.

It is rarely sensible to have all your eggs in one basket. Wise investors will 'spread' their money amongst several different kinds of investments. Each investment has its own particular place in a properly constructed portfolio, but how does the investor choose the best balance?

Building society or bank deposit accounts are the automatic choice for many investors as they are safe, dependable and can offer easy access to your money. But remember you are planning for the future and interest rates are variable.

If you withdraw the income each year, even with modest inflation, the 'real' value of the capital invested in a deposit account is constantly being eroded. While in recent years we have seen relatively low rates of inflation, it is not so long ago that inflation rates were in double figures. Historically, the best method of protecting the purchasing power of capital, over the longer term, has been by investing in areas linked to share markets. Of course, with share based investments you are exposed to risk since share prices can go down as well as up.

Whilst it is impossible to guarantee future growth, stock market investment in the main has generally provided favourable results over the longer term. Shares should, therefore, be considered in any well-diversified investment portfolio.

You can reduce the risk of investing in shares by putting your money into professionally managed funds such as unit trusts and investment bonds. Whilst you cannot eliminate the risk entirely, you can take out investments, which are widely spread both geographically and in different sectors.

Before investing in this area, there are two things you should do:

- establish your own attitude to risk
- look medium to long term for this part of your investment portfolio

The types of investment you need to make will depend on what you want for your future. A Lucra Limited financial adviser will help you strike the right balance, which is the secret of successful investment.

An example could look like this:

- Some capital held in a building society or bank account to give ready access to your money
- Some will be invested to provide you with a regular income, if this is required
- The rest will be in capital growth investment to protect your long- term standard of living from the ravages of inflation

With guidance from your Lucra Limited adviser you can select the investment plan to suit your specific requirements.

You need to decide:

- the amount of income you need from your investment(s), if any
- the security you require
- the risks you are prepared to accept in return for higher potential return on capital

For further information or to book an initial consultation, please call us on 0208 722 0734.

Lucra Limited is an appointed representative of Sage Financial Services Ltd.

Please note that all the information in this guide is for general guidance only and represents our understanding of current rules, regulations and Inland Revenue practice. Specific advice should be taken before acting on any of the guidance set out in this article. We cannot assume legal liability for any errors or omissions it might contain. You should seek professional advice if you wish to make investment decisions.

Investments in stocks and shares or unit trusts may go down in value as well as up, so you may not get back the full amount invested. If you withdraw from a life assurance in the early years, you may not get back the full amount invested. If investing in a With Profits life insurance the return on your investment depends on the profits made by the life office and on its policy as to their distribution (whether on early encashment or in adverse market conditions or other circumstances).

Lucra Limited
Donnington House
2A Sutton Court Road
Sutton Surrey
SM1 4SY

web@lucra.org