Our Guide to Investing

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Financial Planning & Wealth Management

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Giving you peace of mind and time to help you enjoy your life to the full

Most individuals invest to put their money to work, to generate a source of income and capital for the future. This could be saving for your first home, creating a fund to cover financial emergencies, investing in your children's future, ensuring you enjoy your retirement or creating a legacy for your family.

The starting point for any investment strategy should be to think carefully about what you want your money to do in the short, medium and long term as your objectives for each of these could be different.

Short-term

The cornerstone for most financial plans is an emergency reserve - an easily accessible fund to cover unexpected and planned expenditure in the foreseeable future, for example, paying for a wedding, a holiday, a new car or home improvements. Given the short timeframe it make sense to keep this capital on deposit, but any cash you don't need to cover short term needs should be put to work with aim of achieving better returns.

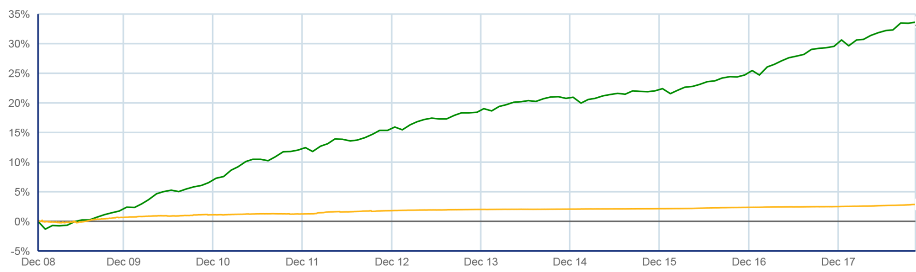
Medium and longer term

Capital you don't need access to in the foreseeable future can therefore be invested. This means investing in other types of assets beyond cash and involves exposing it to a degree of risk. How much risk is very much dependent upon the individual and this aspect needs careful consideration, which we cover later
in this guide.

Why invest rather than simply save?

It is common for people to feel the need to retain cash. Bank and building society accounts are the ideal place for your savings and emergency money as they are easily accessible and tend to be the safest place to put your money, but doing so exposes your capital to the enemy of the investor - inflation. In turbulent times it's natural to respond cautiously, but some investors can over react and sell an investment at the wrong time, or others are discouraged from investing in the future, which is why it is important to understand how investments work.

Cash itself is not risk-free. Although the capital value may be secure, it is easy to overlook the impact of inflation which reduces the purchasing power of each pound. Investing in cash may lead to long-term financial disappointment as savings rates tend to be lower than inflation, meaning prices rise faster than the value of your savings.



A - UK Retail Price (33.6%)

B - IA Money Market (3.0%)

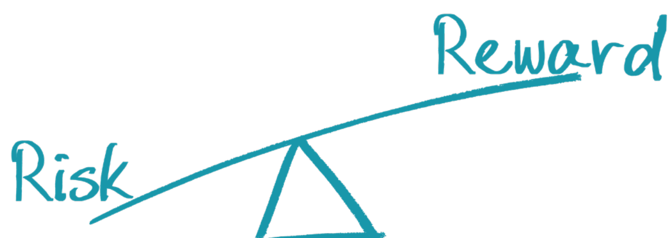
17/12/2008 - 17/12/2018 Performance Data from www.trustnet.com

In order to invest successfully, a clear understanding of your financial goals will help you decide how to balance current against future spending. You also need to decide how long you are prepared to invest for, the risk you are prepared to take and most importantly, whether you can tolerate any losses in the short term. Many people find this aspect of financial planning difficult and prefer to work with a financial professional to help them design their own plan.

Armstrong Watson Financial Planning & Wealth Management can help you to establish an investment portfolio which will provide you with the best chance of achieving your goals, at a level of risk you are able to accept. Our Financial Planning Consultants can also help you allocate the right amount of capital to meet your short, medium and long term objectives.

Understanding the principles of investing

All savings and investments involve some degree of risk, but by making an informed decision to accept risk creates the opportunity for greater returns, known as the risk/reward trade-off.



Your ability and willingness to accept risk will determine the most suitable range of assets for your investment. If you are not comfortable with, or do not understand the risk you're taking, you should not invest.

There are techniques for managing risk and the most common is through asset class diversification.

Broadly, there are four main asset classes:

Cash - This includes deposits with the banks and building societies (investments backed by Financial Services Compensation Scheme and within the protection limit are the most secure). The ability to get your money out of an investment is a risk factor, so generally the more liquid an investment the lower the return. Hence instant access accounts tend to offer lower returns than those which lock in your money.

Fixed Interest, also known as bonds – are in fact loans that are repayable at a certain date in the future after a series of interest payments are made. There are two types:

UK Government bonds, called Gilts as they used to be backed by gold, are perhaps the most secure of these and are almost certain to be repaid on schedule. Other than index-linked variants, they usually pay a fixed rate of return. Debt instruments issued by other countries which are not rated as financially strong as the UK carry greater capital risk, as well as currency fluctuations - not to mention interest rate risk.

Corporate bonds are loans to companies, so carry a greater risk of non-repayment than gilts. The capital value of the bond can also fluctuate and could fall if interest rates rise. Whenever investors buy bonds that offer a fixed rate of return, they are exposing themselves to interest rate risk.

Property - Investing in property can include direct or indirect investments in UK residential and commercial property, or property abroad. The returns come from both rents and capital appreciation. The underlying risks are that tenants may not pay their rent or that properties may be left vacant. Direct investments in property tend to be much less liquid than cash, bonds or equities, as buying and selling buildings can be a lengthy and time consuming process. Therefore, a key risk with direct property investments is that investors may not be able to withdraw their money when they need to.

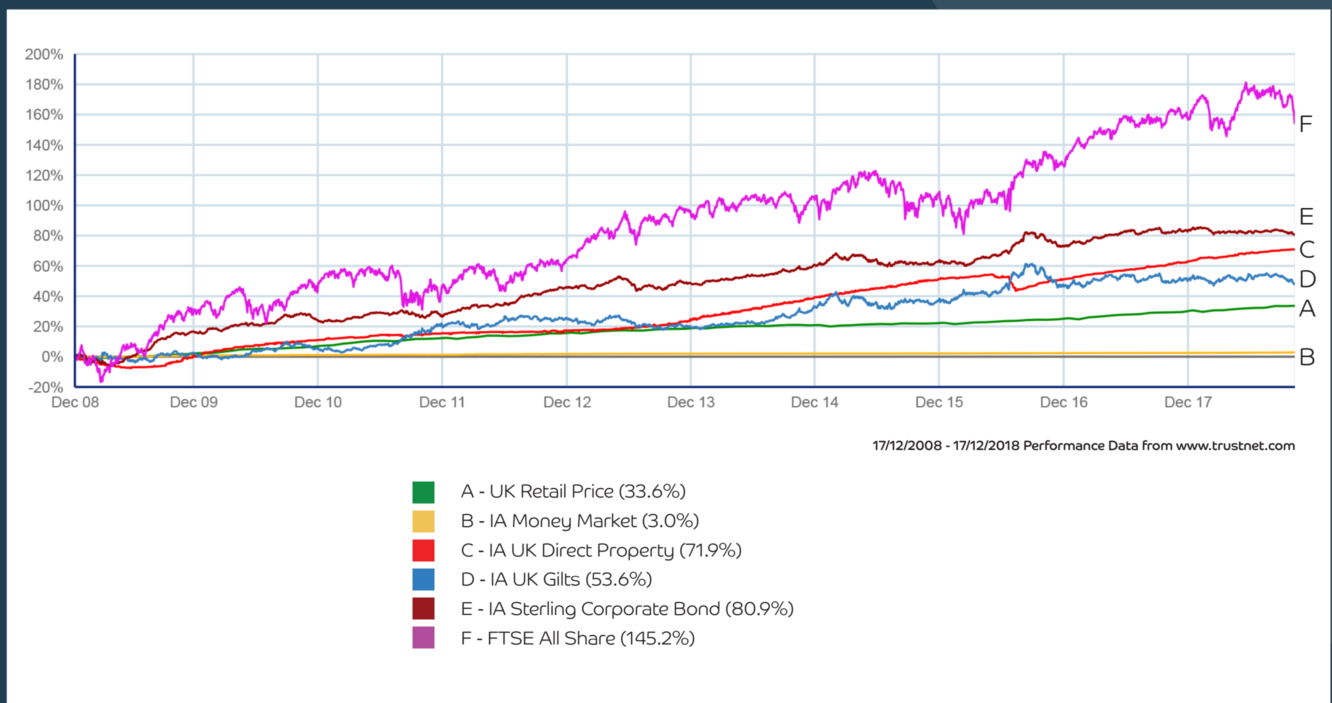
Equities (Stocks/Shares) – Equities mean an ownership in a company. The returns are influenced by a wide variety of factors but the main ones are the underlying performance of each company and the wider economic environment.

There are two types of risk – Specific Risk and Market Risk.

Specific Risk is where the share price is affected by the failing of that company for whatever reason. Market risk is where the share price of a company can be affected by the failings of other companies in the same sector.

You can invest in UK or international equities, such as USA, Europe, Asia, Emerging Markets etc. Equities tend to carry the highest form of risk, but also the greatest potential for return.

The graph below shows the returns over 10 years of the different asset classes and their volatility:



These assets can be held directly, such as shares of a company or as part of a pooled investment with other investors where you own units in a fund that holds that asset class or a blend of classes. These can be held in various tax efficient tax wrappers, such as ISAs and pensions to help with your financial plans.

Each asset class has many sub classes which are more focussed in a particular area. For example equities can be broken down in to geographical areas such as North America, Japan, and Europe etc. In these sectors you only invest in companies listed in that region. Overseas equities also retain currency risk.

Which assets do you choose?

No-one can predict which will be the best asset class each year. The table below shows the performance of individual asset classes over the last decade. It highlights the variability of asset class returns and also shows the risk created by taking investment decisions based on past performance.

Investment Returns

Currency: Pound Sterling Source Data: Total Return

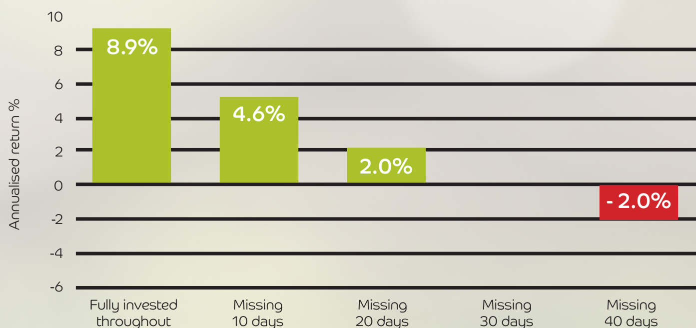
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
BEST	UK Small Cap 63.4	UK Mid Cap 28.4	Gilts 15.6	UK Small Cap 35.0	UK Small Cap 44.2	North America 19.6	Japan 17.6	Emerging Markets 35.4	Asia ex Japan 23.4	Property 2.9
	Emerging Markets 62.5	Asia ex Japan 23.9	Corporate Bonds 4.3	UK Mid Cap 28.7	UK Mid Cap 34.9	Gilts 13.9	UK Small Cap 13.6	North America 34.1	Emerging Markets 21.1	North America 0.8
	Asia ex Japan 55.5	Emerging Markets 23.6	North America 19.1	High Yield 18.9	North America 28.3	Property 12.8	UK Mid Cap 12.0	World ex UK 30.4	UK Mid Cap 18.2	Cash 0.6
	UK Mid Cap 52.8	North America 19.1	Cash 0.5	Asia ex Japan 17.5	Japan 24.9	World ex UK 12.3	Europe ex UK 5.5	Asia ex Japan 28.7	Europe ex UK 16.9	Gilts 0.6
	Europe ex UK 47.9	Japan 19.0	UK Large Cap -2.2	Europe ex UK 17.4	Europe ex UK 24.0	Asia ex Japan 10.0	North America 5.3	Japan 22.7	UK Small Cap 16.3	Corporate Bonds -2.2
	UK Large Cap 27.3	UK Small Cap 17.5	High Yield -3.1	Corporate Bonds 13.3	World ex UK 22.7	Corporate Bonds 9.8	Property 5.3	Europe ex UK 21.2	Japan 14.4	World ex UK -2.7
	Europe ex UK 21.8	World ex UK 16.7	Property -5.6	Emerging Markets 12.8	UK Large Cap 18.7	Emerging Markets 7.9	World ex UK 4.8	UK Large Cap 19.1	World ex UK 13.5	High Yield -3.6
	World ex UK 18.9	Property 12.6	World ex UK -6.1	Property 12.5	High Yield 6.9	UK Mid Cap 2.8	Gilts 0.6	UK Small Cap 12.7	UK Large Cap 11.9	Japan -7.6
	North America 14.8	UK Large Cap 12.6	UK Mid Cap -10.3	World ex UK 11.9	Property 5.4	Japan 2.7	Cash 0.5	High Yield 10.1	North America 11.3	Emerging Markets -7.6
	Corporate Bonds 14.7	High Yield 12.1	Japan -12.9	North America 10.7	Asia ex Japan 1.3	High Yield 1.0	Corporate Bonds -0.4	Gilts 10.1	Property 7.1	Asia ex Japan -8.5
	Property 14.1	Corporate Bonds 7.7	Asia ex Japan -14.8	UK Large Cap 10.0	Corporate Bonds 0.6	UK Large Cap 0.7	High Yield -0.9	Corporate Bonds 9.0	High Yield 6.1	UK Large Cap -8.7
	Cash 0.6	Gilts 7.2	Europe ex UK -15.0	Japan 3.3	Cash 0.5	Cash 0.5	UK Large Cap -1.3	Property 8.5	Corporate Bonds 5.1	Europe ex UK -9.1
	Gilts -1.2	Europe ex UK 6.6	UK Small Cap -15.3	Gilts 2.7	Gilts -3.9	Europe ex UK -1.4	Asia ex Japan -3.5	UK Mid Cap 5.1	Gilts 1.8	UK Small Cap -13.5
WORST	Japan -5.8	Cash 0.5	Emerging Markets -18.4	Cash 0.5	Emerging Markets -5.3	UK Small Cap -1.7	Emerging Markets -10.3	Cash 0.4	Cash 0.3	UK Mid Cap -15.2

Past performance is no guarantee of future performance. The value of investments can fall as well as rise and investors may not get back their original investment. Source: Morningstar Direct

By investing in products that contain a range of asset classes you can reduce the overall risk to which your capital is exposed, as when one area is performing less well, another area may produce higher returns.

Time in, not timing!

No one can predict the peaks and troughs of financial markets and it is extraordinarily difficult to time when the best days (peaks) are. As the chart shows, missing just the ten best days over this period would have cut your annual return substantially. Timing the stock market is extremely difficult, the best policy is usually to stay fully invested over the long term.



Source: Datastream, from 30.06.03 to 30.06.18, annualised return. Returns based on the performance of the FTSE All-Share, with initial lump sum investment of £1,000 on a bid to bid basis with net income reinvested.

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Important areas a financial adviser can help you with understanding your risk outlook

When considering investment, understanding how much risk you are prepared to take is crucial. It is personal to you and will probably change over time according to your objectives and/or time horizon. Risk tolerance often decreases with age or significant life events, so it is important to keep it under review.

Our Financial Planning Consultants carry out a detailed assessment of how much risk you are prepared to take with your money and, importantly, they establish your tolerance for loss. Too much or too little risk can compromise your investments, so our advisers ask clients to complete a risk profiling questionnaire to establish their views. This then provides a 'score' which indicates the individual's outlook and forms a basis for our discussions.

The results will help us:

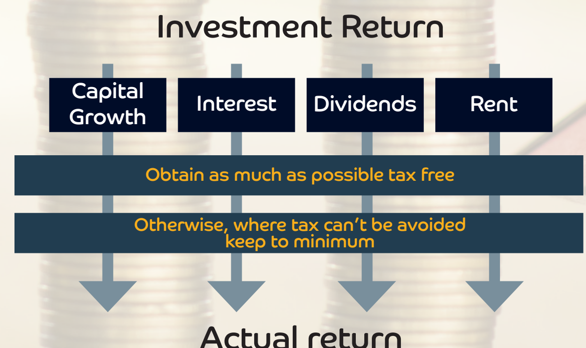
- Explain the risks that come with your financial decisions
- Explore trade-offs that you might need to make between risk and return in order to achieve your financial goals
- Help choose the most suitable investment strategy. This includes the allocation to growth assets (equities and property) and defensive assets (cash and fixed interest).

Your risk tolerance and capacity for loss may change over time so it is important that it is regularly reviewed.

The importance of tax planning

Tax planning can be equally as important as asset allocation when recommending an investment portfolio. After all, there is little point in taking the time to search out the best funds for your objectives if tax then wipes out the return.

Each client's circumstances are different, so we take care to ensure that the most appropriate tax wrapper(s) are selected. This does not compromise asset allocation, but helps to maximise return by minimising tax.



Pensions

Pensions are currently one of the most tax efficient ways to invest for the long term and often the principal way to save for retirement. Although your funds are tied up until you retire, pensions offer considerable tax benefits in comparison to most other investment vehicles.

The principal benefits of a personal pension are:

The amount you contribute attracts income tax relief at your highest marginal rate. 20% is added at source, but higher and additional rate taxpayers can claim back further tax relief via self assessment returns.

HMRC sets a contribution limit, known as the Annual Allowance, each year dependant on how much you earn.

The funds into which contributions are invested benefit from tax advantaged growth. Income from rents, deposits and gilts remains free of tax, as do capital gains.

Pension benefits can be drawn currently from the age of 55.

At retirement, 25% of the accumulated fund can be taken as a tax-free cash sum, the balance providing a pension taxed as earned income. From April 2015, the balance of the fund can be taken as a lump sum, but this is subject to your marginal tax rate at the time.

In the event of death before the selected retirement date, the accumulated fund can be passed to your chosen beneficiaries, completely free of Inheritance Tax.

Individual Savings Accounts (ISAs)

You must be a UK tax resident to invest into an ISA and there is a cap on the amount that can be invested, which currently stands at £20,000 per annum.

All gains, income and dividends earned by the investments in the wrapper are tax exempt. As such, an ISA provides tax-free growth on your investments.

An ISA does not have any access restrictions and you can liquidate your investment at any time. You are able to transfer your ISA investments to a different provider and retain the previous allowance limits.

General Investment Account (GIA)

A GIA is an investment without an upper limit, although Capital Gains Tax may be payable on the growth made. GIAs can prove highly tax efficient as each individual also receives an annual Capital Gains Tax (CGT) exemption, which means that gains below the exemption limit will not incur a CGT liability. GIAs are used predominantly by investors who have already invested the maximum annual allowance into their ISA and those who are pre-retirement and making significant contributions to pensions.

Our Financial Planning Consultants will look to make the most of your tax allowances and exemptions as part of our advice process.

Investment bonds

Investment bonds are single premium life assurance policies, as they pay out a sum slightly higher than the value of the contract upon death, but their primary purpose is as an investment vehicle with distinct tax advantages.

They are available in two forms – onshore and offshore. The former are available from UK mainland based providers, whereas the latter, are usually based in Dublin or the Isle of Man and frequently available from the same providers as their onshore equivalents.

Onshore bonds are subject to UK life fund tax rules, so investors are deemed to have paid basic rate Income Tax on any gains when they are realised. Higher or additional rate taxpayers may face further Income Tax. Due to the tax regime that investment bonds operate under, no gains are subject to Capital Gains Tax. Investment bonds can be held in sole names, jointly, or in some cases, by multiple investors.

Offshore bonds operate in a similar way, but the underlying funds are not subject to UK life fund tax rules, so returns are payable 'gross', meaning that all gains realised may be subject to UK Income Tax at the investor's marginal rate. These arrangements are particularly useful for non-taxpayers and trusts from a tax planning perspective.

They also provide the ability to withdraw up to 5% of the original capital invested each year the bond is in force and roll this allowance up if it isn't used, which is useful for investors wishing to generate additional capital or income. If more than this is withdrawn it may result in a tax charge.

A wide range of investment funds are available within investment bonds and switching between different funds is usually free and creates no tax implications, unlike a GIA.

Our Quest

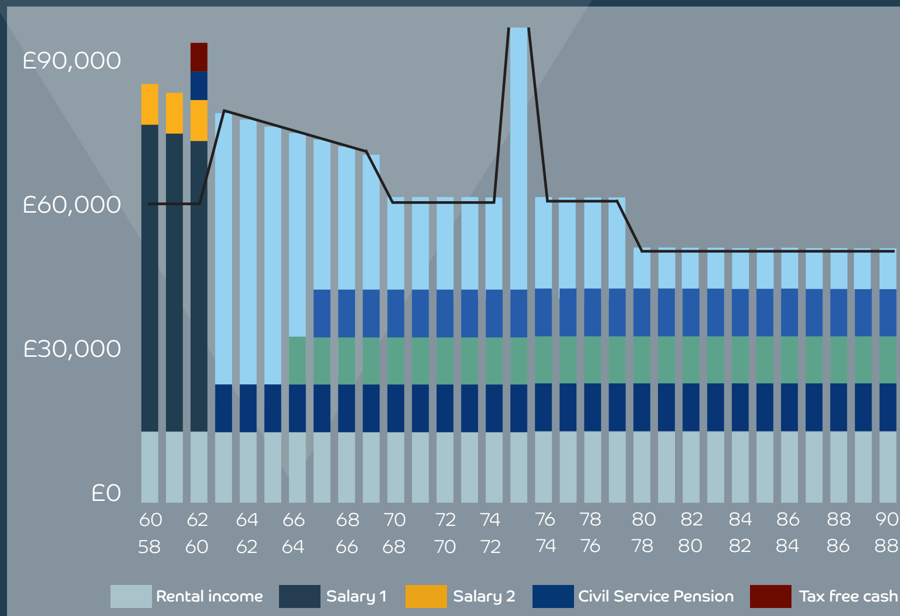
To help our clients achieve prosperity, a secure future and peace of mind.

...we're with you...

Cash flow forecasting

A cash flow model calculates the growth rate required to meet your investment objectives. This rate is then cross referenced with your attitude to risk to ensure your expectations are realistic and compatible with the asset allocation of your investment portfolio. This may be a key consideration for our Financial Planning Consultants at the outset of your investments and at future reviews.

Cash flow modeller:



Savings at start (age 60)	Savings at retirement (age 63)	Savings at end (age 60)
£1,407,000	**£1,558,364**	**£1,594,325**

Summary

Investing money can be complicated and you need to consider a number of issues before committing your money, but with a clear understanding of how your investments work it needn't be something to fear.

Armstrong Watson Financial Planning and Wealth Management is a Chartered Firm. Our approach is to step into our clients' shoes and see their personal or business situation from their perspective providing us with a clear understanding of their aspirations and objectives. This helps shape our advice and to provide bespoke solutions for investors of all types.

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