

SAVINGS & INVESTMENTS

PLANNING FOR YOUR FUTURE

People save to generate capital for the future. Saving takes discipline. It means setting aside an amount of money on a regular basis. Successful savers are those who set their sights on something important to them and work towards making that goal a reality. They save a realistic amount each month that balances their wants for the future with their needs for today.

An investor is someone who already has a lump sum of money and is looking for capital growth, income or a mixture of both.

Whether you are a saver or an investor (or both) with so many options available to you it's easy to be baffled by the amount of choice. Many people leave their money in a bank or building society unaware of the effects of tax on the interest and the erosion of value by inflation. Deposit accounts are great for the short to medium term but to secure value or growth in value, you should consider alternative forms of investment.

THINGS TO THINK ABOUT

Do not put all your eggs in one basket.

Lessons learned from the recent problems faced by Northern Rock customers are that even banks are not 100% safe. Under a depositor protection scheme only a certain amount of an individual's capital is guaranteed should a bank collapse. Spreading investments and savings is a good tactic whatever the objective.

Risks and Rewards

The best investment or savings vehicle is one where you understand the risks and rewards and can rest easily. Everyone is different when it comes to attitude to risk. It depends on your nature, upbringing, experience, where the money has come from and what you are saving or investing for. Your financial adviser will help you understand your personal attitude to risk and therefore select the most appropriate types of investment for you.

Effects of Inflation

You want to make the most of your money, so you need to ensure that the value of your money at least keeps pace with inflation. As you might know, one person's inflation is not another's. It depends on lifestyle. If the price of petrol increases dramatically it has an immediate effect on car drivers but a smaller effect on people using public transport. So, again, making the right investment is important when aiming for an amount of growth or income.

Fluctuating Markets

You might have heard of the expression, 'the value of your investments might go down as well as up'. Stock market performance tends to change on a daily basis. If you are looking for a short to medium term investment, i.e. less than five years, stock market investments are unlikely to be suitable. The value might go down and you are not guaranteed to get back what you invested. However, over the medium to long term stock market based investments have generally provided much better returns than traditional savings accounts.

TYPES OF INVESTMENT

Collective Investments

These allow investors to participate in a large portfolio of stock and shares and other assets with many other investors. This enables them to access a wider spread of investments at a lower cost than would otherwise be available. Investments such as these allow you to utilise your Capital Gains Tax allowance and any income generated will be subject to income tax, (except when in an ISA or Pension Plan).

Unit Trusts

Unit Trusts are collective investments that are subject to certain rules. The managers of the investment fund have to set out the investment objectives and trustees oversee their activity to ensure that the objectives are met. The number of companies in whom investments are made has to be at least 20 but the trust cannot hold more than a certain share capital in any one company. This ensures that there is a certain safeguard on the spread of investments. The investor buys units at the 'offer' price and sells them back to the fund managers at a 'bid' price. The difference between the two includes an initial charge and is known as the bid/offer spread. An annual management charge is also applied and the amount depends on the type of fund.

Investment Trusts

An Investment Trust is a company whose sole business is to manage the investments it owns. The management of an investment trust may be employees of the trust (in which case it is called a self-managed trust) or, more commonly, may be an external fund management company.

The use of the term trust is slightly misleading as (unlike Unit Trusts) there is no trustee involved. It reflects the historical origins of investment trusts.

The shares of investment trusts are listed and therefore they are bought and sold through a broker, like the shares of any listed company. There is usually an annual management charge paid out of the investment trust's assets. Investment trusts are 'closed ended' so the amount of money in the fund does not change; investors cannot withdraw money from an investment trust, or add to the money in the trust: they buy or sell its shares.

Open Ended Investment Company (OEIC)

Open ended investment companies (OEICs) are a form of collective investment fund. OEICs are legally similar to investment trusts in that they are companies whose sole business is to manage the investments they own. However, OEICs operate more like unit trusts in that investors buy and sell shares in the OEIC from and to the OEIC manager rather than on the open market. This is possible as an OEIC can freely cancel existing shares (when an investor sells) or buy new shares (when an investor buys).

As with unit trusts, there may be initial charges and exit charges. However OEICs, unlike unit trusts, are generally single priced. As with any type of fund there will be an annual management fee.

Investment Bonds

These are single premium, whole of life insurance contracts, where the level of life cover is very little more than or equal to the value of the investment. These are similar to OEICs but, because of the insurance link, they are treated differently for tax purposes. Currently, withdrawals of up to 5% of the original investment each year are treated as return of capital and not subject to tax at that time. Income tax might be due when more than this is encashed and will depend on your tax situation at the time. Your financial adviser can guide you through this.

TAX EFFICIENCY

To encourage savings and investments the government provides tax breaks for certain types of investments but limits what you can put in. The four main types are

Individual Savings Accounts
Pensions
Venture Capital Trusts and
Enterprise Investment Schemes

Individual Savings Accounts (ISAs)

ISAs are available to everyone over the age of 18 (16 for cash ISAs) and ordinarily resident in the UK. There is no income tax or capital gains tax to declare on your annual tax return in respect of any income or profits that you make. Due to these tax advantages investment is limited to an allowance of £7,200 per annum.

Up to £3,600 of the allowance can be saved in cash with one ISA provider. The remainder of the £7,200 can be invested in stocks and shares with either the same or a difference provider.

Pensions

You can now put in up to 100% of your earnings each year and attract tax relief, up to a lifetime limit. Of course, few people can afford to put this much aside but, as with any regular saving, it is a good discipline to plan for your future so that you can maintain your lifestyle in retirement. Your financial adviser can help you find the best type of pension plan to suit your income, tax situation and ambitions.

Venture Capital Trust (VCT)

A VCT is a company, broadly similar to an investment trust (see above), which subscribes for shares in, or lends money to, small companies. Under an approved VCT scheme, investors enjoy income and capital gains tax relief. Individuals invest by holding shares in a VCT. The VCT invests in a spread of small unquoted companies, enabling investors to spread their risk, just as they do by holding shares in an ordinary investment trust company.

Enterprise Investment Scheme (EIS)

These are a form of Venture Capital Trust. The EIS is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies. You can also invest through an EIS Fund, which will invest on your behalf in a number of qualifying companies. As with a VCT you are still the owner of the shares.

WHAT TO DO NEXT

We hope this explains some of the choices available to you but if you would like any more information on the topics mentioned, or require any other type of financial planning, please contact us on 0117 930 2393

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