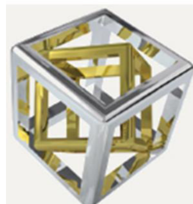

3D Financial Planning
Independent Financial Advisors

Getting ready to invest

Information you need to know before making your first investment.

It's hard to underestimate the importance of preparation for newcomers to investing. Even the most experienced investors will spend a great deal of time defining their goals, exploring their options and developing an investment strategy best suited to their needs.

While it is imperative that you seek professional help before committing to any kind of investment, it's crucial that you have a good understanding of your options beforehand. This includes learning about the technicalities of investing but also involves identifying what you're trying to achieve, assessing your financial position and being honest about your limitations.

Defining your goals

Before you think about which assets you want to invest in, it's important to pin down exactly why you want to invest.

Ask yourself the following questions:

What are your goals?

Merely 'wanting to make more money' is too broad a financial goal and will not help you develop an appropriate financial strategy. Instead think about the specific reasons you want to invest. Do you want to pay off your mortgage? Have a comfortable retirement? Make sure your family is financially stable?

When do you want to achieve them?

Setting measureable goals allows you to evaluate your progress and adapt your investment strategy where necessary. Targeting a specific figure within a set timeframe will help you focus on achieving your ambitions.

How achievable are they?

We would all like a five-figure return in our first year of investing but reality is rarely that kind. Instead of feeling demoralised when you fail to achieve unrealistic targets, keep your ambitions grounded in reality.

Types of investment

Collective investment schemes

Unit trusts and open-ended investment companies (OEICs) are the most popular investment funds. They reduce risk by pooling investors' money together into a collective investment.

Unit trusts and OEICs can either be **passive** or **active**. Passive funds track the performance of a market or index, while active funds are overseen by a professional fund manager who will make investment decisions based on long-term strategies, economic factors, market movements, research etc.

Collective investment schemes are a good option for those who do not have the time or the expertise to manage their own portfolios or who want to spread the risk of investing.

Stocks and shares

Becoming a shareholder will see you become a part-owner in the company and will provide you with voting rights and sometimes other shareholder benefits as well.

Returns come in the form of dividends (a percentage of company profits usually paid on a bi-annual basis) and capital growth (selling your shares for a higher price than you bought them for).

Buying shares directly carries greater risk than investing in them through a collective investment fund. However, unlike a collective investment fund the returns are not shared among investors.

Getting ready to invest

Exchange-traded funds

Some exchange-traded funds (ETFs) are similar to passive collective investment funds in that they work by tracking a particular market index. The key difference is that ETFs are traded on stock exchanges in a similar way to shares and can be bought and sold at any time while the market is open.

ETFs operate by either buying all the shares in an index (known as full replication) or by purchasing a representative sample of an index (partial replication). The latter is used when tracking indices with a high number of listed companies.

Bonds

When a company or a government requires extra capital, they may sell bonds to investors. As a creditor, you will be paid a fixed-rate of interest on an annual or bi-annual basis until the date of maturity. You will receive back the original amount paid for the bond if it is held until it matures.

Bonds are generally regarded as being lower risk than other asset classes such as shares (though this will be determined by the financial health of the company or government selling them). Buying bonds issued by financially-sound governments, such as the UK, will provide security but will not produce a high return. Conversely, purchasing one from a struggling company carries more risk but will pay higher interest.

Stocks and shares ISAs

Stocks and shares ISAs provide a tax-efficient way to invest in shares, bonds, ETFs and collective investment funds. You can place up to £20,000 a year into an ISA and pay no tax on any profits made. There is no minimum term length for investments held in an ISA and assets may be sold at any time.

It is important to note that the ISA allowance is based on the value of your investments at the point of entry. This means that if you deposit the maximum £20,000 of investments into an ISA and they fall in overall value, you will be unable to make further deposits until the next tax year.

We can help you minimise tax on your investments.

Risk

Different asset classes carry different levels of risk. Cash and bonds for example are regarded as being lower risk assets while the unpredictability of the stock market makes equities much riskier. Riskier assets will likely reward the investor with higher returns while lower risk investments will not be as profitable.

Attitude to risk is based on 2 main factors – capacity for loss (how much can you afford to lose without affecting your plans), and tolerance to loss (how you cope mentally/emotionally with loss).

For example, you may not want to take on too much risk if you're investing over a short period of time.

However, you may feel more confident in purchasing riskier assets if you're investing for the long term. The longer you're invested the more time you have to regain any capital lost during a dip in the market.

Fees and costs

The amount of fees and charges you can expect to pay for investing will be determined by how much you invest and which fund you invest with.

The ongoing charge figure (OCF) provides the most accurate estimate of how much you will need to pay to the fund. The OCF is comprised of a variety of different fees charged by the fund. This includes the annual management charge, which covers the day-to-day costs of operating the fund.

The amount charged will vary between funds but as a general rule expect to pay higher fees when investing in riskier assets.

In addition to the OCF, there a number of other charges to be aware of before you invest:

Entry and exit fees

Though they are becoming rarer, some collective investment schemes will charge entry or exit charges of up to 5% of your investment.

Performance fees

Some funds will levy a performance-related charge. This will be paid to the fund manager when the returns are higher than the target figure. These are generally 20% of the amount exceeding the target.

Platform charges

Using a fund platform will see you incur an annual charge of between 0.25% to 0.35%. These online platforms allow you to hold and administer all of your investments and investment wrappers in one place.

You should always seek professional financial advice before making investments. Contact us to find out how we can help.

Important Notice

The way in which tax charges (or tax relief, as appropriate) are applied depends upon individual circumstances and may be subject to change in the future. ISA eligibility depends upon individual circumstances.

This document is solely for information purposes and nothing in this document is intended to constitute advice or a recommendation. You should not make any investment decisions based upon its content.

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