M&G Investments

The M&G guide to

Investing

Contents

Please refer to the glossary found on page 14 for an explanation of the words highlighted in **bold** throughout this guide.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested. We are unable to give financial advice. If you are unsure about the suitability of your investment, speak to your financial adviser. The views expressed here should not be taken as a recommendation, advice or forecast.

Where could you invest?

Introducing the different areas in which to invest

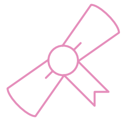
When it comes to choosing where to invest, the option you go for is likely to depend on how you feel about **risk** and what you need from your investment.

Cash

Cash grows only by the interest rate applied to the savings account. When the interest rate is lower than the rate of **inflation,** the actual value of your savings will go down.

Cash savings are perceived to be the safest way to invest, but returns are not high.

Bonds



Bonds are generally lower risk than **equities** and can provide a regular income, with more growth potential than cash. This is because bonds typically have fixed lifetimes, at the end of which, whoever holds the bond should be repaid the original price at which the bond was issued. With equities, there's no guaranteed price when the shares are sold – it's always up to whatever the market is willing to pay. There's also no guarantee that the investor will receive an income from shares, known as dividend income.

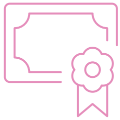
Bonds usually offer the potential for a regular income and tend to be lower risk than property and equities.

Property

Commercial property offers the potential for a long-term income, as well as some capital growth.

Property has the potential for greater returns than bonds over the long term. However, it tends to have less growth potential than equities.

Equities



Equities have the potential for strong growth, but also come with the possibility for greater losses. Shareholders own parts in the company, therefore taking part in its profits, but also its losses.

Equities are higher risk than bonds, property and cash, but they also offer the most potential for strong growth.

Or...

It's possible to create what's called a '**diversified portfolio**', meaning an investment **portfolio** that's made up of a combination of some or all of cash, equities, bonds and property. This might offer more stability through the ups and downs in markets and economies, because different types of investments tend to rise or fall at different times and at different rates.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

Where you can invest: Bonds

How bonds work

Bonds are basically a type of loan. When you buy a bond, you are lending money to whoever issued the bond. Most commonly, this is a company or a government. In return, they'll usually pay you a regular interest (known as the '**coupon**') and at the end of the loan (at the '**maturity**' date), you should get your original investment back.

While you can hold a bond until it matures, this is not necessary in order to get a return from your investment. After you buy a newly issued bond, you can sell it at any point before the bond matures.

Ways to invest

You can buy bonds yourself or you can invest in a fund that buys a wide range of bonds. A fund can give you greater **diversification** through a mix of different bonds from different **issuers**, but the income paid out by the fund to you won't be fixed because the mix of bonds it holds usually changes over time.

For more information see **The M&G guide to Bonds**.

- When you buy a bond you're lending money to a government or company that issued the bond
- The borrower should give you regular interest payments in return, plus the original amount back at the end of the loan
- Interest is the main return you get from bonds, but bond prices can also rise or fall

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Factors that influence the 'market price' of a bond:

A bond's original price (called the '**face value**') is set when it's issued, but thereafter, the market price will either go up or down when the bond is bought and sold. The market price of a bond is mainly influenced by three key factors:

1. Inflation

As inflation (the rate of increase in the cost of living) rises, the fixed level of interest paid by a bond becomes less valuable. This is why falling or low inflation is normally good news for bond prices.

2. Interest rates

The official interest rate in the UK is set by the Bank of England. Banks and building societies tend to base their saving and lending rates on the Bank of England rate. If interest rates go up, the fixed interest paid by a bond becomes less appealing, as you may be able to get the same return from a cash savings account. Therefore, the price of bonds tends to fall. Conversely, if interest rates go down, the fixed interest paid by a bond becomes more appealing, and so the price of bonds tends to rise.

3. Credit ratings

These are assessments of how likely it is that the borrower (or organisation issuing the bond) will repay the loan. If a **credit rating** falls, it means there is the belief that the borrower is more likely to **default**, so the price of the bond tends to fall as well. Conversely, if the borrower's credit rating improves, the price of the bond tends to rise.

Where you can invest: Property

How property investing works

Property investing isn't just about buy-to-let. Another option is to invest in commercial property. This means the buildings used by businesses, such as offices, shopping centres and factories.

What are the advantages?

Commercial property offers the potential for a steady return that is mainly made up of the rental income paid by tenants, though there is also scope for **capital growth**. Returns from property investments tend to be quite different to those from other **asset classes**, so if you have a sizeable portfolio, an investment in commercial property could help you diversify.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

Ways to invest

It's very hard for individuals to invest in commercial property directly, as it tends to require large sums of money to buy a building. Rental default – albeit less likely than with residential property – is still a potential disadvantage, along with less liquidity and maintenance costs. However, this is not all bad news, as there are many funds you can invest in that either buy commercial property or hold the shares of companies that manage/develop properties.

- You can put your money in residential property or commercial property
- Commercial property offers a number of advantages for investors over residential property
- Commercial and residential property could offer income as well as capital growth potential

The differences between residential and commercial property

Commercial property is normally considered to be a more stable investment than residential property. There are three main reasons for this:

1. Leases

The leases tend to last much longer – five to ten years, compared with the six months to a year of residential letting.

2. Tenants

The tenants normally have access to much larger sums of money, so it's less likely they will fail to pay their rent.

3. Notice periods

The notice periods are normally longer, so there's more time to find a new tenant when a company decides to move on.

Where you can invest: Equities

How equities work

When you buy equities, you become part-owner of a company, and so you can have a share in its profits. Clearly, there is also the potential for loss if the company goes bankrupt or if the shares are worth less than when you bought them.

Ways to invest

You can buy equities yourself or you can invest in a fund that buys a wide range of equities. A fund can spread risk between a mix of different equities from different businesses across a range of industries and countries. However, any income paid out by the fund to you won't be fixed because the mix of equities it holds usually changes over time. In addition, your investment can go down as well as up so you might not get back the amount you put in.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

For more information see **The M&G guide to Equities**.

- Equities are shares in a company, so investing in shares makes you part-owner of the business
- The value of your investment is likely to rise or fall with the company's successes or failures
- You could also receive a share of the company's profits in the form of dividends

There are two ways you can potentially receive a return from your investment:

1. A change in the share price

If the company does well, its shares are likely to become more desirable, which means the price should rise. This means your investment will probably be worth more than you paid for it when you come to sell it.

On the other hand, when a company struggles, the share price may fall, so the value of your investment will drop as well.

Share prices rise: when a company is doing well

Share prices fall: when a company is struggling

2. Dividends

Some companies also pay a portion of their profits to shareholders in the form of **dividends**. These aren't guaranteed, as they depend on the company's business strategy and how well it's doing. In some cases, companies prefer to reinvest most or all of their profits back into their business with the aim of driving future growth.

If you invest directly in shares, any dividends will be paid to you. However, if you invest through a fund (these are introduced on page 13), the dividends will be paid to the fund. You can then choose whether you want to receive them as a regular income or reinvest them to increase the size of your investment.

Understanding Risk

Managing risk

Wherever you choose to put your money, there will be some level of risk involved. But risk is not necessarily a bad thing. It does mean your investments could fall in value, and you may not get back your original investment, but higher risk also has the potential to produce greater returns. The important thing is to make sure you aren't taking on any more risk than you need to.

For more information see The M&G guide to Risk.

- Risk describes the potential for losses
- Taking some risk is a part of investing
- There are strategies to help ensure you don't take more risk than you need to

Here are four strategies to help you manage risk:

Invest in funds

When you put your money in a fund, it's combined with investments from many other people. This means it can be spread across a much wider range of investments than you could buy on your own – so you're less exposed to any one holding falling or rising in value.

Diversify

If you hold a blend of investments, they have the potential to perform well, or badly, at different times, which reduces the risk of your overall investment falling significantly in value. One way to diversify your investments is to combine higher-risk funds focusing on equities with lower-risk funds focusing on property, bonds or even cash.

Invest for the long term

Markets can drop suddenly at times, often in reaction to political or economic news. Taking a long-term perspective, over a period of ten years or more, asset price fluctuations may even out.

Invest regularly

Investing on a regular basis (such as once a month) means you'll make some investments when markets are rising and some when they're falling. This can help smooth out some of the ups and downs in the markets' performance.

Where you can invest: Multi-asset

A blend of everything

Equities, bonds, cash and property all have advantages and risks. A combination of these asset classes could be an option for some investors. Investing in different types of **assets** means you can create a portfolio with the potential to do what you want, at a level of risk you are comfortable with.

Find what you need

There are many different multi-asset funds in which you can invest. This means you should be able to find one that is balanced for the particular blend of income and growth you are looking for.

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

- Different funds offer different blends of income and growth potential
- Holding a blend of asset classes (ie investing in a multi-asset portfolio) can lead to more steady performance
- You can do this yourself or invest in a fund that does it for you

Two ways to create a multi-asset portfolio

You can do this yourself, of course – either by investing directly in a blend of asset classes or by holding a selection of different funds.

However, investors can also choose an actively managed multi-asset fund that has the choice to invest across a range of equities, bonds, property, cash and, at times, currencies.

An advantage of this approach is that the investment decisions are made by experienced fund managers, who would look to combine assets that are attractively priced and have the potential to perform differently in different market conditions. Just as importantly, the fund managers should know when to make changes to their holdings in response to changes in the market environment.

For more information see **The M&G guide to Multi-asset investing**.

Some of the ways you can invest

You can buy equities and bonds directly – even commercial property in some cases – or you can invest in them through funds. These pool money from many investors, so they can give you access to a much wider range of opportunities than you could invest in on your own. There are several types of accounts you can hold your funds in.

- You can invest in many asset classes directly
- Alternatively, you can hold them in a fund
- You can hold your funds in accounts that protect your investments from tax

Types of fund

Unit trusts and Open-Ended Investment Companies (OEICs)

You'll often see **unit trusts** and **OEICs** described as 'open-ended'. This means they can create more units or shares whenever someone wants to invest, so the price of the units or shares always reflects the value of the investment.

Investment trusts

These are 'closed-ended' funds, which means they have a limited number of shares. They are also companies in their own right, so their shares are traded on stock exchanges. As a result, their share price can be higher or lower than the value of the investments they hold.

Examples of accounts available

Individual Savings Account (ISA)

An ISA is not an investment in itself – it's an account that protects your investments (whether equities, bonds or cash savings) from tax. In particular, you don't pay capital gains tax on growth, income tax on interest or higher rate tax on dividends.

Junior ISA

This has the same tax advantages as an ISA, but is designed for UK-resident children under the age of 18. You can transfer Child Trust Funds into Junior ISAs, but you can't hold both.

The value of your investment can go down as well as up so you might not get back the amount you put in. ISA and Junior ISA tax rules may change in the future and ISA and Junior ISA tax advantages depend on your individual circumstances. □

Glossary of investment terms

The following are explanations of some of the terms you would have come across in this guide.

Asset Anything having commercial or exchange value that is owned by a business, institution or individual.

Asset class Category of assets, such as cash, company shares, fixed income securities and their sub-categories, as well as tangible assets such as real estate.

Bond A loan in the form of a security, usually issued by a government or company, which normally pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.

Capital growth Occurs when the current value of an investment is greater than the initial amount invested.

Coupon The interest paid by the government or company that has raised a loan by selling bonds.

Credit rating An independent assessment of a borrower's ability to repay its debts. A high rating indicates that the credit rating agency considers the issuer to be at low risk of default; likewise, a low rating indicates high risk of default. Standard & Poor's, Fitch and Moody's are the three most prominent credit rating agencies. Default means that a company or government is unable to meet interest payments or repay the initial investment amount at the end of a security's life.

Default When a borrower does not maintain interest payments or repay the amount borrowed when due.

Diversified/Diversification The practice of investing in a variety of assets. This is a risk management technique where, in a well-diversified portfolio, any loss from an individual holding should be offset by gains in other holdings, thereby lessening the impact on the overall portfolio.

Dividend Dividend represents a share in the profits of a company and are paid out to a company's shareholders at set times of the year.

Equities Shares of ownership in a company.

Face value The initial price of a bond, also known as par value.

Inflation The rate of increase in the cost of living. Inflation is usually quoted as an annual percentage, comparing the average price this month with the same month a year earlier.

Issuer An entity that sells securities, such as fixed income securities and company shares.

Maturity The length of time until the initial investment amount of a fixed income security is due to be repaid to the holder of the security.

Open-Ended Investment Company (OEIC) A type of managed fund, whose value is directly linked to the value of the fund's underlying investments.

Par value The initial price of a bond, also known as face value.

Portfolio A combination of investments held by an investor.

Risk The chance that an investment's return will be different to what is expected. Risk includes the possibility of losing some or all of the original investment.

Unit trust A type of managed fund, whose value is directly linked to the value of the fund's underlying investments.

The M&G guides

The M&G guides aim to give you the basics about investing, to help you make informed decisions about your financial goals and how to reach them.

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- Investing
- Bonds
- Equities
- Risk
- Multi-asset investing
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