Teachers Financial Planning

Investment UPDATE

Investing for income

A guide to help you decide when to invest for income and some of the assets available.

There are 2 main reasons for investing: income and growth. Targeting growth can help build your overall wealth, while investing for income can potentially give you a more predictable flow of cash at your disposal.

On the surface this is quite a simple, however, deciding whether to invest for income or growth is not always a straightforward choice. Many investors chose a mixture of both.

Your exact strategy and the assets you chose to invest in will depend on your goals, circumstances and appetite for risk.

Understanding your goals

What do you want to achieve and when you want to achieve it? This can be specific *(I want to be mortgage-free in 10 years)* or more general *(I want a comfortable retirement)*.

When you need your money is as important as what you want to achieve. For example, *I want a comfortable retirement* is a reasonable general goal.

However, the strategy to achieve this is likely to be much different for a 25-year-old than a 55-year-old.

Popular goals that suit for investing for income are:

- wanting more income each month
- to pay for a specific ongoing expense such as school fees or care
- to maintain a certain standard of living during retirement.

Understanding your circumstances

Broadly speaking, younger investors might be better suited to growth strategies as they have longer to recoup any losses they may have, although it is important to understand that you can invest for growth at a range of risk exposures.

Older investors or those who need access to their money more immediately might favour income generating investments that are also lower risk.

However, the changing pensions landscape and longer life expectancy means that this is not always the case.

Family members, particularly dependants, are also likely to be part of your planning. If you are married or have a civil partner it may be advantageous to transfer some of your investments into their name. Though seek professional advice before making any decisions.

Understanding risk

While people may tend to think that investing for growth involves greater risks than investing for income all investments carry a degree of uncertainty and both kinds of investments can be made at a range of risk levels. It is of central importance to understand that the value of your investments may fall as well as rise before you decide on a strategy.

Different asset classes also contain different levels of risk which is why financial advisers usually recommend diversifying your portfolio by investing in different types of asset, e.g. shares, bonds, cash etc.

Another important aspect of risk to understand is that it is fluid; it changes over time. Market conditions outside of your control may turn a safe investment into a riskier one in a matter of hours. Your portfolio should be reviewed and rebalanced to reflect any changes in attitude to risk and goals.

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Equities

Equities are shares in companies so their value depends on the performance of the business. Shares can provide a return in the form of dividends (usually paid twice a year) and a lump sum if investors sell their shares for a profit.

Companies with a history of paying dividends could be a good starting point if you are aiming for a stable income as businesses are not obliged to pay dividends (which they do to attract investors to buy and hold their shares), although past performance is not always an indicator of future performance.

Dividend income is taxed at a different rate to other income. The situation is further complicated by changes to dividend taxation rules which will come into effect from April 2016.

We can advise you on what these changes will mean for you in practice.

Bonds

Bonds (also called fixed interest securities) are issued by governments and companies in order to raise money. Investors receive regular income in the form of interest as well as the potential for capital growth if the market value of the bond is positively affected by interest rates and you sell before maturity.

Each bond has a nominal value, usually £100, which is decided when the bond is issued and remains the same throughout the term. Interest is calculated using the nominal value. For example, 5% interest on a bond with a nominal value of £100 would provide an investor with £5 in annual interest for every £100 of stock they own, and is paid on a monthly, quarterly, semi-annual or annual basis.

A bond can be sold before the end of the term (although some bonds are open ended and have no fixed term) at the prevailing market rate, which will reflect general interest rates, the remaining term (and the income this will generate) and demand in the market – this can be at a profit or a loss against the amount that you paid for the bond.

At the end of the term (known as maturity) each bond is repaid at its nominal value.

Property

There are 2 options for individuals who want to earn an income from a direct investment in property.

Buying **commercial property** such as offices or shops and renting them to businesses can generate a healthy rental income.

Given the large initial costs of purchasing such premises, commercial property is not affordable for many individuals. However, individuals can invest in commercial property through a fund which is cheaper than doing it alone.

A more affordable option is **buy-lo-let properties**. You can buy a property outright or get a buy-to-let mortgage though these are likely to have a lower loan to value ratio than other types of mortgage.

You should also consider the time and costs involved in managing a property. You will have to pay for repairs and buildings insurance and won't receive any income if your property is vacant.

Pooled funds

Pooled funds (also called collective investment schemes) allow investors to pool their resources and buy units in a fund that is managed by a professional.

Typically a fund will include a mixture of gilts, bonds and equities.

Pooled funds are generally easier to manage and less risky than going it alone on the stock market.

Unit trusts or open ended investment companies are the most common types available, and there is a large number of pooled funds, including those for equity income, available in the UK.

Diversification is seen as a key strategic component when it comes to investing in pooled funds. Detailed research or seeking the advice of a financial adviser will help you identify the opportunities that are right for you and your goals. An understanding of the risks involved in any type of investment is also an important requirement.

Investment trusts

These are also a kind of pooled fund, but they are an equity listed on the stock market and only offer a fixed number of shares, unlike unit trusts with an unlimited number of units. They are generally referred to as investment companies.

The fact that they are traded on the stock market means that the share price will move up and down in relation to supply and demand in the marketplace. Investment trusts can trade at what is known as a premium and a discount, i.e. above and below the value of the assets that they hold, depending upon market sentiment. They may also pay dividends like other equities. As with other pooled funds, investment trusts are not limited to one sector and can be spread across a wide variety.

We can help you use your money to create new streams of income by navigating through the crowded marketplace and selecting the best option for you.

Speak to us about your investment strategy.

Important Notice

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. The value of investments can fall as well as rise and you may not get back the amount you originally invested. Past performance is not necessarily a guide to future performance.

Your home may be repossessed if you do not keep up repayments on your mortgage. Property investments are relatively illiquid compared to bonds and equities and can take a significant length of time to sell.

Whilst considerable care has been taken to ensure that the information contained within this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information.