Oury Clark Quick Guides:

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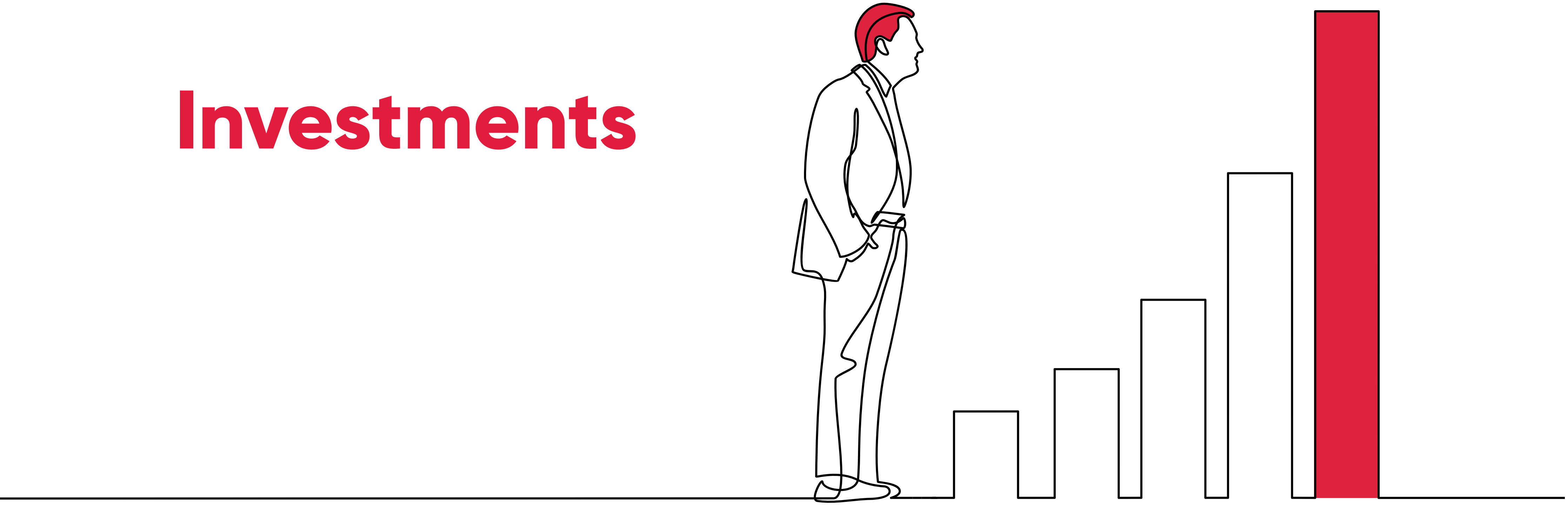
Investments



Financial Services: E23

Building a Portfolio

The word 'portfolio' is the shorthand term for the collection of investments you own across all your accounts – from pensions to bank deposits.

Ideally, this will be spread across a variety of assets – equities, bonds, property and cash – and the mix will have been determined by your specific objectives and attitude to risk.

Ultimately, a portfolio's success is dependent on its performance – but one investor's idea is never the same as the next. Your needs are highly personal and your portfolio needs to reflect that. Risk is key to helping determine which asset classes you select and in what proportion. For example, cash provides security of capital and the interest it earns provides you with a regular income. However, those income payments are generally quite low and change in line with interest rates. There is also no opportunity for capital growth.

At the other end of the risk scale are equities – that is, shares in a company that allow you to participate in its growth and profits. Equities generally offer greater long-term opportunities as a successful company will increase its dividends and capital value as it increases its profits. However, unlike cash, equity prices are volatile and vulnerable to both short-term changes in market sentiment and consumer downturns. Ultimately, if things go very wrong for a company, you may end up getting back less than you originally invested - or nothing at all if that company goes bust.

Deciding how much of your portfolio goes into each asset class is known as asset allocation. Perhaps surprisingly, different asset classes tend to perform in different ways, even when the background conditions are constant - but this lack of correlation can be used to your advantage. Rather than choose just one asset for all your money and take your chances on it being the right one, you can instead put a little bit into each. In this way, at least some of your money will be performing the best it can all the time - and this diversification helps to smooth out those bits which are not performing quite so well.

Investment is a long-term decision but, given these caveats and knowing the short-term risks, a good portfolio should generate the maximum possible return for your attitude to risk. To ensure you get that risk decision right, and don't get taken by surprise in a downturn, it's a good idea to talk over your options with an expert.

Maintaining Your Portfolio

It is important to conduct periodic portfolio reviews, as the value of the various assets within your portfolio will change, affecting the weighting of each asset class.

In order to reset your portfolio back to its original state, you need to rebalance your portfolio. Rebalancing is the process of selling portions of your portfolio that have increased significantly, and using those funds to purchase additional units of assets that have declined slightly or increased at a lesser rate. This process is also important if your investment strategy or tolerance for risk has changed.

Tax Efficient Investment Vehicle

Once we have ascertained the above we must decide which is the most appropriate vehicle to use. This will depend on your own individual situation and would normally mean a combination of vehicles to maximise the tax efficiency.

Individual Savings Accounts -ISAs

An Individual Savings Account (ISA) is a tax-efficient wrapper in which you can place a number of different investments to shelter them from further liability. There are two types; cash and stocks and shares; which allow you to invest a combined annual total of up to £20,000 this tax year (2023/24).

The cash ISA element also has a maximum limit of £20,000 and can be used to access your choice from a range of deposit accounts, National Savings investments and/or certain qualifying cash funds. The type of account that will suit you depends on your circumstances but, in general, like any deposit account, the longer you are prepared to tie your money up for, the higher the interest rate you will receive.

A stocks and shares ISA, on the other hand, can be used to access a whole range of stock and bond market funds and investments. This ISA can be used for the entire balance of your allowance after your cash ISA decision has been made - right up to the full amount if you decide to have no cash ISA investment at all.

The kind of investments eligible for inclusion in a stocks and shares ISA are numerous. They include authorised unit trusts, investment trusts and open-ended investment companies (OEICs), as well as individual shares listed on recognised stock exchanges.

Collective Investments (Unit Trusts / OEICS)

For those who lack either the knowledge, capital or simply the time to research direct investments into shares, pooled funds offer a good alternative. Investor's money is collected together and the total is then invested across a range of assets in return for a fee. There are hundreds of pooled funds to choose from - some aiming to provide an income, others to deliver capital growth. Some simply track a stock market index while others are actively managed by a professional manager with stock selection expertise. Some even target a specific country, region or market sector. However, the principle is the same - by pooling your money with other investors, you can achieve greater diversification from a far smaller outlay of capital.

Investment Bonds

Investment bonds are investment products offered by life companies and are usually made available primarily for lump sum investments. Within the bond, investors are offered a range of investment funds into which they can invest, the most popular of which have traditionally been with-profits, managed and distribution funds as each combines a number of different asset classes within the one fund. Today, however, the fund choice is much wider, with life companies offering links to fund management houses alongside their internal range.

When you take out an onshore investment bond, your income and gains within the fund are subject to tax, which is then deemed equivalent to you paying basic rate income tax. So, if you are a basic rate taxpayer, you will pay no further tax on gains at any time. If you are a higher rate taxpayer, however, you will pay another 20% on the total profit you make when the bond is cashed in. There are, however, ways to mitigate this. For example, you can withdraw up to 5% of the initial value of the investment every year for up to 20 years – ie: up to 100% of the initial investment - without immediately becoming liable for additional tax.

When the investment bond is finally cashed in, you would then be liable for the higher rate tax bill. However, if you postpone this encashment until you are a basic rate taxpayer - perhaps after retirement or when you are simply earning less - you could actually end up with no further liability at all.

Venture Capital Trusts (VCT)

The UK Government introduced VCTs in 1995 to encourage individuals to invest in qualifying UK companies, providing a unique source of funding for UK businesses.

The tax benefits provided by VCTs offer you an upfront Government-subsidised return, along with additional tax benefits over time.

Tax Benefits

The Government encourages investment into VCTs by offering investors a series of tax benefits:

- upfront income tax relief of 30% (on up to £200,000 invested in the first tax year providing the shares are retained for five years);
- tax-free dividends; and
- tax-free capital gains (when you sell your shares)

Enterprise Investment Schemes (EIS)

Enterprise Investment Schemes (EIS) are one of the most tax-efficient investment products available to UK investors. The UK Government introduced them to encourage individuals to invest in targeted UK companies.

It encourages investment by offering investors a series of tax benefits that can be realised within just three years. They're particularly suited to investors with income tax liabilities, or those with capital gains to defer.

Provided underlying investments are held for at least three years, you're entitled to four separate tax advantages:

- 100% capital gains tax deferral for the life of the investment
- 30% income tax relief (on investments up to £1,000,000 per tax year)
- 100% inheritance tax relief as underlying investments are made and held for two years (if investments held at time of death)
- Up to 50% loss relief on any holding that falls in value

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