

Play that funky music, white boy.

This article is to look at investment options that are available for direct investments or rather under advice from investment professionals.

Most advisers are quite comfortable with the range of Open-Ended Investment Companies (OEICs) or Unit Trusts (UTs) that can be selected on various platforms within investment umbrellas, such as ISAs, Investment Bonds or simple mutual funds. It is a reasonable stance that the choice available within these “mainstream” funds is more than sufficient to cover the investment needs of most clients.

Indeed, many advisers simply get an Attitude To Risk questionnaire completed and then choose a multi-asset fund with a corresponding risk grading for their clients’ money to be invested. This is a simple solution that is effective for many advisers and passes the investment strategy onto a specialised fund manager.

This is cost-effective for advisers, in that little time is lost to research and choice of investment strategies and ongoing review of the investment performance of the chosen funds.

But what about advisers that want to differentiate themselves from the mainstream? Those who feel that they can add value for the client by exercising some judgement relating to the clients’ investment objectives. There are plenty to choose from that may do this investment more effectively for some clients.

Investment Trusts

Long considered to be the best kept secret of the City. Investment trusts are Public Limited Companies (PLCs) that are listed on a stock exchange, so investors buy and sell from the market. They come with their own independent board of directors, and you become a shareholder when you invest in a trust.

Investment trusts, like unit trusts, invest in a 'basket' of underlying assets such as equities, bonds or property. ... A fixed number of shares is issued (hence 'closed-ended'), raising a fixed amount of money for the manager to invest in a portfolio of assets. The shares are then traded on the stock market.

A key difference between investment trusts and funds, is that investment trusts are 'closed-ended', meaning that they have a fixed pool of capital. This makes them easier to manage, as investors buy shares on the stock market rather than by buying them from the fund manager.

Once the capital has been divided into shares, investors can then purchase the shares. Investment trusts can be more volatile than unit trusts or OEICs due to them being able to borrow money for their investments and the ability to invest in unquoted or unlisted companies not trading on the stock market.

It is this ability to borrow and invest in unquoted or unlisted companies that spooks advisers who have not done sufficient research to understand the way they are managed and the efficiencies that can be achieved within investment trusts.

Exchange Traded Funds

An exchange-traded fund is an investment fund traded on stock exchanges, much like stocks. An ETF holds assets such as stocks, commodities, or bonds and generally operates with an arbitrage mechanism designed to keep it trading close to its net asset value, although deviations can occasionally occur.

Most exchange traded funds, like mutual funds, are SEC-registered investment securities that provide investors with shares of a portfolio that's invested in stocks, bonds and/or other assets. ... In the same way, ETFs also have boards of directors and officers who oversee how the funds are run.

One big difference between traditional mutual funds and ETFs is how they are traded. Traditional mutual funds — whether actively managed or index funds — can only be bought and sold once daily, after the market's 4 p.m. ET close. In contrast, ETFs trade throughout the day like stocks.

The biggest advantage an ETF has over a mutual fund is the taxation. Due to their construction, ETFs only incur capital gains taxes when you sell the fund. In a mutual fund, capital gain taxes are incurred as the shares within the fund are traded during the life of the investment.

Exchange traded funds enable investors to invest in specialised areas, such as asset classes, specific indices or geographical based funds. In my opinion, their labelling is clearer than most mutual funds and therefore it is easier to understand the nature of the underlying investments.

Structured Funds

Structured funds are a type of fund that combines both equity and fixed-income products to provide investors with a degree of both capital protection and capital appreciation.

A structured product, also known as a market-linked investment, is a pre-packaged structured finance investment strategy based on a single security, a basket of securities, options, indices, commodities, debt issuance or foreign currencies, and to a lesser extent, derivatives.

A structured product is a note with 10 years or less until maturity, usually linked to an underlying stock index or multiple stock indices. An investment vehicle specifically designed to manage risk.

Structured funds have specific maturity dates, but also may offer the option to mature early (kick-out) if certain targets are met at times throughout the contract, normally plan anniversaries. This enables the crystallisation and often reinvestment to lock in gains.

Innovative Finance ISAs.

An Innovative Finance ISA (IFISA) allows you to make peer-to-peer (P2P) lending investments within a tax-free wrapper. ... This allowance can be fully invested in an Innovative Finance ISA, or spread across the different types of ISA. You can also transfer funds from existing cash or stocks and shares ISAs into an IFISA.

Innovative finance Isas (IF Isas) offer the promise of a good return, sheltered from tax, to investors willing to take on the higher risks of the peer to peer (P2P) finance market. ... Introduced in April 2016, the IF Isa now allows investors to pay into a stocks and shares Isa, cash Isa and IF Isa in the same tax year.

Peer-to-peer lending, also abbreviated as P2P lending, is the practice of lending money to individuals or businesses through online services that match lenders with borrowers.

The investors' money is lent to business, often on a revolving credit basis. This often offers a rate far higher than normal bank deposits due to the risk of lending to businesses and possible defaults.

Investors need to be aware that the rate being offered is representative of the underlying risk of business lending. IFISAs should not really be considered to be an alternative to cash deposits, although in some instances, they are marketed in that way.

Venture Capital Trusts (VCT) & Enterprise Investment Schemes (EIS)

A venture capital trust or VCT is a highly tax efficient UK closed-end collective investment scheme designed to provide private equity capital for small expanding companies, and income (in the form of dividend distributions) and/or capital gains for investors.

EIS companies qualify for business property relief after you have held them for two years, which exempts them from your estate for IHT purposes. However, EISs are considerably riskier than VCTs and do not generate tax-free dividends – a key attraction of VCTs.

Although VCTs offer attractive tax benefits, their high risks mean that you should only invest in them if you have a high-risk appetite and long-term investment horizon. ... In any case, you should not sell your shares within five years of your initial investment or you will not receive income tax relief.

Although both VCTs and EIS are eligible for 30% income tax relief, an investor has to hold a VCT for five years to be eligible for tax relief, as opposed to three years with EIS. However, VCT investments cannot be carried back to previous tax years, whereas EIS can be carried back to the previous year.

EIS investments qualify for BPR, which means they become exempt from the investor's estate for IHT purposes. ... Investors get 100 per cent BPR on a business or interest in a business and shares in an unlisted company - so EIS investments qualify for this relief.

Conclusion

All of these investments offer different solutions that satisfy a whole range of clients' needs and objectives. Many of them are not used widely by advisers because they are often considered to be too high risk and advisers do not know enough to be confident about recommending them to their clients.

Each of the providers in these areas needs to invest time and money to educate advisers to enable the advisers to understand their applications to meet client objectives.

I guess that the Professional Indemnity providers also need to be educated to enable them to correctly ascertain the risk levels of these types of fund.

It all depends on the appetite of the Clients, Advisers, Compliance Departments and PI companies to learn enough to trust their own judgement.

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