The basics of investing

Discover simple ways to invest your money

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Investing can give you strong returns over the long-term and it's easy to start once you get the hang of the basics. Discover simple ways to invest your money, without needing to watch the business news every morning. Here's what you need to know:

Contents

02 **What is investing?**

06 **Are you financially ready to invest?**

07 **Investing in funds - the basics**

What is investing?

What is an investment?

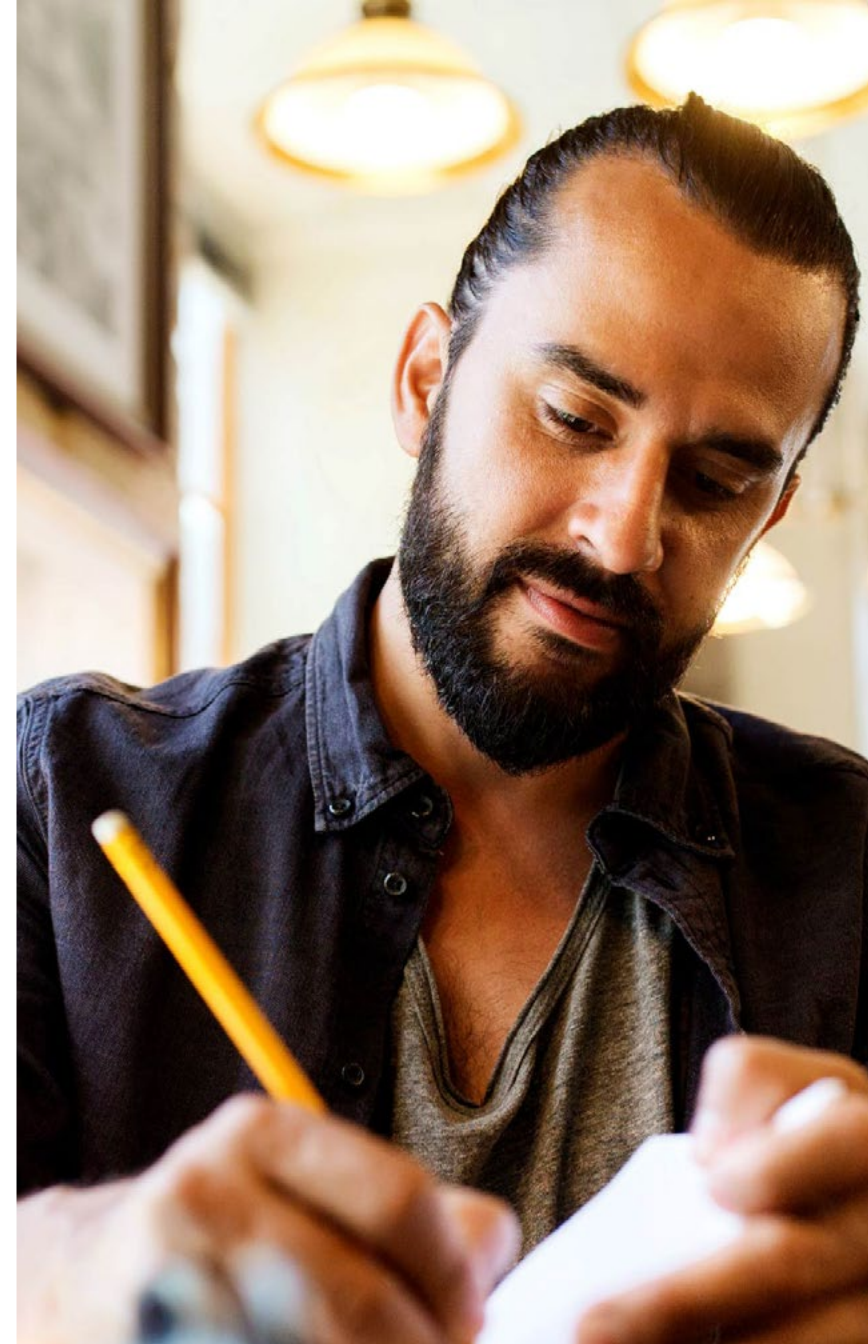
To put it simply, investing is the act of buying assests, with the expectation that they'll increase in value over time. For example, when you buy a portion of a company, you're buying a 'share'. Your investment can then go up or down in value depending on the amount of growth that company makes. You could get back less than you invested if that company makes a loss.

You can invest in all kinds of things such as property, government bonds and even gold. You can buy shares in the financial markets, a place where people buy and sell investments.

Capital appreciation and income

The rise in the share price is the capital return investors get from investing in the shares of a company. Income and dividends are a source of return and are paid by companies to investors.

The FTSE 100 Index® contains the biggest 100 UK companies you can invest in and is known as being home to many big dividend-paying companies.



Should you move all your money out of savings and into investments?

No – you want to hold both investments and savings so you're not relying on one or the other.

It would be prudent to save up enough money to cover any unexpected expenses before you start investing. You don't want to dip into your investments for spending money if you can help it.

Investments do offer a bigger chance of higher returns over the long term but only because of the risks involved with investing.

Understanding risk

As with many things in life, the less risk you take, the smaller your potential reward.

Savings are where most people start; putting any spare cash to one side to build up a short-term safety fund in case of emergency. The rate of interest paid on money held in deposit accounts tends to be relatively low but the amount of cash you have shouldn't fall in value.

Investments are long term savings, five years or more, where different amounts of risk can be taken. Investing is about putting money away either as a lump sum or regularly, providing the opportunity for your money to grow in value over the long term.

There is a wide choice of investment types each with their own pros and cons. For example, investing in riskier investments, such as the shares of companies in less developed markets because of factors such as political risk, means that there could be more bumps along the way, although there is more potential for higher returns. Charges might also apply to investments. Remember the value of investments can go down as well as up and you may get back less then was invested.

Work with risk – not against it

You can manage risk to help your money work harder.

For example, put your money into lots of different investments and you'll 'spread' or 'diversify' your risk.

Just like not putting all your eggs into one basket, you won't have all your money invested in one company that could suddenly fall in value. You can also invest little and often to help smooth out the zigs and zags of the market.

Another good way to manage your risk is to invest for long-term goals instead of short-term ones.

For instance, invest for a goal at least five years from now. That could be anything from a house deposit, university fees for children or simply to grow your own pension pot.

If your investment drops in value in the short term, you'll be less likely to panic sell before it has a chance to go up in value again.

To sum up, risk may sound scary at first. But it's the reason you could get a higher return on your money to begin with.

When you see it that way, risk is a good thing, so long as it's carefully managed. An easy way to manage your risk is to put your money into a fund.

Experts can do all the hard work for you

A fund is when money from different investors is pooled together and a fund manager invests on their behalf. Think of a fund like a shopping basket containing the value of many investments. It could be a sensible way to manage your risk.

Professional fund managers will pick and choose investments so you don't have to. They undergo training and study for qualifications from the Chartered Financial Analyst Society.

This means your fund manager is qualified to manage money as well as being held to the highest of industry standards, as laid out by the Financial Conduct Authority.

The FCA is a financial regulatory body in the UK which aims to make markets work well for individuals, businesses and the economy as a whole.

You can invest towards your annual tax allowance

If you're wanting to keep as much of your money as possible, then a tax-efficient stocks and shares ISA could be for you. It works just like a normal cash ISA, except it holds investments instead of cash.

Any interest and dividend payments in your ISA will be free of income tax. And any potential profits will be free of capital gains tax too.

A stocks and shares ISA goes towards your annual ISA allowance, which for 2020/21 is £20,000.

The sooner you open an ISA, the sooner you can make use of your annual allowance. You don't need a lot of money to get started – even £50 a month is enough.

Remember, tax benefits are subject to change and depend on your personal circumstances.

What do you want the money for?

Once you know what you want the money for, you'll find it easier to choose how long to invest for.

- **Want to buy a house?** You could invest between now and five years and potentially end up with a sizeable contribution for your new home.
- **Want to send your child to university?** Consider a Junior Individual Savings Account. Your child will be able to withdraw the investments as cash when they turn 18.
- **Want a comfortable retirement?** Think about investing a portion of your earnings every month from now until you retire. Any potential profit will go towards your pension.

You'll feel more committed to your investments once you know what you want to spend your money on in the future.

Are you financially ready to invest?

You might think you don't have enough money to start investing. But you may be closer than you think. If you can answer 'yes' to these three questions, then you may be financially ready to invest.

1. Are you free of any high-interest rate loans?

You'll want to pay off any high-interest rate loans you may have before you start investing.

The reason is simple: you might have to pay more interest than the amount of interest you would actually make from your investments. Put yourself in a better financial position so you can focus on growing your investments instead.

2. Do you have enough money saved up for unexpected emergencies?

Build up your emergency savings and you won't have to dip into your investment money from time to time.

You want to have saved at least three to six months of living expenses. That way, if you do have to dip into your savings for an emergency, your investment money stays untouched.

3. Are you prepared to invest your money for at least five years?

The longer you invest your money for, the more time you give yourself to allow any potential returns to grow in value.

Your investments can rise and fall in value and you could get back less than invested. You need the confidence to hold onto your investments for the long-term and stick to your financial goals.

The results

If you answer 'yes' to these three questions, then you may be financially ready to invest.

You can still learn more about investing in general in our **Investment Knowledge Hub**.

If you answered 'no' to one or more of these questions, then you may want to pay off any loans, build up any savings and put long-term financial plans in place first.

Investing in funds - the basics

Funds allow you to invest in more than one asset at once. An asset is anything with monetary value, such as shares in a company, gold or property.

So rather than putting all your money into company shares or property, you're pooling your money with other investors and putting it into a fund made up of shares and property.

It's not guaranteed: investments can go down as well as up and you could get back less than you invested.

With funds, you're trying to achieve diversification with your investments – so, for example, if one company's shares go down, another company's might remain stable or even go up.

What are funds made up of?

Shares: Buying a share is like buying a tiny piece of a company. If the value of the company goes up, so does your share. If it goes down – you guessed it – so does your share.

Bonds (also known as gilts, if it's a UK Government Bond): When a government or company wants to raise money, they might 'issue a bond' – effectively asking for a loan in the financial markets. Investors give them that loan, and are paid interest on a regular basis, as well as the capital of the bond when it matures.

Money Markets/Cash: Investing in money markets/cash involves purchasing a money market fund, buying a Treasury bill, or opening a money market account at a bank. Money market investments are generally low risk, but also low return. There is also the potential that inflation will reduce the purchasing power of cash.

Property: Property can be good to include in a portfolio as it can pay an income and there is capital growth from the value of the property and it behaves differently to other assets, so it can be a good way to achieve that all-important diversification. Your money might be invested in commercial or residential property (or both). It's important to note that property can take longer to sell than other assets, so there may be a delay if you want to move your money out of a property fund.

How are funds managed?

You've got two choices when it comes to how your funds are looked after – actively or passively.

Actively managed funds

Actively managed funds aim to outperform the market. Fund managers monitor the market and decide what to invest in or when to buy and sell assets. For example, a fund that invests in UK company shares will be aiming to outperform the FTSE (Financial Times Stock Exchange) All-Share Index®.

Why choose an actively managed fund?

- The human touch: the benefit of a fund manager's judgement and expertise
- Flexibility with investments
- Potential for higher returns than the benchmark

Passively managed funds

In comparison, the fund manager of a passively managed fund or index fund aims to replicate the performance of an index, such as the FTSE (Financial Times Stock Exchange) All-Share Index®, rather than outperform it.

Why choose a passively managed fund?

- Usually lower charges
- Track the performance of the benchmark

Growth or income?

Funds don't try to be a jack of all trades. The focus will either be growing or generating an income for you. Which approach you choose depends on your financial goals and future plans.

Ask yourself this: are you in a position to leave your money alone for a while in the hope that it grows as much as possible, or would you rather get some money back regularly? If it's the former, you should look at growth funds; if it's the latter, it might be better to focus on income funds.

Don’t panic, remember the long term and seek help

At times of uncertainty, it’s understandable to have a sense of worry. But when it comes to investing, it’s helpful to not let worry become panic. Investment decisions made under stress are rarely good ones. It’s wise to not let short-term volatility dictate long-term investment decisions.

And finally, it’s often sensible to seek help. Unless you’re an experienced investor, you may choose to leave investment decisions to someone else. Your financial adviser will help you select funds that meet your financial objectives within your personal tolerance for risk.

Pension providers offer a mix of funds - ready-made investment solutions that look after your money during the journey to retirement, as well as a choice of funds for you to choose from if you feel confident about deciding where to invest.

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