aic The Association of Investment Companies

Getting more from your savings

A guide to investment trusts

www.theaic.co.uk

Time to consider investment trusts for your portfolio?

Think of an investment trust as a single investment which gives you a share in a much larger portfolio.

Investment trusts allow you to spread your risk and access opportunities you wouldn't be able to invest in on your own. This guide explains how investment trusts work and how to invest in them.

Interested in tax-efficient investments?
Read 'Going for growth' to find out about venture capital trusts

Available at www.theaic.co.uk or by calling 020 7282 5555

Introduction

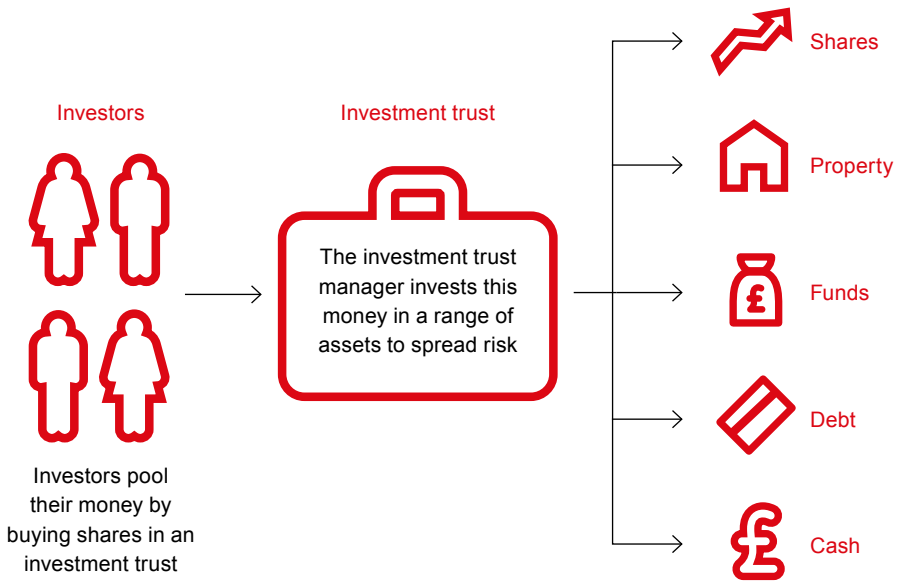
There are more than 200 investment trusts listed on the London Stock Exchange. Some are a few years old, while others have been around for more than 100 years. Each one offers you a portfolio of different investments to spread risk.

Buying an investment trust is as easy as buying any other share. You can do it using an investment platform or trading app. There is no minimum investment and you can hold investment trust shares in an ISA or a pension.

Although you can buy and sell investment trust shares easily, investment trusts are mainly intended as long-term investments. You should be prepared to hold them for at least five years, and preferably ten or more.

Investment trusts are sometimes called investment companies. That's because every investment trust is an independent company with its own board of directors, whose job is to look after the trust's investors.

How an investment trust works



The benefits

Investment trusts, like other types of investment fund, give you:

A way to spread your risk

Every investment trust owns a range of investments, so when you buy a single investment trust, you get access to a diversified portfolio. This spreads your risk as you are not dependent on just one or two investments.

Economies of scale

When you invest on your own, you may have to pay dealing costs, foreign exchange fees, and other charges which eat away at your investment. With investment trusts, all money is pooled together so these costs are spread across a wider base.

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Investment trusts offer a wide range of investment opportunities

Professional management

Investment trusts use professionals to manage their portfolios. These people are experts on the sectors they invest in, so they can make informed decisions.

Flexibility and convenience

You can invest lump sums in investment trusts, or drip feed money on a regular basis, from as little as £50 a month, and start and stop when it suits you. Although it's generally best to hold investment trusts for the long term, you can sell anytime if you need to.

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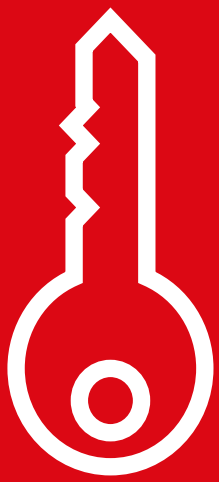
Why investment trusts?

Investment trusts have some important benefits compared to other kinds of fund.



Easy access through the stock market

You buy investment trust shares just the same way as you buy any other shares – through your investment platform or trading app.

You can sell when you want, any time the stock market is open.

A wider choice of investments

Investment trusts can invest in assets that other funds can't. This is because their shares are traded on the stock market, so the investment trust manager doesn't have to hold cash, or sell investments, to give you your money back.

This means investment trusts can invest in assets that are hard to buy or sell quickly, such as private companies, property and infrastructure. Many of the world's most exciting companies are private companies. If you want to own them, investment trusts may be the only way.

A more consistent income

Investment trusts can hold some of their income back in good years. This helps them maintain or increase their dividends in leaner years.

Some investment trusts – known as 'dividend heroes' – have been able to increase their dividends for decades (see page 8).

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Your interests – protected

Investment trusts have independent boards of directors whose job is to look after your interests as an investor. The directors meet regularly and monitor the investment trust's performance. They can even replace the fund manager if the performance isn't good enough.

The board is responsible for managing an investment trust's costs, including the fund manager's fees. The board negotiates with the fund manager to get the best possible deal for investors. You can research the costs of an investment trust on the AIC website.

Magnifying performance

Investment trusts can borrow money to make additional investments (known as 'gearing'). The idea is that the additional investments make enough money to pay the interest on the debt and make a profit on top. If it works, this can add a lot to your returns over time.

Of course, gearing also adds risk. In down markets, investment trusts with gearing are likely to perform worse than the wider market. Not all investment trusts use gearing and most use only modest levels.

Better over the long term

Comparing investment trusts with similar funds shows that investment trusts tend to outperform over the long term. You can find out more about these comparisons on the AIC website.

Of course, investment trusts also carry risk, especially over the short term. Because they are traded on the stock market, their performance is affected by market sentiment. When sentiment is negative, investment trusts may trade at wide discounts to the value of their assets. That's why investment trusts are best seen as long-term investments.

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How to invest

Buying investment trust shares

To buy investment trust shares, you'll need an account with an investment platform or trading app. Most platforms and apps allow you to buy investment trust shares.

Once you have a platform account, buying shares in an investment trust is just like buying any other share. On some platforms, you'll pay a dealing commission, which is usually less than £10.

You can buy investment trust shares easily and cheaply online

ISAs

Investment trust shares can be held in stocks and shares ISAs. This is a tax-efficient way to invest, as both growth and income can be enjoyed tax free. For the latest ISA rules and limits, see the HMRC website.

Self-invested personal pensions (SIPPs)

Investment trust shares can also be held in self-invested personal pensions or SIPPs. Like other pensions, SIPPs offer tax relief on your contributions, within certain limits.

Investment trusts can be useful when building up a pension, because of their long-term growth advantages. They can also be helpful when drawing income from a pension in retirement (see next page).

Regular saving helps smooth out ups and downs in the market

Regular saving

Many platforms allow you to save regularly, from as little as £50 a month. Regular saving is a good way of reducing the risks of stock market investment. You can put away a little each month to smooth out stock market fluctuations, or ease into riskier investments.

Getting financial advice

You can invest in investment trusts without getting financial advice, but a financial adviser can take your personal circumstances into account and may save you a lot of money in the future. Not all financial advisers will recommend investment trusts, so you may want to check this with them first.

Advice could end up saving you a lot of money in the future

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The right mix
Investment trusts can offer a mixture of income and capital growth to meet your needs

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Looking for income?

Regular dividends

Many investment trusts pay income in the form of dividends – usually twice a year or quarterly.

Some investors, such as those in retirement, use this income to help meet their living expenses. Other investors, who don't need the income, may choose to reinvest it to buy more shares and benefit from compounding their returns over time.

Investment trusts have a number of advantages for income investors. They can invest in a wider range of assets that produce income, including property and infrastructure. They can use gearing to boost income payments. They can also smooth dividends over time to make income payments more predictable.

Dividend heroes

The dividend heroes are a group of investment trusts that have increased their dividends for at least 20 years in a row.

They have achieved these long records of dividend increases by holding some income back in good years. This reserved income can then be used to top up dividend payments in leaner times, such as during the Covid-19 pandemic.

Dividend smoothing is an advantage of investment trusts that isn't shared by other kinds of fund. Remember that dividends are never guaranteed.

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A little bit extra

Investment trusts offer a unique set of benefits for income seekers

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Saving for children

With all the financial demands being placed on children today, it's no wonder so many parents and grandparents are thinking about how they can help.

Investment trusts have many benefits when it comes to saving for children. They have strong long-term performance, offer a wide choice of investments, and have diversified portfolios so you're not putting all your eggs in one basket.

Ways to save

The simplest way to save for children is by using a Junior ISA in the child's name. The investment belongs to the child and they can access it when they turn 18. The usual tax benefits of ISAs apply. Many investment platforms offer Junior ISAs which can be used to hold investment trusts.

There are other ways to save for children, some of which offer you more control over how the money is used. For example, you could set up a discretionary trust, but you should take legal advice before considering this option.

You can even set up a pension for a child if you really want to get them into the saving habit early!

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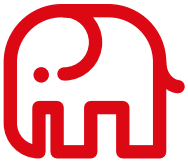
Buying an investment trust inside a Junior ISA is an easy way to save for a child or grandchild

Key things to remember

- Investment trusts offer you access to a wide range of different investments, some of which you can't access through other types of fund.
- Though investment trusts can deliver strong returns over the long term, they can be risky, particularly in the short term.
- Investment trusts have some key advantages when it comes to delivering a regular income, such as being able to smooth dividends.
- Every investment trust has an independent board whose job is to look after your interests, including negotiating fees with the fund manager and holding the manager to account.
- Investment trusts are designed to be long-term investments. You should be prepared to hold them for at least five years, and preferably ten or more.
- As with any investment, your income and capital may fall as well as rise. You may not get back the full amount invested. If you are unsure about whether investment trusts might be right for you, you should take financial advice.



Don't forget
You should be prepared to hold investment trusts for at least five years, and preferably ten or more

Be prepared
Make sure you understand the benefits and risks of investment trusts before you invest

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You can research and compare investment trusts on the AIC website

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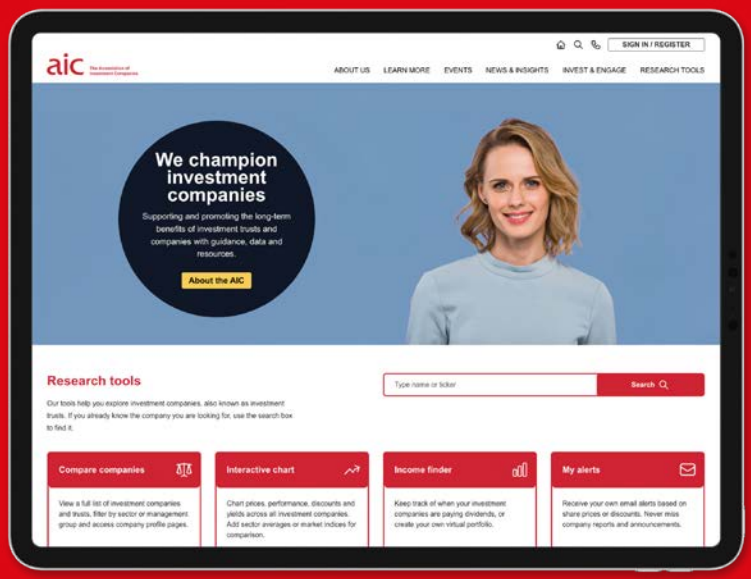

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