onefamily
modern family finance

A short guide to investing

We've written this short guide to help you understand a little more about investing in stocks and shares ISAs.

If you're still not sure, we recommend that you seek professional advice. Unfortunately, we're not able to give you investment advice ourselves.

What is investing?

People invest to help protect their money from inflation or to give it the potential to grow over time (but remember, these can never be guaranteed). As an investor, you will need to accept that you'll be taking some financial risks to achieve any financial reward because the value of an investment may fall as well as rise and it's possible it could be worth less than the amount you invested when you come to take the proceeds.

It's possible to invest in all sorts of different things, such as in shares of companies or in property. These are known as 'investment assets'. We'll look at the main types below.

How do I invest through a fund?

One of the simplest ways to invest is through an investment fund. An investment fund pools together money from many investors and an experienced fund manager uses this money to invest in a number of different assets. When you pay into your ISA account, your money buys a small part of a fund called a 'unit'.

The price of each unit can go up and down. If the price increases, the value of your stocks and shares ISA account will rise. Similarly, if the unit price falls, so will the value of your account. You should bear in mind that charges applied by the providers of your ISA or your fund provider may impact on the value of your investment. We publish the price of units of our funds every day. You can find these on our website, www.onefamily.com/connect-with-us/fund-information/daily-prices/

What are investment assets?

Assets are the 'building blocks' of investment funds. They are the things that the funds themselves invest in. There are typically four main types and funds will tend to invest in one or more of them. Each type of asset comes with different risks. At the same time, the potential for each one to provide investment growth will vary.

Shares

Buying shares, also known as 'equities', means owning a small part of a company. When you own shares, you may receive a part of any profits the company makes. These are called 'dividends'. When you invest in a fund that itself invests in shares, any dividends are invested back into the fund, generally increasing the value of each unit.

If a company whose shares the fund holds is seen to be successful, their shares may be in high demand, pushing up the share price and with it the value of the units in the fund. Share prices can also fall which will reduce the value of the units of a fund.

Share prices can be highly volatile in the short term but can offer long-term growth potential. Shares tend to only be suitable for medium to long-term investments – that's to say at least five years, preferably longer.

Bonds

Sometimes called 'fixed interest securities', bonds are basically IOUs; a promise to pay back your original investment at a fixed date in the future, plus payments at regular intervals between now and then.

Bonds are issued to raise money. They can be issued by companies (when they're known as 'corporate bonds') or by governments. UK government bonds are sometimes referred to as gilts.

Returns can come in two ways. Firstly, income is provided by the issuer of the bonds over its lifetime. Secondly, bonds, like shares, can be traded. This means a fund that invests in bonds can increase its unit price by selling a bond for more than you bought it for.

The potential financial gains that can be made from investing in bonds tend to be lower than investments in shares. However, bonds tend to be less volatile over the short to medium term (three to five years). Nevertheless, their value is not guaranteed and may fall as well as rise. This could result in the value of your ISA falling.

Property

When it comes to investing, property means commercial property such as warehouses, shops or offices and other business buildings.

Investments in property can make money from both rent paid by the tenants or by the market value of the property rising.

Property should be seen as a long-term investment (five years or more).

However, property prices can be volatile and properties can be difficult and take time to sell. If the value of property falls, you could get back less than you invested in the first place.

Cash

Over the medium to long term, returns from cash are usually much lower than from any other asset. Indeed, inflation is likely to reduce the buying power of your investment if you hold it in cash. However, cash is an important asset type as it tends to be very stable and offer greater security over the short term. Investment funds often hold some money in cash to give them the flexibility to invest quickly in other assets or to be able to pay out when people sell units without having to sell other assets.

Risk and reward

It would be great to be able to make our money grow substantially without taking any risk. Unfortunately, this just isn't possible:

Almost all investment involves some degree of risk. Therefore, the most important thing is that you understand the risks you're taking and are comfortable with them.

For example, if you keep your savings in your bank account, there's almost no risk. However, your reward (the interest the bank will pay you) will almost certainly be quite low.

At the other extreme, you could use your savings to buy shares in a single company. If that company runs into difficulty, you could lose every penny – the risk is high. However, if that company does really well, you could make a huge return – the potential rewards are significant.

In other words, higher risk does mean the potential for higher rewards, but it also comes with a greater chance of your money decreasing. On the other hand, a lower risk has a smaller chance of loss, but the growth of your money will normally be less.

You should make sure that you understand, and are prepared to take the risk associated whichever of the funds you choose for your stocks and shares ISA. If you're not comfortable with either, a stocks and shares ISA may not be right for you.

Is it possible to reduce risk?

You can't get rid of risk completely, but it is possible reduce it. One of the best ways to do this is by investing in a fund:

As we explained earlier, a fund is a way of investing where you pool your money with other investors to buy a whole range of different assets rather than just a few that you might be able to achieve on your own. This could be a fund that invests in a wide variety of shares in companies not just in the UK but from around the world. Alternatively, it could be a fund that invests in a mixture of asset types. In other words, funds are a convenient way of not putting all your eggs in one basket. Of course, if stock markets, bond markets or property prices are falling as a whole, then, depending on how the fund invests, the value of the units you hold will also go down.

Whichever fund you chose to invest in, holding a range of assets means that, if something happens to one of them, your overall loss is reduced as it's balanced out by the other assets.

What are the different risks of investing?

It's important you know about what could happen to your money when you invest it, so here's some information about the different risks.

The amount you get back - You may not get back as much as you put in. This is because the value of investments can go down as well as up in value, some types more than others. For example, share prices change daily.

Your goals - You may not meet your investment goals. For example, you may need a set amount of money to buy your first home and your ISA doesn't perform as well as you hoped, leaving you with a shortfall.

Inflation – The value of your ISA may not keep up with inflation which will reduce what you can buy with your money in the future.

Lost opportunity - You may move between funds or move to another product. The risk is that your ISA won't perform as well as where your money was before. Equally, it could perform better.

Timing when you buy and sell - In an ideal world you'll always buy units at the lowest possible price and sell at the highest price. However, this isn't always possible. For example, if you pay into your account by regular direct debit, you won't have control over the price when we buy units in a fund on your behalf.

How do I find out more about the funds?

When you apply for a stocks and shares ISA, you will be provided with detailed fund information for each of the funds you're thinking of investing in. Amongst other things, these documents outline how the fund will be managed; which assets it will invest in. They also contain a scale showing the level of risk associated with each fund. It's really important that you read these documents carefully before you make your investment decision.

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