Investment types

All clients should read these descriptions of investment types carefully.

This document cannot disclose all the significant aspects and risks of the investment types referred to. You should not invest in them unless you are sure you understand their nature and the associated risks.

You should also consider carefully whether or not the types of investment described are suitable for you in light of your circumstances and financial position, and if in any doubt seek professional advice.

This document sets out a brief general description of the nature and risks of the main types of investments which we may either recommend to clients to whom we provide investment advisory services or purchase on behalf of clients to whom we provide discretionary management services.

Regulated collective investment schemes (pooled funds)

Collective investment schemes are open-ended funds (unit trusts or open-ended investment companies) which enable investors effectively to pool their money with other investors to share profits (and losses) or income arising from the acquisition, holding, management or disposal of the underlying investments held within the scheme.

Each fund has a stated investment strategy, enabling investment in particular asset types, countries, markets and market sectors, and such funds will then be selected according to the investor's needs and objectives.

Although part of the rationale for purchasing a collective investment scheme is to buy an investment vehicle that already contains an element of diversification, some schemes will be riskier than others. For example, funds investing in emerging markets or smaller companies would generally be considered to carry higher risks than those investing in, say, large global companies.

See separate notes in relation to shares and bonds generally.

Investment companies and investment trusts

An investment trust is a listed company which invests in the shares of other companies or in fixed-interest securities, unquoted securities or property. As a quoted company, the share price of an investment trust is determined by the supply and demand for its shares.

Many investment companies and investment trusts have the ability to use gearing as an investment strategy or invest in other companies which use gearing as an investment strategy. Gearing is a strategy which enables the company to increase its exposure to investments without increasing the amount contributed by its own investors.

These investment companies and investment trusts are referred to as 'geared investment companies.' They borrow money to invest or buy investments (such as derivatives or warrants) in circumstances where a relatively small movement in the price or value of the assets underlying the investment will result in a larger movement in the value of the investment itself. The investment strategy used by these geared investment companies may therefore result in:

- Movements in the price of the geared investment company's securities being more volatile than the movements in the price of the underlying investments
- The securities of the geared investment company being subject to sudden and large falls in value
- Investors getting back nothing at all if there is a sufficiently large fall in value in the geared investment company's securities

See separate notes in relation to shares and bonds generally.

Exchange-traded funds

Exchange-traded funds (ETFs) are generally funds structured as OEICs which are typically designed to track an underlying market index, and are traded on a regulated market or designated investment exchange.

Many ETFs are also structured as regulated collective investment schemes. If so, they will be subject to a special regulatory regime designed to provide particular protections for investors.

ETFs will generally fall into one of the following categories:

Physical ETFs aim to replicate the performance of the underlying index by investing in all the securities of that index or a representative sample of those securities.

Synthetic ETFs either:

- Use investors' cash to buy a basket of securities from a swap counterparty and exchange the performance of these securities with the counterparty for the performance of the underlying index; or
- Transfer investors' cash to a swap counterparty in exchange for the performance of the index, with the counterparty placing a basket of securities as pledged collateral in a segregated account with a third-party custodian.

ETFs will often have a lower expense ratio than otherwise equivalent traditional open-ended investment funds such as unit trusts or OEICs. Another key difference is that ETF shares can be bought and sold throughout the day on a stock exchange at prices established by the market.

ETFs are subject to 'tracking error' risks. For example, expenses together with imperfect correlation between an ETF's assets and those in the underlying index, and between the ETF's share price and the price of the underlying assets, may cause an ETF's performance to deviate from the underlying index.

A further risk is that ETFs typically lend the securities held by them. Although the loan will be secured by collateral, the loan counterparty may become insolvent and not be able to meet its obligations, and the collateral may prove inadequate to cover those obligations. In such circumstances, the investor in the ETF could lose all or part of the value of the investment.

An important additional issue for UK investors is whether an ETF which is an offshore fund has been given 'reporting fund status' by HMRC, which will affect whether any gain on disposal is subject to Capital Gains Tax or Income Tax.

Listed shares

Shares are securities representing a shareholder's rights in a company. Shareholders have financial and ownership rights which are determined by law and by the issuing company's articles of association. Shareholders are therefore, as owners of the company, subject to risks associated with the company's trading performance. For example, if a company makes trading losses, this can impact the value of the shares and the amount the company can pay out in dividends.

Shares are said to be 'listed' if they have been admitted to trading on an investment exchange or other regulated market.

Investors will normally buy existing shares which are already being traded on the markets, but from time to time new shares can be purchased when a company wishes to raise additional funding for its business. These new shares may be made available directly, or via rights issues or warrants (sometimes called subscription or bonus shares), which may or may not be traded on an exchange. Rights issues and warrants typically have expiry dates and can expire worthless if not exercised. Exercising them requires a subscription payment before they are converted into new fully paid shares at a specified date. Investment companies and investment trusts may issue warrants to raise new capital from investors.

Investing in shares involves taking the risk that their value may fall as well as rise. The scale of the risk involved in relation to a company's shares may depend on the size of the company, the type of business it is in, its profitability, its track record, and the liquidity of its shares in the market. Share prices are subject to price fluctuations arising from a range of factors which may affect the performance of the company and/or its market sector, and from the performance of the market as a whole. Additionally, for foreign company shares priced in foreign currency, their value in sterling will also be affected by exchange rate movements.

Applying for new shares issued by a company raising additional funding involves a risk that the level of demand may be such that the applicant may receive fewer shares than the number applied for, or none at all.

Bonds

Bonds are debt instruments issued to creditors by governments, companies or other bodies.

They should not be confused with other instruments, which are not discussed here, which are issued by life insurance companies and typically called 'investment bonds'. The latter are single-premium life insurance contracts combining investment with life cover.

The par value of a bond represents the amount of debt to which it relates. The duration of the debt, and the terms and conditions associated with it, are established at the outset. Bonds are typically repayable at a specified date, although in certain cases a range of repayment dates are specified and in some cases the issuer, and in other cases the bondholder, can choose to redeem, in whole or in part, on specified dates between the first and final date.

Corporate bonds are issued by companies, and they are typically regarded as not as safe as most government issued bonds. In exchange for extra risk, a higher income yield is payable. Corporate bonds will normally rank in front of shares if the company gets into financial difficulties. However, there is always a risk that the underlying company may get into such severe financial difficulties that bondholders will not be paid in full.

Some bonds are 'index-linked' (where the interest, and the amount ultimately repaid, are adjusted by reference to an index such as the Retail Price Index in the UK) while others are issued at a fixed interest rate and a fixed capital repayment.

In the case of fixed interest bonds, the market value will tend to rise if market interest rates fall, and fall if market interest rates rise. For all bonds the market value will be impacted by whether, and to what extent, the market perceives there to be a risk of payment default by the issuer. The closeness or otherwise of any specified repayment date will also tend to affect the value.

Additionally, if bonds are priced in foreign currency, their value in sterling will also be affected by exchange rate movements. Within collective investment schemes, fund managers typically use foreign exchange derivatives to hedge exchange rate risk back to each share class's currency.

Applying for new bonds issued to raise additional funding involves a risk that the level of demand may be such that the applicant may receive less than the amount applied for, or nothing at all.