How to make your money work harder

Your handy guide to **investments**

When it comes to investing your hard earned cash, there's a huge variety of options available.

In fact, so many that it can be confusing. Yet once you know the basic principles of investing, you'll soon be able to make confident choices.

All investments carry a degree of risk, but some are more risky than others. Once you have established a solid foundation of savings for the short term, you may look to investments to provide more growth potential over a longer period, typically five years or more.

This guide from Prudential aims to help you determine your attitude to risk, get an overview of some of the types of investment that are available, and help you make informed decisions about how, when and where to invest for the future.

And if you have any questions, we're always here to help.

Your way around the guide

Understanding Investments

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Information in this handy guide is based on our understanding of current taxation, legislation and HM Revenue & Customs practice, as at March 2011, all of which are liable to change without notice. The impact of taxation and tax relief depends on individual circumstances.

1 Where, when and how long to invest?

Getting ready for investing

Before you start investing, it's a good idea to:

- clear debts – such as credit or store cards and loans. The interest rates charged on these can be high, so it makes sense to clear these debts before you begin to invest.
- Once that's done, you can think about setting up an emergency fund that's easy to dip into – an easy access savings account for instance, where your money will be secure and which will provide you with enough to live on for about six months.
- You should also think about taking out insurance to cover common risks, such as life, health or income protection insurance.
- Consider your retirement needs too. It's never too early to start putting money aside for the future – in fact the earlier, the better.

With all that taken care of, you're ready to start making considered investment choices and attracting potentially higher returns on your money.

Where to invest

It's the potential to grow your money that's one of the biggest reasons for investing. The stockmarket has almost always been more rewarding (though riskier), over the long term, typically five years or more, than putting cash in a bank or building society account.

However a stockmarket investment is not like a bank or building society account and may not return all the money that you have invested, particularly during the early years, whereas a bank or building society account would generally return all your capital.

When to invest

You may feel you need a large sum to invest to build a future fortune. **But however much or how little you have to invest it's never too late to start.**

If you're worried about investing during a stockmarket high or low, don't worry. You can help smooth the ups and downs by investing regularly.

How long to invest for

To give your money a chance to grow, you need to be prepared to invest for the medium to long term – typically five years or more.

Why invest?

There are two main reasons to invest, for:

1 Income

Investing for income means that you use the interest and dividends earned from your savings and investment plans to boost your earnings or pension income. These investments could include equities, ISAs and savings accounts.

2 Growth

Investing for growth means that any interest or dividends your investment earns is put straight back into your fund so that it grows further through the power of compounding.

Investing for income and growth

You can invest for both income and growth. Investments that can help you achieve this include equity-based funds invested in both the UK and abroad.

Compounding means you earn money on your original investment ***plus*** on any dividends or interest earned. So your capital can steadily increase, attracting more potential growth all the time.

2 Five categories of assets

Later in this guide we will explain the investment choices you have. When you choose to invest, your money can be spread across five types of assets:

1. Cash
2. Gilts (Government bonds)
3. Corporate bonds
4. Equities (stocks and shares)
5. Property

You should remember that different types of investments may get different tax treatment, which could affect your choice. Tax can depend on individual circumstances, so you may want to speak to a Financial Adviser to find out more about your own tax position.

1 Cash

You can deposit your cash into a bank or building society. This is seen as a safe investment as you will normally get a return on your capital, but the returns can be low, depending on the market rate and interest rates.

You can also invest in cash-like assets as part of a fund you choose to invest in. Funds which invest in cash may include some cash-like assets which are less secure than money in a bank or building society. Some of these cash-like assets can fall in value.

2 Gilts (Government bonds)

With gilts, **you lend your money to the UK Government**. Your returns will be paid in the form of a regular income (known as the "coupon"). At the end of the period, the loan is repaid on the "redemption date". Your money will have gone towards Government funding e.g. road maintenance, schools, etc. You can buy or sell gilts whenever you choose.

Why are they called gilts?

Government bonds are known as "gilts" because the certificates were originally edged with gilt, which showed how golden the Government's finances were considered to be.

Gilts are the most secure type of investment you can obtain because the UK Government has never failed to pay its debts and is unlikely to go bankrupt. The coupon is fixed and regular no matter which political party is in Government at the time – the actual coupon amount will vary from issue to issue and the economic outlook at the time. Your total return will depend on the price at which you buy and sell.

Gilts can be a good way to provide yourself with an income.

3 Corporate bonds

With corporate bonds **you lend your money to a public company** in return for a fixed rate of interest. As with gilts, you can buy and sell corporate bonds whenever you want, so you're not locked in for any length of time.

Corporate bonds have a broad risk range. It all depends on the underlying strength of the company you invest in. Lower risk corporate bonds pose less risk to your capital, but may mean lower returns on your investment too. Higher risk bonds are just the reverse – they expose your capital to more risk, but can mean a potentially higher level of return on your investment however the company is more likely to default i.e. be unable to meet the loan repayments.

On the whole, **corporate bonds tend to offer better returns than gilts, but are less secure as the Government doesn't underwrite them.**

The art of investing

When forming an opinion about investing in stocks and shares or funds, there are a few things that might help. You can read financial newspapers and magazines, for example.

And you could also consider a few words by Peter Lynch* , one of the world's most successful investors:

"Go for a business that any idiot can run – because sooner or later, any idiot probably is going to run it."

* Source:www.woopidoo.com

4 Equities (stocks and shares)

Equities mean **you buy shares in a company** and become a "part-owner". The price of a share that you buy (or sell) depends on:

- how well the company is expected to perform in the future
- how many people want the shares, and
- how many shares are available (in a nutshell, **"supply and demand**").

Of course, a number of things can happen to shares once you've bought them since the stockmarket can be up one day and down the next, or the performance of the company could change. So the value of your shares could rise or fall.

Once you own shares, you may also receive an income from them in the form of dividends. The value of your **dividends** will depend primarily on how well the company you've invested in is doing.

Investing in individual shares can be risky. You should carefully research the management and market potential of any company you are interested in. If you do decide to invest directly, make sure you have all the key facts to hand before making a decision. If you are in any doubt, you may want to speak to a Financial Adviser.

5 Property

Investing in commercial or residential property can provide an income in the form of rent. Buy to let properties have been popular over recent years, but a slump in the property market when you come to sell could make it difficult to find a buyer immediately, meaning it may take some time to get your hands on your money. Also, if the property falls to less than the original price you paid, and you have to sell at that time, you'd make a loss.

As a rental property owner, you are liable for tax on the income received from your tenants, and you could incur capital gains tax on any profit when you sell. Also, if the property is unoccupied for any time you'll still have to cover the mortgage and you'll have to maintain the property whether you have tenants or not.

3 Your attitude to risk

When you invest your money there is always a degree of risk involved, whether it's high or low. Equities are considered high risk, for example, while a deposit account is low risk. Generally, the higher the risk, the higher the potential growth on your money (and the higher the potential loss). In fact, with some investments you could risk losing not only any growth on your investment, but also your capital.

So for reasonable returns, some risk may be necessary – meaning that the value of your money could go down as well as up. **Only you can decide how much risk you're prepared to accept.**

As a guide, you should take the following into account:

- your personal circumstances (your age, and how much money you're prepared to invest)
- the length of time you want to keep your money invested
- how much access you need to your money
- your attitude to risk (how much you're prepared to lose)
- tax implications
- the effect of inflation in reducing the value of your money over time.

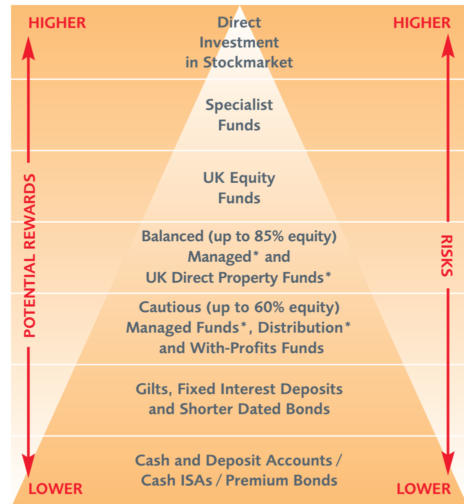
However, you may be ready to take calculated investment risks and balance them out with other, less risky investment strategies so that your chances of higher overall gains remain good.

4 Balancing risk and reward

Most experts suggest you aim for a "balanced" portfolio. This means spreading your investments across a range of products to minimise your exposure to risk. In turn, this means your individual investments will have a different potential for growth (and of course, loss).

Given some forward planning, you can decide on the amount of risk with which you're most comfortable. Use the pyramid (right), to consider which investments are right for you, depending on your attitude to risk.

Please note that this risk assessment has been classified by Prudential and is not a generic description across the fund management sector. The investment approach may change in the future.



*As classified by the Association of British Insurers.

Choose your investments wisely, to control your exposure to risk

Some investments offer features that help reduce risk. For example, a with-profits fund benefits from the **smoothing effect** (described on page 21). And if you invest in a **guaranteed equity bond** your capital will usually be guaranteed, providing you keep your money invested for the duration of the term. (You'll need to check the specifics with your provider.)

While most of us would like to say "no" to risk completely, the nature of investments means there's always some level of risk involved. **The trick is to keep your balance.**

5 Collective investments

Go it alone or become a collective investor

As a private investor, you may not have the time or expertise to create a diverse portfolio that helps to spread your investment risk. **So another choice you need to make is whether you're going to invest on your own, or make "collective" investments as part of a group**.

Most private investors tend to invest collectively – which means their investments are pooled with lots of people's money and spread over a number of different investments.

Unit trusts and OEICs (Open-Ended Investment Company), for instance, pool together lots of money from thousands of small investors to spread their risk and give them the investment "clout" of a multi-millionaire.

When you make a collective investment, you invest in **a fund**. Think of a fund as a briefcase containing one or a mixture of assets such as stocks and shares, equities, bonds, property or cash. You can even invest in funds made up of other funds. In this instance, your **fund of funds** briefcase will contain smaller briefcases which in turn contain similar sets of assets.

So a fund can contain a great variety of things. And it's this variety, spread across different risk levels, that often makes collective investments an attractive option.

Unit trusts

Unit trusts are **collective investments that allow you to invest indirectly in shares, both in the UK and overseas, by buying units in your chosen unit trust. You can then benefit from expert investment management**.

You should expect an **actively managed** fund (one where a team of managers aim to pick the best performing stocks and shares) to beat the average stockmarket performance, known as the **market index**.

Other unit trusts are known as **tracker funds**. This means they aim to mirror the performance of the index rather than try to beat it. As a result, the gains (or losses) might not be as spectacular as some actively managed funds. The charges for this type of fund are generally less than for actively managed funds.

OEIC (Open-Ended Investment Company)

A number of unit trusts have been converted into OEICs. An OEIC is an investment company where shares are issued instead of units. The principal difference is that OEICs have a single price to which the initial charge for purchase is added.

› Investment bonds

With-profits bonds

These are bonds **that invest in a with-profits fund, which in turn invests in a mixture of equities, bonds, property and even cash**. With-profits bonds benefit from **smoothing**. Smoothing basically means holding back some of the profits in years when returns are good, in order to help the fund maintain its payouts in leaner years. This reduces the impact of ups and downs in the underlying investment performance, so **it aims to give you a steadier return on your money**.

Unit linked bonds

These bonds offer a wide range of funds for you to choose from. Each fund will have their own aims, management styles and risk rating. You can choose to invest in the funds which match your investment objectives. It is important to review your fund choices with your Financial Adviser regularly to ensure that the funds chosen are performing as you expected and are in line with your investment objectives.

For information about Prudential's investment products, please visit **www.pru.co.uk/investments**

These products are available through Financial Advisers. You can find an adviser in your area and find out about how advisers can help you by visiting: **www.pru.co.uk/find_an_adviser**

More about funds

It's important to know this about funds:

- The mix of **assets** that make up a fund can be changed over time, however a fund may operate within set limits.
- Funds are generally looked after by a **fund manager**, which means that when you invest in a fund, you are also investing in the fund manager's opinion, research and expertise (as well as the strength of the company he or she works for). Normally you pay for this expertise through a fund management charge, which varies from fund to fund.
- You'll also need to give some thought to what **level of risk** a fund involves before you invest in it.

There are several types of funds available, including:

Equity funds

They are made up primarily of stocks and shares.

Corporate bond funds

These funds invest in a range of corporate bonds.

Property funds

These invest in a portfolio of commercial and residential properties.

Multi asset funds

These funds invest in many different assets which can help to spread risk within a single fund.

6 Tax efficient savings

› Individual Savings Accounts (ISAs)

These are a tax-effective way to invest in different assets, including cash, government or company bonds and shares. An ISA lets you buy certain investments and any returns you make are free of income or capital gains tax under current legislation. So an ISA is a tax-efficient wrapper, protecting your investment – whether cash, equities, bonds or property – from the taxman.

› The current ISA limit for the tax year 2011/2012 is £5,340 in a cash ISA and up to £10,680 in a stocks and shares ISA, within an overall annual limit for an individual of £10,680. This means that you and your partner or spouse will have the same annual limit.

For information on Prudential's ISA call **0800 072 6159** or visit **www.pru.co.uk/isa**

Index-linked Savings Certificates

With Index-linked Savings Certificates from National Savings and Investments:

- the value of your savings is increased in line with the Retail Prices Index (as long as you keep your investment for at least a year) with a guaranteed rate of interest on top – so you can be sure the returns on your savings will outstrip inflation, and
- **all returns are tax-free –** and you can **invest up to £15,000** in each issue without affecting any other tax-free investments you may have.

Premium Bonds

This government-run prize draw offers a fun way to invest. Each premium bond is worth £1 but must be bought in blocks of a minimum of £50 via standing order or £100 by cheque or cash. Each individual bond is put into a prize draw and gives you a chance to win a cash prize randomly decided by **ERNIE**, the famous computer. Every eligible bond has a separate and equal chance of winning a prize, irrespective of where or when it was bought. Best of all, **premium bond prizes are tax-free**.

You could win a prize each month ranging from £25 up to £1 million. The more premium bonds you hold, the better your chances of winning. Even if you never win a big money prize, you will always at least get your money back. **And you have much better odds with ERNIE than with the National Lottery.**

ERNIE

Electronic Random Number Indicator Equipment still picks the winning numbers, although these days he's a little bit quicker than he used to be. ERNIE 1 was produced in 1957 and if he was still in use today, it would take 52 days to complete the draw. In 2004, ERNIE 4 was unveiled and he completes the draw in under two and a half hours. Today, ERNIE is the size of a personal computer, but back in 1957 he was the size of a van.

7 Other types of investment

Invest in a business

Maybe you've always dreamed of owning a café or a florist shop. **You could set up in business using your savings**. By employing an experienced manager, you can work your own hours while benefiting from any profits. If you do your research and grow your customer base, it could be very rewarding – but to be frank, the risks are variable with no cast-iron guarantee of reward.

Become a wine connoisseur

Some people invest in such things as antiques, rare coins and fine wines. It's beyond the scope of this guide to tell you which Bordeaux to invest in, but if you know your stuff you could earn a living this way. However, as with all investments, remember that there are risks, including changing tastes, unpredictable markets and even breakages!

Alternatively, dig out a Van Gogh

It may pay you to clear out your attic. Because you might just find an original painting you've forgotten about. If you were to find a Van Gogh, here's how much it could be worth: US $82.5 million. That's how much a Japanese investor allegedly paid for Van Gogh's "Portrait of Dr Gareth".*

* Source: www.vggallery.com/painting/p_0753.htm

8 Questions to ask

Here are some key questions to ask before you make your final investment decision:

- Is this investment designed to give me income (i.e. regular payments) or capital (i.e. a lump sum in the future)?
- In what markets, sectors or companies is my money invested?
- Does this investment have any special conditions – like a fixed investment term?
- Does it offer any guarantees?
- What are the risks and potential rewards involved with this type of investment?
- How and when can I access my money and are there any penalties, charges or costs for this?
- Are there any tax advantages? For example, can I buy this investment as a part of my ISA allowance?
- What are the tax implications of the investment?
  Speak to your Financial Adviser to discuss your own circumstances.

In addition, you can also do the following:

- Look out for any newspaper articles that have been written about the investment, or company, you are considering. (Although past performance doesn't mean an investment or company will do well in the future, it could be useful to know about its history.)
- Ask yourself if you are happy with the size, strength and reputation of the company you are buying an investment from.

A quick recap

Before you begin investing, make sure your debts are under control and think about having an emergency fund and taking care of your pension and insurance needs.

Then:

- Assess any existing investments you have and decide if you're happy with the balance between their different risk levels or whether you should think about changing any of them.
- Decide whether you're happy with the amount of money you have in deposit accounts.
- Have you (and your partner or spouse) thought about using your ISA allowance?
- If you are eligible for Child Benefit or a Child Trust Fund, you could consider using it to build a long-term nest egg for your children. Please see "A parents guide to money" from the Consumer Financial Education Body for more information: **www.moneymadeclear.org.uk/parents**

9 What to do now

Some Prudential Pension and Investment products are only available through Financial Advisers as we believe they require specialist advice.

A Financial Adviser will assess your individual needs and circumstances before recommending relevant products (not necessarily from Prudential and they may charge for this advice). If you do not currently have a Financial Adviser or if you are unsure what to expect from seeing a Financial Adviser, you can find more information at www.pru.co.uk/find_an_adviser

To contact us:

- For Prudential Unit Trusts and ISAs call **0800 072 6159** between 8am and 6pm, Monday to Friday, and between 9am and 1pm on Saturdays.
- For Prudential Investments you can visit us 24 hours a day at **www.pru.co.uk/investments**

Existing Prudential customers can:

- email us via **PruMail** – our secure email system – if you wish to contact us about an existing policy. Log on to **pru.co.uk** for more information.

Calls may be monitored or recorded for quality and security purposes.

10 Technical terms explained

› Actively managed fund

A fund where a team of analysts and portfolio managers aim to pick investments that will outperform the average performance of the stockmarket (although they are not guaranteed to do so). The charges tend to be higher than for tracker funds.

› Corporate Bonds

A bond is a loan, in return for which you receive annual interest and your capital back after an agreed period of time.

› Capital

Financial wealth in the form of cash or property.

› Compounding

The process by which interest earned on an investment is added back to the original sum invested, thus increasing the capital amount which will then attract further interest in future.

› Equities

This is another name for stocks or shares in a company.

› Gilts

A gilt is a loan made to the UK Government in return for regular interest payments, usually with a promise that the nominal value will be repaid at a specified date.

› Index-linked Savings Certificates

A government investment that pays guaranteed interest rates designed to increase the value of the investment at least in line with inflation. All returns are tax-free.

› ISA

An ISA (Individual Savings Account) offers a tax-efficient way to invest. It acts as a wrapper in which you can shelter investments from income and capital gains tax.

› OEIC

An open-ended investment fund is structured as a company. Investors buy shares, the number of which may vary, depending on demand; the share price of the OEIC mirrors the value of the underlying investments.

› Single price

A single price for buying and selling shares, e.g. in an OEIC.

› Stocks and shares

In effect, both words mean the same. A share certificate confers ownership rights in a company. Ordinary shares (or common stock) give voting rights at company meetings and allow the holder to benefit from a share of the profits.

› Tracker fund

A fund that is designed to follow the performance of a stockmarket index (up or down). Generally the charges are lower than for an actively managed fund.

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