

## **A C EGGLETON & CO**

### **A DESCRIPTION OF SOME INVESTMENT PRODUCTS AND TERMS**

#### Equity Shares

These are issued by joint-stock companies to their investors and represent a bundle of rights received in exchange for their (non-refundable investment) in the company. For the investor the chief rights are the right to share in the surplus assets of the company on a winding-up and to share in any distribution of profits i.e. dividends. After the initial issue the shares trade in the market place at a price which reflects demand and supply.

A public company is one whose shares are quoted for sale on a recognised stock-exchange. A private company is one whose shares are not so quoted and the market for such shares may be very limited.

The quoted price of the shares reflects the market value of the company. However, shares in general also move as one in response to stock market confidence i.e. in a bull-market (a sellers market) they tend to move up together and in a bear-market (a buyers market) they tend to go down together, regardless of the intrinsic value of the individual shares.

#### Corporate Bonds

In addition to raising capital through share issues companies raise funds by offering loan stock (bonds) to investors (lenders). The rate of interest offered by the company in exchange for the loan reflects the standing of the company and the risk to the lender of not getting all (or any) of his money back. Blue-chip companies i.e. old established, well run and well financed companies need to offer lower rates than others who are perceived to be riskier. Such bonds vary from investment grade (good security) to junk (high risk of default).

Some loan stocks are convertible, meaning instead of being redeemed the investor can purchase shares in the Company, often at an advantageous price. Quoted company loan stocks are traded on the stock exchange in the same way as equity shares. Their values rise and fall with interest rate changes/expectations and confidence in the lending companies.

Unfortunately, and very confusingly, the word "bond" is used to describe a wide variety of other mainly insurance-based investments, such as investment bonds and income bonds (see below). These are not the bonds to which we are referring here.

#### Government Gilts

Your Government borrows money from a variety of sources to help fund its activities. It issues its own loan stock under different descriptions e.g. Treasury Loan, Exchequer Loan. They are traded on the stock exchange in the same way as equity shares and corporate loan stocks. They are perhaps the securest loan stock since

ultimately they are backed by the UK tax payer. National Savings products are similarly secure against default.

### Collective Investments

This is the name given to all forms of investment where a Fund Manager makes investment decisions on behalf of a number of investors. By joining together with other investors, an investor can purchase a share in a whole range of equity shares and bonds thereby spreading his risk enormously as against purchases of individual shares and bonds. They may be unit trusts (or open ended investment companies) or investment trusts.

Unit trusts have a Board of Trustees who protect the investors' interest and oversee the activities of the Fund Manager. The value of the units in the fund is assessed and published daily, and the units are bought and sold through the Trustees. Typically there is an initial charge on the purchase of the units known as the bid/offer spread i.e. the buying price on a particular day is set a little above the selling price on that day and the gain on the transaction accrues to the fund.

Investment Trusts are quite different. They are companies which are themselves quoted on the stock exchange and investors purchase shares in the Investment Trust. An Investment Trust has a fixed capital from its initial share issue and it uses those funds, sometimes with borrowings, to buy shares in other companies.

Neither Unit Trusts or Investment Trusts can be simply stated to be appropriate to one category of risk profile or another – it all depends upon what companies, industries and markets they choose to invest in. A Unit Trust investing in emerging markets such as Russia and Venezuela is a very much higher risk fund than an Investment Trust investing in well established UK “blue chip” companies. The real risk distinction between the two is that Unit Trusts can only borrow up to 10% of their fund value, while Investment Trust companies are usually permitted by their rules to borrow more typically up to 20% or even more, the additional funds give them leverage to invest greater funds than they have available from their own investors, which can create additional gains when their shareholdings increase in value, and additional losses in a falling market. Consequently where a Unit Trust and an Investment Trust have the same investment policy then the Investment Trust route will be likely to be considered a little riskier, depending upon the borrowing policy of the Trust.

There are a vast number of unit trusts investing in different areas of the market place, typically segmented together as UK, European, Global, North American, Emerging Markets, in various guises such as Distribution, Cautious or Balanced Managed Funds, Equity Income, Growth, and Special Situations, as well as sector specific funds such as Smaller Companies, Technologies and so on.

### Distribution Funds

These are designed to provide income and capital growth, might have a significant but not excessive component in equity shares selected for income as well as growth, and substantial investments in bonds to provide reliable sources of income. A typical fund may look like this:-

	%
Property	20
Index linked Savings Certificates	3
Cash	7
UK Equity Shares	43
Overseas Bonds	2
UK Fixed Interest Bonds	<u>25</u>
 TOTAL	 100%
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However, such funds can be constructed for a variety of risk profiles e.g. AXA's Distribution Bond products vary from Protected and Highly Secure through to Speculative.

### Managed Funds

There are designed more with capital growth in mind, have a lower proportion of bonds and property, and a greater proportion of equity shares bought for their growth prospects. Typically it may look like this:-

	%
UK Equity Shares	56
UK Fixed Interest Bonds	10
UK Property	2
North American Equity Shares	9
Japanese Equity Shares	4
Far Eastern Equity Shares	4
Cash	5
European Equity Shares	<u>10</u>
	100%
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and there are endless variations: a Managed Fund with a lower equity share content and a greater fixed interest bond content will be a Cautious Managed Fund, one with a greater equity share content will be a Balanced Managed Fund.

Such funds are in themselves portfolios of investments in different sectors, in such proportions as the Fund Manager determines to be suitable for the objective – but the same objective can be achieved by making a selection of individual funds more precisely tailored to suit you should you prefer.

**In all cases, the risk is not to be safely determined by the simple description of the fund, but by what its investment policy is.** Every fund, whatever its **nominal** description, is capable of being anything from low to high risk.

### Investment Bonds

These are properly known as “Whole of Life Assurance Bonds”. They are technically life assurance policies which pay out on death a sum, typically equal to 101% of the fund value. Since they are taxed under the special rules applying to Life Companies the funds into which the investments are made are known as Life Funds. Any gains made or income received by you are deemed to have already been taxed at the basic rate. They have a very useful facility whereby up to 5% of the investment can be drawn upon annually by way of an “income” source without any immediate tax implication.

There are three common types of investment bond: With Profits Bond; Distribution Bond; Multi-Fund Bond.

### With-Profits Bonds

These were very popular for many years and were a mainstay of the UK retail savings sector. At one time they were considered low risk, with investments in UK equities at 40% or thereabouts they looked very much like many distribution bonds. However, many suffered very severe losses some years ago as a result of over exposing themselves to equity shares (holdings of 70% or even 80% at one time). They lost a packet when the stock market collapsed and with it the confidence of many investors. They have an additional inherent risk in that they are very complex funds, not easily explained or understood, the gains in the fund are distributed by a system of bonuses which are determined by the Directors on behalf of the provider who also has an interest in the fund. These features have made the product markedly less popular in general but they can in certain circumstances still be appropriate.

### Distribution Bonds

These are designed primarily for income (see Distribution Funds in our Description of Some Investment Products and Terms). They consist of a single fund containing all the assets selected by the Fund Manager.

### Multi-Fund Bonds

These are, as the name implies, Bonds containing a bespoke selection of funds, which may be from a range of independent funds or from within the provider’s own in-house range. They are simply “wrappers” to hold the chosen investments. Ordinarily we prefer to select from independent funds, typically as many as ten within the fund. This enables us to achieve a greater risk dilution, match more closely your individual preferences, and, most importantly, limit the damage which can be done by a single-fund manager behaving recklessly (see With-Profits Bonds above). It also enables a wide degree of flexibility, with funds being switched within the wrapper to give effect

to changing circumstances and preferences as to asset allocation, with no or minimal transactional costs and no tax implication.

### Hedge Funds and Private Equity Funds

These have traditionally been suitable only for wealthy investors and require specialist (expensive) advice. Hedge-funds, while originally created to be lower risk (hedging against risk), are usually anything but. Private Equity involves the buy-out of businesses and their subsequent resale.

Both types of fund are high risk and currently unregulated. We do not ordinarily consider them suitable investments for our clients.

### “Guaranteed” Funds

These often have guarantees that you will not get back less than the capital invested. However, the conditions have to be read and considered carefully: typically it is only guaranteed if the stock market index does not fall below a certain figure. If it goes beyond that the guarantee is lost. Any gains are shared between you and the provider.

### Property Funds

These can be of two types: bricks and mortar funds and funds which invest in property companies. Bricks and mortar funds actually buy property or interests in property, often shopping malls, industrial development land and so on, with their investors funds. Investment funds buy equity shares in other companies which themselves own properties or interests in properties. Both have an additional significant risk which other funds do not: they can be illiquid. Properties cannot be readily turned into cash and as a result such investments are often valued at a substantial discount to the true value of the property. However the UK is presently moving towards the introduction of Real Estate Investment Trusts which should resolve the problem of illiquidity. Such trusts will issue shares which, as with other investment trusts are tradeable on the stock market, and hence any investor wishing to sell his shares should normally expect to find a ready market.

Property funds invariably only invest in commercial property. The yield on residential property is ordinarily too poor to attract the attention of professional fund managers.