Preparing to invest

What to think about before you start investing.

After a decade of low interest rates, many savers have been looking beyond their bank accounts to make their money go a little further.

As appealing as higher returns may seem, investing requires more involvement than putting your money safely away and waiting for the interest to grow.

This could mean putting more research into where you put your money, as well as reviewing your progress frequently and adjusting your strategy as needed.

Investing also comes with a significant amount of risk, and you'll need to define how much risk you are comfortable with, while also taking precautions to lessen its impact.

Whether you're a seasoned investor or just starting out, careful planning is essential.

Setting goals

The first thing to be clear about when investing is why you're doing it. It's not enough to simply aim to make more money – successful investing should have a specific, achievable goal.

For example, you may be aiming to pay off your mortgage, cover your child's school fees, or save enough for a comfortable lifestyle in retirement.

Whatever your priorities are, having a clear goal in mind will help you form a plan and measure your progress towards it. This also makes it easier to evaluate the level of risk you can manage.

Assessing your attitude to risk

It bears repeating – investing always comes with risk. There's never a complete guarantee that the value of your investments will grow, and in the worst-case scenario, you could lose them altogether.

As greater returns usually come with a higher level of risk, you'll need to weigh up your priorities and figure out how much risk you're realistically willing to take.

This includes your personal feelings about it. Would you be able to stomach rapidly rising and falling investments, or would this be a source of too much stress?

Perhaps more importantly, it's also about assessing your capacity for risk, or the level of risk you can take on without it jeopardising your financial goals.

To figure this out, give some thought to your financial circumstances more generally.

If you have any outstanding debts, it's usually better to focus on clearing those before making any investments. On the other hand, if you've got enough savings to play with, you should be able to absorb the impact of losses or low returns.

Your goal-setting will also play a part in determining your capacity for risk, as you'll need to consider how soon you want to achieve your desired return on your investments.

In general, it's better to stick to low-risk investments for shorter-term goals. If you're saving for the long term, you may have the capacity for higher risk, as you'll have more time to ride out any short-term fluctuations.

Types of risk

There are various types of risk that could impact on your situation, so considering these different factors should form a part of your investment planning.

Inflation risk

Over time, inflation will erode the buying power of your money. This creates the risk that a low return on your investment might not be enough to counteract it.

Market risk

Changes in local and global markets may affect your investments.

Market risk, or systemic risk, refers to these wider changes. It is caused by various economic factors and can affect any type of investment.

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Specific risk

In contrast with the broader factors involved in market risk, specific risk relates to individual assets or groups of assets.

This can be caused by disruptions and problems within the company you've invested in.

Shortfall risk

While it's helpful to set goals, there's always a chance you won't reach them.

For example, your retirement income will be lower than you anticipated if you've set a goal of building up a pension pot and you don't meet your target.

This risk of a shortfall means it's important to give serious consideration to your capacity for risk, and have fallback options in case you don't reach your goal.

Creating a strategy

Once you have a good idea of your investment goals, your timeframe for reaching them and your attitude to risk, you can start to refine your strategy.

One decision to make is whether you'd prefer to invest in a lump sum payment or make regular investments over time.

While **lump sum investing** could provide a larger return sooner, it could also result in more significant losses. **Regular payments** allow for more flexibility to diversify and tailor your investments.

Diversifying is also important because it reduces the level of risk you're taking. It means spreading your investments across different types of asset classes, to minimise your chances of making a large loss.

Types of investment

From property and cars to artwork and collectables, there are few limits to what you can invest in.

There are also several different ways you could go about investing. Here are a few of the most common types.

Shares

When you buy a share in a company, you become an owner of a small fraction of its value. This can come with voting rights and other shareholder benefits.

Shares can provide a return through capital growth, if you sell them for a higher price than you bought them for.

Whether your share rises or falls in value can depend on the company's growth and performance, as well as sentiment among other investors and the wider economy.

You can also gain returns on shares in the form of dividends, which are a percentage of company profits.

Funds

Alternatively, you could invest in a fund. This way, your cash is pooled with money from other investors and used by a specialist fund manager to buy a selection of shares.

It doesn't require the same level of time and expertise as buying shares individually, as the fund manager can handle these decisions for you.

Any returns you receive are proportionate to your investment into the fund.

Bonds

Companies or governments that require extra capital may sell bonds to investors.

When you buy a bond, you're effectively lending money to that company or government, and they'll pay you a fixed rate of interest as long as you hold the bond. If you hold the bond until it matures, you'll be paid back the original amount you put in.

These are generally regarded as being lower risk than other investments such as shares, although they can fall in value if you don't hold them until they mature.

Bonds from the UK government, also known as gilts, are a particularly secure option. However, this means they tend to come with low returns.

Conversely, purchasing a bond from a struggling company carries more risk but will usually pay higher interest.

Stocks and shares ISAs

Stocks and shares ISAs allow you to invest up to £20,000 a year free of tax. This could take the form of various types of investments, including shares, funds and bonds.

This could mean a significant tax saving, especially if you're investing in large amounts, so it can be efficient to use up your allowance each year if your circumstances allow.

Contact us for advice on investing.

Important information

The way tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change. ISA eligibility also depends upon individual circumstances.

This document is solely for information purposes and nothing in it intended to constitute advice or a recommendation. You should not make any investment decisions based on its content. The value of investments can fall as well as rise and you may not get back the amount you originally invested.

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