

# its for income or capital growth



*When selecting an investment, it makes sense to consider not only your current circumstances, but also your plans for the future.*

## whether you are looking for income, capital growth, or a combination of both, investment trusts give your money the opportunity to work hard on your behalf...

As a general rule, the young usually invest for growth, whilst the retired invest for income.

But, as people retire earlier and live longer, it has become increasingly important for many investors who would ordinarily want an income to consider some element of capital growth too.

In this way, they can try to ensure the value of their capital - and the income from it - is not eroded by inflation over the years ahead.

Either way, there are a great many different investment trusts to choose from. So it is important to clarify your investment needs as far as

possible to make sure that you choose a trust that fits your current circumstances and will meet your future expectations.

This factsheet explains what you need to think about when selecting the investment trust that's right for you.

## investing for income



There are many investors who want a high level of income from their money. Typically, these investors have a lump sum of capital they want to invest and then live off the income, rather than gradually whittling away at their nest-egg. They may also have additional sources of capital which they can lay their hands on if necessary. To meet this demand, some investment trusts concentrate on squeezing as much income out of their investments as possible.

UK High Income Investment Trusts generally concentrate their investment in UK companies where dividends tend to be higher, but some trusts do seek to generate income from a global portfolio. They invest the vast proportion

of their assets in high yielding shares, but can also choose other stocks such as preference shares and convertibles.

**Preference shares** offer a fixed rate of return in the same way as bonds, but are actually classed as shares and form part of a company's share capital. They rank ahead of ordinary shares in the pecking order, which means that at wind-up they stand first in line for income and capital pay-outs. They offer a high income stream, but offer little potential for capital growth.

**Convertibles** are like preference shares in that they receive a fixed rate of return, but differ in that they can be converted into ordinary shares at a set future date. Their income stream may

be lower than pure preference shares because they offer some potential for capital growth.

Investment trusts which belong to the UK High Income category must aim to offer a yield of around 200% of the yield generated by the FTSE All-Share Index. As their priority is to generate a high and rising income stream, capital growth is not a priority, so they are not suitable investments for those looking to maximise capital growth.

If you are looking exclusively for income at the expense of capital growth, you could also consider some of the income shares of split capital investment trusts. See our separate factsheet '**its split capital investment trusts**' for more information.

# investing for income with some capital growth

Growth and Income Investment Trusts have a different priority to High Income Investment Trusts. Although they too seek to provide an attractive rate of income, it's not their only objective.

The main difference between Growth and Income and High Income Investment Trusts is that the former also aim to grow the original capital investment to protect their value in the future - this is particularly important, for example to those who may just be retiring.

Investment trusts in the Growth and Income category concentrate on companies which pay out a more modest dividend yield but which offer a better chance of capital protection.

They choose companies which reinvest the bulk of their profits for future expansion in the hope that, as those companies grow, so too will their dividends.

## **The reinvestment of dividends**

If you need capital growth in the short term but know that your needs will change in the near future, perhaps with retirement approaching, an option may be to take out an income fund but reinvest the dividends until you decide to draw the income.

This is a popular option for many investors and some funds where income is reinvested can produce excellent returns which have even been known to outstrip many growth funds.

## **Income payments**

The frequency with which you want to take income will be another consideration that will affect your investment decision. Some trusts may offer you a monthly or quarterly income payment facility while others will only pay you once a year. If you think you'll need an investment trust which pays out more frequently, make sure you check the payment dates before going ahead.

Please note that investment trusts are primarily intended as long-term investments. Because an investment in an investment trust may go down in value as well as up, you may not get back the full amount invested. This type of investment is not suitable for everyone and if you have any doubt whether it is suitable for you, you should obtain expert advice. Past performance is not necessarily a guide to the future. Exchange rates may cause the value of underlying overseas investments to go down as well as up. Levels and bases of, and reliefs from, taxation are subject to change. Any reliefs referred to are those currently applying. Value depends on individual circumstances of investor. The tax credit rate is currently 10% and cannot be reclaimed in cash. From 2004, the tax credit will not be able to be reclaimed in cash in an ISA or a PEP.

# investing for capital growth

There is a large variety of growth investment trusts to choose from and the one you finally pick will predominantly be dictated by the length of time you want to invest for and the level of risk you want to take.

One of the things that growth investment trusts do have in common is that they tend to steer clear of interest paying investments, such as bonds and gilts, and invest almost exclusively in stocks and shares. This is because, over the longer term, the stock market has proved itself to be the best place to invest if you want capital growth that beats inflation. It can also outstrip the returns provided by many other forms of investment.

There are many different investment sectors for growth that investors can choose from - all with varying levels of risk and potential reward...

- UK growth
- Overseas growth
- Smaller companies
- Global growth
- Europe
- Far East
- Emerging markets

- North America
- Venture and development capital

And the choice doesn't stop there. More specifically, you can invest in a particular country or region such as Latin America. You can also choose what specific types of companies you want to invest in, such as technology, pharmaceutical, global mining or utility companies.

Similarly, you can select the size of company in which you want to invest, from big multinationals to small venture capitalist companies, plus everything else in between.

Another choice that's available to you is whether you want to try to beat average stock market returns or simply mirror a market's performance - in other words a trust which is managed on an active or passive basis.

Trusts which try to outperform the markets are called "managed" and these form the vast majority of investment trusts available. Whether your investment actually beats its target benchmark will depend on the skill of your fund manager. It's their job to analyse

companies for their growth prospects and to monitor their performance on a regular basis to make sure the trusts stay on track.

'Index trackers', on the other hand, don't aim to beat an index - they simply attempt to match the performance of a market by replicating the mix of companies which make up that index.

Although there are only a handful of these types of trusts currently available, they are growing in popularity. As they aim to produce a return identical to that of the markets, you can easily track the performance of your investment. Your fund will generally rise and fall according to the fortunes of the index it follows.

Split capital investment trusts offer zero dividend preference shares, which generate no income at all, but provide an opportunity for a predetermined, but not guaranteed, amount of capital growth over a fixed period. See our separate factsheet on **'its split capital investment trusts'** for more information.

# choosing the growth trust that's right for you

## Long term investments (more than 10 years)

If you are investing for the long term, perhaps as part of your pension planning, it may be worth aiming for high growth with part of your investment by considering a medium to high risk fund.

This is because fluctuations which the market may experience in the short term generally tend to smooth themselves out over the longer term. Investing for a very long time can actually reduce the amount of risk you are taking on your investment compared to someone who is investing for only a short period of time.

This enables you to make more adventurous choices. Investment trusts which venture further afield may appeal to you, such as Emerging Market trusts or Far East trusts, both of which invest in areas with promising opportunities for the long term, but whose economies tend to be rather volatile over the short term.

However, you may wish only to commit a proportion of your money to such investments, leaving the majority in less risky investments.

## Medium term investments (5 to 10 years)

If you are investing for a specific purpose, such as a holiday home, you will want to play it a bit safer and choose an investment that doesn't carry too much volatility.

Investing in a large global or European investment trust may be an option for medium term investors because it spreads your investment across a variety of countries in an effort to reduce risk.

What's more, such trusts tend to invest in larger companies which are more likely to deliver consistent returns.

## Short term investments (less than 5 years)

In general, the longer you leave your money invested in the stock market the better chance you give it to grow.

However, if you are prepared to invest for a short term requirement, there are investments that could help your money grow slowly but consistently.

A UK Growth trust invests in the largest growth companies in the UK, which means that you don't have to worry about currency movements in the same way that you would if you invested in Europe. It also means that you could benefit from the growth of household names such as British Petroleum. However, their UK profits will be subject to the results of any overseas subsidiaries.

# what to do next

Before making any investment decisions it's important to carefully examine your needs to help you make the wisest choice possible.

Take your age, for example. Generally speaking, younger people usually don't worry about increasing their income - they are more likely to invest for growth over the longer term.

Conversely, if you have retired, your priority may be to find ways of boosting the amount of income you receive from your savings.

Whatever your investment priority, whether it's to grow your original investment as much as possible or to generate a high and growing income stream, there are many different investment trusts available to choose from that can satisfy your requirements.

## For further information...

### Visit our website

Our website is a good place to start if you want to learn more about investment trusts and how they can help you get the most from your savings. You can find us at [www.itsonline.co.uk](http://www.itsonline.co.uk)

### Contact an Independent Financial Adviser

If you would like any further information or advice, you should consult an Independent Financial Adviser (IFA). You can get the details of three IFAs in your area by calling 0800 707 707.

### Look out for this symbol



Investment trusts regularly advertise in the national and financial press - just keep your eyes open for the symbol above.

## information factsheets

The AITC publishes a range of introductory factsheets which are available free of charge by calling **0800 707 707**

- **its** for investment trusts
- **its** understanding risk
- **its** split capital investment trusts
- **its** for pensions
- **its** for children
- **its** for individual savings accounts (ISAs)

We are also currently introducing a more detailed range of factsheets about investment trusts and how they work; please call us or visit our website for further information.



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