aic The Association of Investment Companies

A new direction for your clients

An adviser's introduction to investment companies

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www.theaic.co.uk

Financial advisers are increasingly using investment companies in their clients' portfolios to build capital and to deliver a higher or growing income.

This guide introduces you to investment companies and explains why you should consider them for your clients' long-term financial needs and to demonstrate the value of your advice.

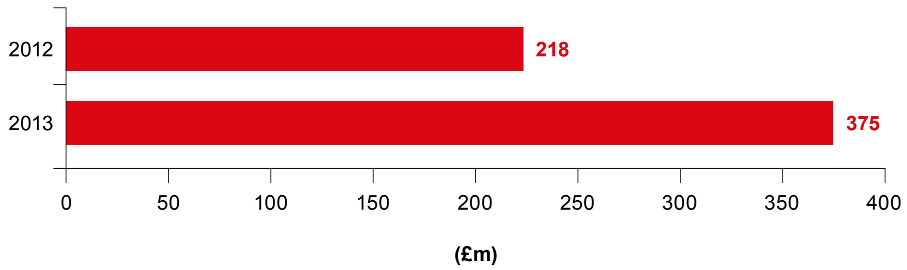
Introduction

In the first 12 months since RDR, purchases of investment companies by advisers through platforms increased by 72%.

And the number of advisory firms recommending investment companies has increased by more than 30%. This supports the findings of a recent survey by FE Trustnet that found that a third of the advisers responding had recommended their first investment companies within the last year.

So what are investment companies and why are so many more financial advisers beginning to include them in their clients' portfolios?

Investment company purchases by advisers via platforms



Source: Matrix Solutions – Financial Clarity

Go ahead
Post RDR, more and more advisers are choosing to recommend investment companies to their clients

What are investment companies?

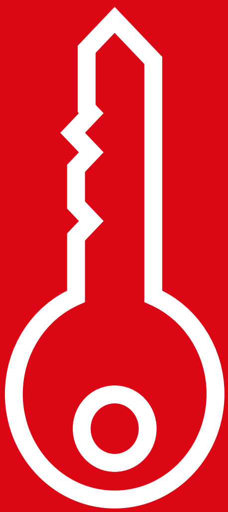
Investment companies are a type of collective investment fund, like other funds you may be more familiar with, such as unit trusts and OEICs. Like these other funds, investment companies provide your clients with easy access to a professionally managed, diversified portfolio of investments to spread risk.

There are around 400 investment companies, many of which have existed for more than 50 years. They include:

- investment trusts
- offshore investment companies
- Venture Capital Trusts (VCTs)

For every journey
Investment companies offer new and effective ways to help clients reach their investment goals

How do they differ from other funds?



Access through the stock market

You buy shares in investment companies on the stock market. This can be done directly through a stockbroker, but many platforms now offer the ability to trade shares in investment companies quickly and efficiently.

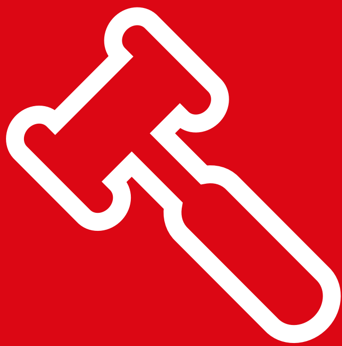
Closed-ended structure

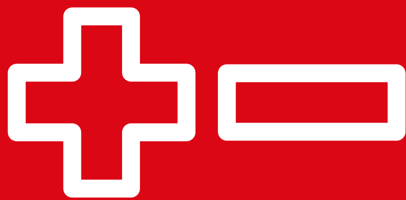
Investment companies are 'closed-ended', unlike unit trusts and OEICs which are 'open-ended'. In an open-ended fund, money moves in and out of the fund as investors buy and sell, meaning the manager has to manage the portfolio to meet these demands (for example, by selling investments to raise cash).

With an investment company, when you want to sell, you simply buy and sell the shares on the stock market, which has no impact on the underlying portfolio.

A wider range of investments

Being closed-ended means investment companies can invest in less liquid asset classes that other funds cannot offer, such as private equity, venture capital, infrastructure and commercial property. These have the potential to deliver better long-term returns or higher levels of income.





Gearing

Investment companies can borrow money to make additional investments (gearing). The idea is that the additional investments make enough money to pay the costs of the debt and make a profit on top. If it works, the more the company borrows, the more profit it makes. If the investments fall in value, however, the more the company borrows, the more it loses.

Gearing can boost both capital profits and income, but also increases the risks. However, not all investment companies use gearing and most only use modest levels.

Governance

Investment companies have independent boards of directors which look after your clients' interests as an investor. The directors meet several times a year and monitor the company's performance. They can even replace the fund manager if the performance of the company is not satisfactory.

Discounts and premiums

An investment company's share price is mostly driven by the value of its portfolio. However, it can also be affected by general sentiment towards the company and other factors. As a result, the share price may be higher ('at a premium') or lower ('at a discount') to the value of the underlying investments. So, depending on when you buy or sell shares, the returns your client gets may be better or worse than expected.

Helping you understand gearing

The AIC publishes three gearing figures on its website:

Gearing	The current level of gearing an investment company has.
Historic gearing	The highest and lowest level of gearing an investment company has had over the past 3 years.
Gearing range	An indication of the maximum and minimum levels that the company would expect to be geared in normal market conditions.

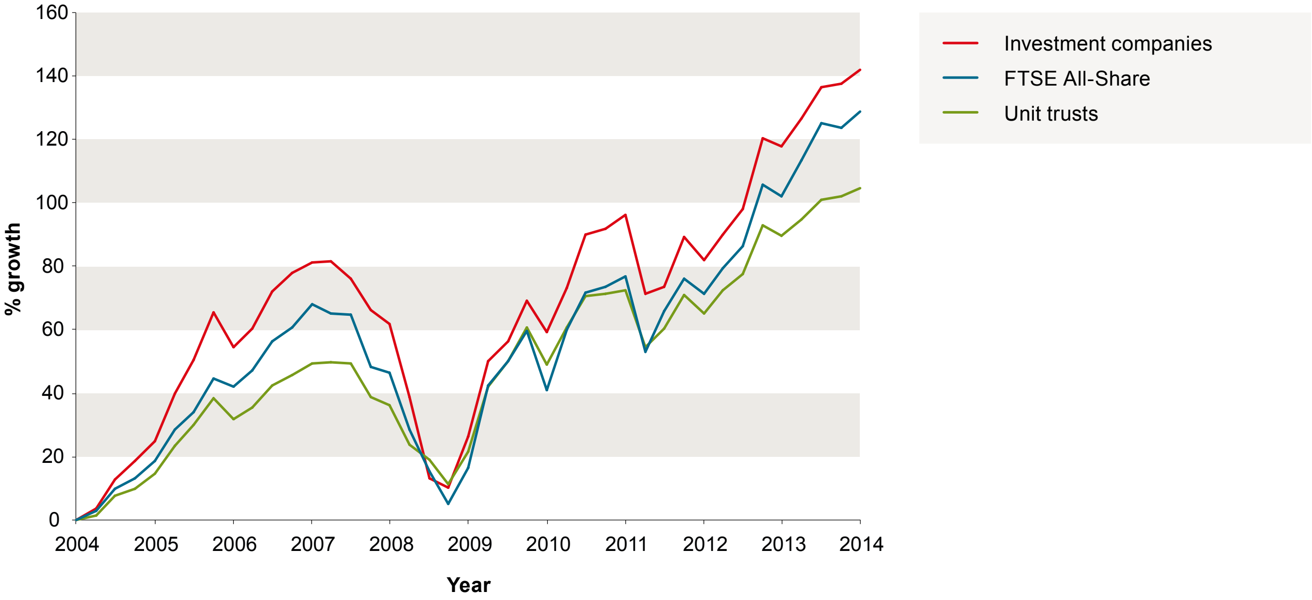
Taken together, this builds up a picture of how an investment company has used gearing in the past, how much it is using today and where it may go in the future.

Why should I consider investment companies for my clients?

Better long-term performance

Although investment companies can be more volatile in the short-term, their closed-ended structure, ability to gear and access to a wider range of investments mean they can outperform in the long-term.

Performance of investment companies over 10 years



Going up a gear
Investment companies' unique combination of features can enhance performance potential

Shareholder total returns to 30 June 2014

Sectors	1 Year		5 Years		10 Years	
	Investment companies	OEIC/Unit trusts	Investment companies	OEIC/Unit trusts	Investment companies	OEIC/Unit trusts
Global	112.9	108.9	197.3	176.4	272.4	207.8
Global Equity Income	111.6	108.8	236.7	190.0	305.9	213.2
UK Equity Income	113.5	114.3	253.3	198.6	312.1	216.8
UK Growth v UK All Cos	117.0	114.1	218.4	198.9	250.0	220.8
North American	105.6	110.3	207.9	205.6	221.0	197.3
Europe v Europe ex UK	126.1	113.8	235.6	178.5	350.6	236.5
Global Emerging	100.9	101.8	149.1	148.8	361.4	322.1
Asia Pacific ex Japan	102.9	103.2	202.1	166.0	414.1	314.0
Japan	107.5	98.3	201.8	140.5	172.0	131.6
Property	138.4	107.3	231.8	161.9	165.6	147.4
UK SmallCap	122.9	122.4	287.0	247.3	330.8	278.1
Japanese SmallCap	107.6	106.1	211.6	175.1	117.5	133.1
TMT	121.1	114.0	254.2	208.9	472.9	223.3
European SmallCap	128.1	117.5	233.0	215.0	314.7	321.9
North American Smallers	113.4	109.0	225.0	236.3	200.4	256.8

Investment company outperformance

OEIC / unit trust outperformance

The investment company data is unweighted share price total return performance figures on a mid price to mid price basis. OEIC/unit trust data is unweighted total return performance figures on a bid price to bid price basis. Source: IMA/Morningstar. All data to end of June 2014.

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Research from Canaccord Genuity shows that investment companies outperformed comparable open-ended funds in 12 of 15 sectors over 10 years

More choice for a higher income

Investment companies have a number of unique advantages over other types of fund when it comes to paying a regular income in the form of dividends. Unlike open-ended funds, they can keep some of their income back in good years to maintain or boost dividends in leaner ones. Investment companies can also invest in a far wider range of income-producing investments.

Though higher levels of income can come with increased risk, many investment companies have been able to increase their dividends for decades.

Demonstrating the value of your advice

The Retail Distribution Review means that clients are considering the cost of financial advice more closely than ever. Investment companies offer the chance of demonstrating the value of your advice by opening up your clients' portfolios to areas of the investment market that they are likely to feel less comfortable about considering on their own.

Meeting your regulatory requirements

Investment companies are one of the designated 'retail investment products' that independent advisers must consider as part of the reforms introduced by the Retail Distribution Review.

Investment companies are an obvious candidate for part of a long-term income portfolio in retirement

A smoother ride
Because they can keep some of their income in good years to boost dividends in poor years, investment companies can give income seekers a smoother ride

Your questions answered

I have heard that many platforms do not offer investment companies. Is this true?

No. Although a few of the biggest platforms do not offer investment companies, the platforms shown below all offer access to investment companies.

In practice, independent financial advisers are using more than one platform to meet their regulatory requirements.

There is a lot of discussion at the moment about the use of an 'Ongoing Charge' in preference to the Annual Management Charge. Where does the AIC stand?

The AIC has never shown just an Annual Management Charge on its website. We show Ongoing Charges (previously Total Expense Ratios), which are based on the same methodology used for open-ended funds. We show Ongoing Charges including and excluding performance fees.

We also publish details of the management/performance fees and other costs incurred when buying investment company shares, such as the bid-offer spread.

"It is likely to be very rare, if possible at all, that a firm could use one platform for all clients and meet the independence rule."

Financial Conduct Authority
Supervising retail investment advice: Delivering independent advice, March 2014

Research from Winterflood Securities in September 2013 showed that 66 investment companies had daily trading volumes of more than £500,000

Is liquidity an issue?

If you are managing your clients' portfolios yourself, and recommending larger, mainstream investment companies, you are unlikely to be dealing in such large volumes that liquidity will be an issue.

If you are likely to be recommending smaller, or very specialist, investment companies (e.g. Venture Capital Trusts) to clients with large sums to invest, then you may need to plan to buy/sell these over a period of time. You can find daily, monthly and yearly trading volumes on our website.

Liquidity tends to be more of an issue if you outsource portfolio management to a discretionary manager, particularly if they use model portfolios. This is because these firms are often providing the same service to many clients, and so need to deal in very large volumes.

However, you should think carefully about using such services if this means you cannot offer access to investment companies.

Are investment companies affected by the rules relating to non-mainstream pooled investments?

As of 1 January 2014, independent financial advisers cannot recommend certain pooled investments (which might include open-ended funds, ETFs and investment companies) to their ordinary retail clients. These are referred to as 'non mainstream pooled investments' (NMPIs).

As the rules are complicated, the AIC publishes a list of those shares and securities which AIC member companies have confirmed can be recommended to ordinary retail clients. This list is updated on a monthly basis and confirms that the vast majority of investment company shares and securities are not NMPIs.

Want to know more?

Join the AIC Financial Advisers Centre

As an adviser, you can join the Financial Advisers Centre on our website. This will provide you with full details of our training programme, as well as access to news, videos, information and statistics on investment companies. You can also sign up for regular updates, including our monthly newsletter 'Spotlight'.

Free AIC training

Online training

We offer a series of online training sessions on investment companies. These sessions are structured using the FCA's examination syllabus to provide training to at least level four. These sessions run for approximately one hour and CPD certificates are available.

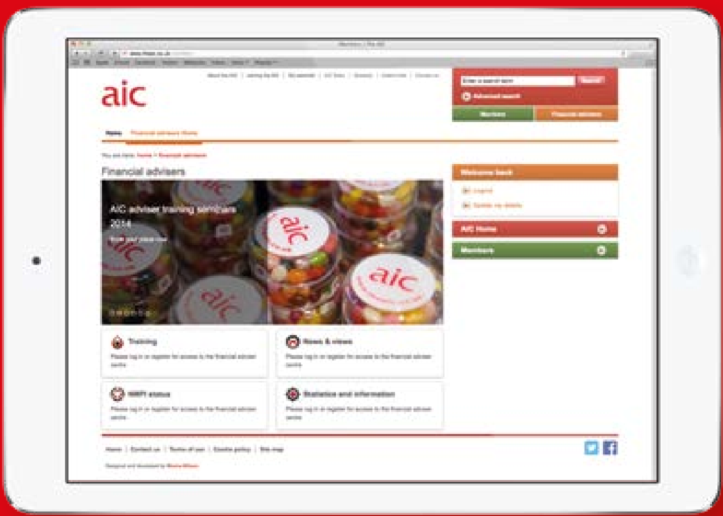
All of these training sessions are accredited by the Institute of Financial Planning, the Chartered Insurance Institute and the Chartered Institute of Securities and Investment.

Face-to-face training

The AIC runs a series of free adviser training seminars around the country each year. You can find full details of these events in the Financial Advisers Centre. You can also find information on other events the AIC is speaking at.

Visit the AIC's Financial Advisers Centre for access to our free training, news and statistics

www.theaic.co.uk/financial-advisers



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