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UK Edition

4th Edition

Investing FOR DUMMIES®

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Learn to:

- Make sound investment choices, whatever your budget
- Minimize the risk of investment gambles
- Differentiate between the major investment categories
- Understand the new changes to pensions and ISAs, and keep track of the ultra-low interest rates

Tony Levene

Consumer finance journalist

Investing

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Investing For Dummies®

Visit www.dummies.com/cheatsheet/investinguk to view this book's cheat sheet.

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Introduction

So much has happened for investors in almost the twinkling of an eye, it's certainly time for a new edition of *Investing For Dummies.*

Over the past seven or eight years, economic and investment market crises convulsed the world. They include the first ever run on a UK bank in a century and a half; the nationalisation of two of the biggest UK banks; the collapse of some of New York's biggest investment banks; mayhem in the US housing finance market; the bankruptcy of Icelandic banks; the rescue of the Greek and many other smaller European economies in the Eurozone; record low interest rates almost everywhere, guaranteeing that savers get a bad deal; and the rise of emerging market economies such as India and China. And that's only scratching the surface of all the recent changes in the world of investing.

And then, as day follows night, the dark side of financial markets turned sunnier. Share prices in the United States soared to record levels, 'euro' and 'crisis' no longer automatically always appeared one after the other, UK markets perked up – and investors who had placed their faith in the great emerging markets of Brazil, Russia, India and China were disappointed.

Dramatic? Yes. But these big ups and downs have existed ever since financial markets came onto the scene.

On top of all that, UK rules governing what is most people's biggest and most crucial investment – their pension – have changed out of all recognition. So many restrictions have been introduced that I've had to completely rewrite the chapters on what to do about your retirement income for this new edition of the book.

Knowing about investments could almost have been a hobby when I wrote the first edition of *Investing For Dummies* nearly a decade ago. Now, you're out there on your own with pension investment decisions.

But really nothing has changed in the investment world. No matter how chaotic it may seem, or how complex the hedge fund universe appears to all but those with a double degree in investment rocket science, the essentials remain just as they always were.

Investment markets are still a battleground between fear and greed. When fear gets the upper hand, most prices fall – the exception being so-called 'safe haven' investments such as gold. And when optimism returns, everything moves up – except for those 'safety first' assets.

And how investments will fare from here is anyone's guess. No one can be trusted to predict the future. So neither *Investing For Dummies* nor any other source of advice will ever be right all the time. The essential aim is to get more than half of your decisions right and beat the averages. If you can do that then you're doing as well as you're likely to. This applies to the so-called experts and professionals as well.

This book gives you the facts up front and honestly. So you'll find no magic formula for wealth here. Besides, even if there were a get-rich-quick recipe, I wouldn't be telling anyone about it; I'd be using it.

No one can predict which shares will do well (although that doesn't seem to stop people from asking me for sure-fire tips at parties). But what I can provide is guidance to help you make sensible decisions that suit your circumstances.

Investing involves more than understanding an economics textbook or balance sheet. It involves understanding a whole lot about human reactions to the ups and downs of money, plus (really important) understanding how you react. And it's fascinating because it's where you find all the drama of human life: investment values represent nothing other than the combination of the minds of all the people involved in investment markets.

Over all the decades that I've been writing about money, I've continued to find investing a fascinating subject and endeavour, and I've become moderately more well off than I would've otherwise been. I hope that this book helps you become fascinated with investing too. And I also hope that by reading it you'll be better off than you would've otherwise been.

About This Book

This book is designed to be read in several ways. It's a reference book, so you don't have to read the chapters in chronological order, from front to back, although of course you can read it cover to cover, like a novel, to gain appreciation for the huge variety of investment opportunities that are available. (If you approach the book this way, I suggest doing so with pen and paper at the ready so that you can note areas for further research on the Internet or from publications such as the *Financial Times*.) Or you can just pick a topic that interests you or go straight to a section that answers a particular question you have.

But my preferred way for you to read this book is to go through Part I and *then* pick up on the investments that concern or interest you. For example, after reading Part I you may want to go straight to Part III to find out what collective investments are because, say, an advert about collective investments has caught your eye or a financial adviser has suggested one or two of them. Reading this section helps with your pension choices. But you may want to skip the chapter on buy-to-let properties because, say, being a do-it-yourself landlord is the last thought on your mind. Or the one on betting opportunities because they're simply too scary.

Conventions Used in This Book

I've tried to avoid jargon as much as I can, but know that the investment world is full of it. Like all professions and occupations, finance and investment have their own insider language that's intended to mystify outsiders. When I do use the industry's language in the text, I *italicise* the term and define it for you in an easy-to-understand way.

Foolish Assumptions

While writing this book, I made some assumptions about you:

- You're either completely new to investing or have limited information about it, and you want someone to help you understand what investing is really about and what types of investments are available.
- You don't want to become an expert investor at this point in your life. You just want the basics – in informal, easy-to-understand language.
- You want to make up your *own* mind while using a guide through the investment jungle. You want enough

pointers for you to risk only what you can afford to lose and for you to make a worthwhile return on your hard-earned cash.

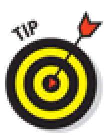
Beyond This Book

Find out more about investing by checking out the bonus content available to you at www.dummies.com. You can locate the book's e-cheat sheet at www.dummies.com/cheatsheet/investinguk, where you'll find handy hints and tips.

Be sure to visit the book's extras page at www.dummies.com/extras/investinguk for further information and articles.

Icons Used in This Book

I've highlighted some information in this book with icons:



This icon points out useful titbits or helpful advice on the topic at hand.

I use this icon to highlight important information that you'll want to keep in mind, so don't forget this stuff!

This icon points out just that – a warning – so take heed. The investment world is full of sharks and other nasties. I don't want you to lose your money to crummy schemes and criminals.

You'll find this icon next to, well, technical stuff that you may want to skip. I've been sparing with this stuff because investment can be pretty technical anyway. (Note that even though you may want to skip this material on your first reading, and please feel free to, this info may be worthwhile coming back to later with your greater knowledge of the fundamentals.)

Where to Go from Here

This book is set up so you can dive in wherever you want. Feel free to go straight to Chapter 1 and start reading from the beginning to the end. Or look through the Table of Contents, find your area of interest and flip right to that page. Or better yet, read Part I and *then* flip right to that page of interest. Your call.

Wherever you go from here, if you find a piece of advice or a warning that you think applies especially to you, copy it down and then fix it to the fridge with a magnet, or pin it on a board.

And as you read through this book, either in part or in whole, why not practise some dry-run investing? Buying a dummy portfolio using pretend money is always a good way of getting familiar with investment without the worry of losing money. You'll find plenty of resources online to help you establish and plan your pretend portfolio.

Part I

Getting Started with Investing

For Dummies can help you get started with lots of subjects. Visit www.dummies.com to learn more and do more with *For Dummies*.

In this part ...

- Find out all the things you always wanted to know about investing.
- Discover what the term investment really means.
- Look at the five basic investment choices – the foundation of most portfolios.
- Discover how to increase the benefits and shrink the drawbacks of investment choices.
- Learn that the small print is vital in understanding what you invest in – ignore it at your peril!

Chapter 1

First Steps on the Money Trail

In This Chapter

- Understanding basic investment philosophy
- Discovering your own money make-up
- Looking at where you may be investing already (whether you know it or not)
- Getting familiar with five basic investment choices

This chapter explains the first steps you must take in your investing ventures. But take heed: in this chapter (and throughout the book, for that matter) you need to think deeply about some personal matters, to understand yourself better and know where you're going in your life and what makes you tick. In other words, you need to wear two hats – that of investor *and* that of self-examining philosopher. So be prepared for some tests that ask just what sort of person you are, what you want for yourself (and those around you) and what you're prepared to do for it.

And if you don't run into a test, such as a risk profile from a financial adviser, that's no bar to testing yourself. Many 'risk profiler tools' online can help, but no matter how you go forward, the final decisions you make are down to you and no one else.

Understanding the facts and mechanics of investment decisions is just a start. Knowing how to apply them to your own circumstances, and to those of your family and other dependents, is what will make your strategy succeed.

What’s Your Reason for Investing?

This section is very basic, comprising just one simple *Investing For Dummies* test question: why did you buy this book? Chances are you probably did so for one of these four reasons:

- **You have no money but want to make some.** Most people fall into this category. You want to invest some money and accumulate funds but don’t know where to start. How you go about it depends on how well you can discipline yourself. Take heart, though: even the most confirmed shopaholic can build up a nest-egg for later use.
- **You have some money, want it to make more and currently make your own investment decisions.** You’re the traditional investor who wants to make your personal wealth grow. You already make your own investment decisions and want to get better at it. How you go about it depends on who you are, how you made your money and where you hope to be in 5, 10 or 20 years.
- **You have some money, want it to make more and currently have others handle the investment process for you.** Maybe you have fund managers or

investment advisers handle your investments so you can gain tax advantages or because your savings are lumped together with those of others in a pension or similar fund. Or maybe your life is just too busy or complicated for you to do the investing yourself. Regardless, you now want to understand how investing works so you can either take over your own investment decisions or monitor what others are doing with your hard-earned cash. I'm not sure many people will pick up this book just to check up on the professionals, but I could be wrong.

- **You're now in charge of your pension decisions.** Unless you work in the public sector, the chances are that you now have to take stock of your own pension arrangements. What you get when you retire is now largely up to you rather than your former employer or employers. And the new pension freedoms extend this choice into your retirement years. Because building up and then winding down a pension are likely to be the biggest investment decisions you make, Chapters 14 and 15 are devoted to helping you construct your retirement funds and then make the most of your pension's nest-egg.

What's Your Personality Type with Money?

Some people spend all they have each month (and then some on top – ouch!). Others put away a bit in the bank or building society on a regular basis. And still others buy and sell stocks and shares, with some going in for some very complex investments.

Test time: you need to decide whether you're a spender, a saver or an investor. Doing so isn't as easy as it looks, though. Spenders can be savers or investors. Savers can be spenders and investors. And investors are generally also savers and must, at some stage, be spenders. But most people are predominantly one of the three types – spender, saver or investor. Which category you think you fit into determines what you do from now on, how you react and how you progress.

Spenders have fun

Spenders are generally people who live for the here and now. They may want more than they can have and end up borrowing money, probably on plastic cards. For many spenders, accumulating cash for the future has no priority.

Here are ten attributes of spenders. If the majority of them apply to you then, yep, you're a spender:

- You don't look forward to the end of the month.
- You love new things: you'll queue all night for the latest smartphone and your friends gasp when you tell them how much your new handbag cost.
- You have more than one credit card – maybe you use one to pay for the other.
- You can't resist two-for-one offers, even if you throw half of what you buy away.
- You buy unnecessary clothes.
- You're always first – and last – to buy a round of drinks.
- You believe in living a lot now.
- You see the future as a foreign land.
- You worry about money at times but then go out to the shops to stop fretting.

- You buy glossy magazines as much for the advertisements as the articles.

If you’re in this category, your first priority is to recognise that investors can’t always be spenders. Getting familiar with investing is a good way to accomplish this priority because it offers an alternative use for your cash.

Know that while on your way to becoming a saver or an investor, you can start with very small sums. You can become a saver with £1. And some regular stock-market-based investment plans start at £50 a month less than the cost of a coffee-chain cappuccino a day.

Savers have cash

Savers are people who want to keep their financial cake and eat small slices at a later date. Here are ten saver attributes. Tick those that apply to you, and if the majority do then you’re probably a saver:

- You have a surplus at the end of each month.
- You go to the supermarket with a shopping list.
- You don’t have a credit card, or you pay it off in full each month.
- You’re prepared to put off purchases.
- You’d rather buy second-hand than run up a debt.
- Your property is more important than your furniture.
- You look at the display windows at banks and building societies.
- You know what the current interest rates are.

- You believe in the saying ‘waste not, want not’.
- You’ve read *Sorting out Your Finances For Dummies* (published by Wiley) – or, if you haven’t, you’ll get a copy the next time you buy a book.

REMEMBER Saving is a stage you must reach before investing. You can be a saver as well as an investor, but you can’t be an investor without first saving up some money to invest.

‘Hi, it’s me, Spender. Can’t I just use my credit card to finance an investment?’

You can’t use a credit card to buy investment products over the phone, via the Internet or in other circumstances where you can’t send a cheque. Some of the reasons lie in the complexity of consumer credit legislation. Another factor is that financial companies only want you to invest what you can afford, although unauthorised, illegal and probably fraudulent offshore investment firms may try to sucker you into schemes by telling you to use your credit card.

But the most important reason you shouldn’t borrow to invest or save is that doing so only makes financial sense if the return is going to be higher than the interest rate charged. Paying 29.9 per cent annual interest – and that’s by no means the top credit card rate – is pointless unless you can be very sure that your investment will grow even faster and that your original capital will be safe. Both now and in all of history, no such investments exist.

And note that even if you could borrow at 0 per cent annual interest, you’d still have to be sure of getting your money back with one of those rare investments that can’t fall, in order to be better off.

Investors build up future funds

Investors are people who are prepared to go the extra mile to try to ensure that their wealth goes the extra thousands, tens of thousands or even more. Investors want control over their money but are ready to take a risk provided that they're in charge and know the odds. They want their money to work hard for them – as hard as they worked to get the money.

You don't need an MBA, a posh old-school tie or stacks of money. However, know that although you can sleepwalk into just saving your cash, you must be wide awake to be an investor.

As a pure saver, you really don't have to know what you're doing. You can just stash your cash under the bed, for example. As an investor, you *must* know what you're doing and have the self-discipline to follow your strategy, even if the strategy is doing nothing, buying and forgetting, or benign neglect.

So are you an investor? Check out these attributes to find out:

- You have spare cash.
- You have an emergency fund for the day the roof falls down or the car collapses.
- You want more than the bank or building society offers.
- You think about your money-making strategy and tactics.
- You can face up to bad days (and there'll always be some) on investment markets without worry.
- You're ready to swap certitude for a bigger potential reward.
- You can afford to lock away your spare cash for five years at the very least.
- You understand what you're doing with your money.

- You're prepared to lose money occasionally – knowing it's an occupational hazard.
- You're ready to invest your time into growing your fortune.

All these attributes belong to an investor.

Working out where you fit

So, what's your bottom-line personality type when it comes to money?

- **You decided you're an investor.** Congratulations! You're ready to embark on the road to growing your money. It won't be easy. You may face stiff climbs, vertiginous falls, rocky surfaces, long deviations and dead ends. But give it enough work and time, and I promise that investing will work out.
- **You didn't qualify as an investor.** You got as far as a saver and no further. Or you're really stuck as a spender. You're wishing you'd spent the price of this book on something else or stuck it in your savings account, where at the current virtually invisible savings rates it'll double in about 100 years. Well, don't regret your purchase or vow to send this book off for recycling, or try to recoup some of the price by selling it in a car boot sale. Stick with it. The very fact that you bought this book shows you're ready to move on to investing when you're financially and psychologically ready.

  And even if you decide you never want to buy a share, sell a bond, invest in a unit trust or check on foreign exchange rates, this book is still for you. Why? Because you're almost certainly an investor already.

(The following section tells you how, if I've piqued your curiosity.)

Surprise! You've Probably Been Investing Already

Your financial fate already depends on the ups and downs of the stocks and shares markets. Few people can escape this fact, and every day the number of people who can ignore the investment world diminishes. You may be an unconscious investor or even an unwilling one, but there's no running away from it; you're already an investor.

Investing through your pension fund

The biggest amount of investment money you're likely to have is the value of your pension fund. And whether you pay into it yourself, rely on your employer or build it up via a partnership with your employer, it all rides on investment markets.

Just to give you an idea of how much you may have, suppose that you earn £25,000 a year and put 10 per cent of your earnings each month into a pension fund that grows at a 7 per cent average per year. Here's what your fund is worth over the course of 45 years (I've ignored tax relief on pension contributions, future wage rises, inflation, and fund and pension management charges to keep this example simple):

Number of years	***Value of fund***
5	£14,915
10	£36,059
15	£66,032

20	£108,525
25	£168,762
30	£254,157
35	£375,214
40	£546,827
45	£790,111

That's serious money! And it all started with a first monthly payment of just £208! Of course, the assumptions I make are foolish. No one continues on a flat salary for 45 years – some see earnings soar and others stop work. And although the annual growth rate I've used is an average based on the past, whatever happens in the future, it won't be smooth!

Most people haven't a clue that they have the potential for anything like the preceding example over a working lifetime. But even if you're aware of what you could achieve, I bet you didn't know that you have a good chance of taking some investment control over that sum. Even if you don't want to, at the very least you should be able to check up on what the pension fund managers are doing with your money. Understanding what other people are doing with your money can help you increase your own pension fund in good markets and prevent it from going down when the investment world turns sour.

Note that your pension plan isn't the only area where you may be an unwitting stocks and shares investor. Endowment mortgages and other investment-linked insurance schemes also revolve around stocks and shares.

Investing in your employer