INVESTMENT FUNDS

Your guide to getting started

Registered charity number 268369

CAF Charities Aid Foundation

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INTRODUCTION

In today's uncertain economic environment, low interest rates look likely to remain for some time, making it harder to generate a sustainable, long-term income from reserves alone. This means that the investment decisions you make for your charity now matter more than ever. But with a huge range of funds on the market – and a whole host of ways to access them –investing can be far from straightforward.

The investment decisions you make for your charity now matter more than ever.

That's why we've put together this guide to provide you with information to help you understand the investment journey.

You can find out more about investments and your options by calling our Charities team on 03000 123 444.

BALANCING RISK AND REWARD

When it comes to investing, there's never any guarantee of a return - and there's always a degree of risk. But investment risk can be managed, and this starts with deciding how much risk you're prepared to take to achieve your charity's investment goals. This risk tolerance is unique to your organisation.

How much risk are you happy with?

If you have a low risk tolerance, you're keen to avoid losing money and to keep your charity's capital as safe as possible. Keeping your money in cash based savings is very low risk, but in times of low interest rates, returns are also low. And if inflation rises, the value of your investment could fall in real terms.

If you have a medium risk tolerance, you feel able to take some degree of risk with your charity's capital. This means you're likely to be happy to keep your money invested for several years so it can recover from any short-term falls and have the opportunity to grow over the longer term.

If you have a high risk tolerance, you will feel that your charity can accept the risk of more significant short-to medium-term losses that come with targeting higher potential returns. This means you're comfortable with investing in riskier asset classes. While this strategy could pay off over the longer term, it's important to realise that the value of your investment can also fall, sometimes below the value of your original investment. You could also lose some or all of your charity's capital.

Typically, the higher your risk tolerance the longer you should be prepared to invest. The longer the time frame the more opportunity there is to ride out any short or medium term downturns in markets.

Investing comes with both risks and rewards.

Establishing your risk tolerance is about finding the best balance between the two, based on your charity's goals.

Types of investment risk

Managing risk in your investment portfolio isn't just about deciding on the level of risk you're willing to take on; it's also about understanding the types of risk you might face. These can include:

Capital risk: If you invest in 'risk' assets, such as equities, then you could lose some or all of the money you invested in the first place. There are even some complex investments that might lose you more than the amount you place in them. If you keep your money in cash deposits, the first £85,000 of your money is protected under the Financial Services Compensation Scheme if the bank runs into financial trouble. Visit www.fscs.org.uk for more information.

Market risk: If you buy shares in a company that is performing strongly, a dip that affects the wider market can also affect the value of your returns.

Currency risk: If you invest in shares of a company that is headquartered abroad, exchange rates could reduce the money you get when you sell your charity's investment.

Sector risk: Concentrating too much of your portfolio in one sector – like health care or information technology – could reduce your returns as a downturn in that sector is likely to affect all the companies within it.

Specific risk: This is the risk of the specific company you've invested in performing poorly.

Manager risk: If you choose to invest through an actively managed investment fund (see Make the management decision on page 8), a manager will aim to predict the market and adjust the investments accordingly. An index tracking manager may very accurately mirror the market, or they may not. This means it makes sense to do your research on managers before choosing a fund.

Inflation risk: A rise in inflation will erode the value of your charity's savings over time. To protect against the impact of inflation, some investors might choose to buy other investments instead of, or as well as, holding cash.

GET TO GRIPS WITH ASSET ALLOCATION

Asset allocation is all about selecting investments that work together to achieve the best possible balance between risk and return for your charity.

Different asset classes – or groups of investments – perform in different ways at different points in the market cycle. This means not having all your eggs in one basket can help to offset losses; if one asset class is suffering, another one may be outperforming. Diversification is all about spreading your investments across different asset classes – and even different geographic regions – to avoid concentrating all risk and volatility in one area.

Depending on your charity's investment goals, and the level of risk you're comfortable with, there are many types of asset you could choose. We've listed the five main ones below:

Cash

Keeping your money in cash, for example by depositing it in a bank account is a straightforward way of investing that requires no special expertise.

Risk level: Generally speaking, cash is the lowest-risk of all investments. But with interest rates currently still very low, cash is also likely to produce lower returns. What's more, if inflation rises above interest rates, the value of your investment can be eroded over time.

Bonds

A bond is like an IOU issued by a government (a government bond or gilt) or a company (a corporate bond). When you buy a bond, you're buying a unit of debt in the organisation that issues it. The face (or nominal) value of the bond is fixed when it is issued, and is also used to work out the coupon – or interest payment – you receive while you hold the bond. When the bond matures, you get back the face value.

Risk level: Bonds typically come with lower risk than equities, but low interest rates mean that bonds are paying lower returns than they have historically too. Government bonds are usually seen as less risky than corporate bonds, as governments are less likely to run into serious financial difficulties that would prevent them from repaying your capital.

Putting all your investment eggs in one basket is a risky strategy.

That's where diversification comes in.

Equities
Investing in equities – also known as stocks and shares – is effectively buying a stake in a company's capital. If the company does well, your stake should increase in value and you may also receive an income, but of course the reverse is also true.

Risk level: Equities can generate higher returns than cash, bond or property, but they also typically represent a higher-risk option. That's because returns are driven by the performance of the company and the stock market itself – and both prices and stock markets can be volatile. What's more, investing in the shares of companies based in emerging market countries – Brazil or South Korea – presents a higher risk than investing in UK equities.

Property
There are several ways to invest in bricks and mortar, whether residential or commercial: investing directly by buying and managing properties yourself; buying shares in companies that own and manage property; or by investing in a dedicated property fund. You might also have exposure to property already – through your charity's premises.

Risk level: Investing in property is generally seen as higher risk than investing in cash and bonds as both property prices and rental demand can fluctuate significantly. And if you invest directly in property, selling your assets can take a long time, making this an asset class with a longer time horizon than some.

Alternatives
Alternative investments fall outside the conventional asset classes like equities and bonds. They include private equity, hedge funds and commodities. The complexity and higher cost of alternative investments typically puts them beyond the reach of individual investors and smaller organisations.

Risk level: Alternatives can provide some lucrative investment opportunities, but the higher potential rewards on offer typically come with some higher risks and/or costs relative to more conventional asset classes.

MAKE THE MANAGEMENT DECISION

There are several options for managing your charity's investments: an active management, passive management or multi-manager approach. And you can also choose whether to invest in single-asset or multi-asset funds.

There are two main styles of fund management: active and passive.

Active management approach
An active management approach is just that: managers do everything they can to outperform a certain benchmark, or index. Instead of investing in the same stocks that make up that index, they scrutinise every available piece of information (including company, industry and market developments) to pinpoint the stocks they believe have the greatest potential to generate a profit.

Actively managed funds are typically more volatile, so may be better suited to investors with a higher tolerance of risk. Conversely, these funds often have greater potential for profit than passively managed funds (funds that simply aim to track an index).

Passive management approach
A passive management approach is the polar opposite, aiming to match the returns of a specific benchmark, rather than outperforming it. Passively managed funds tend to be a lower-risk option than actively managed funds in the same asset class due to higher levels of diversification and lower costs. It's important to remember that because passively managed funds match the performance of the index – in good times and in bad – they can be hit hard when the market takes a tumble.

Choose the management style that's best aligned to your charity's goals and risk tolerance.

There are three main types of fund you can access:

Single-asset funds
Single-assets funds are focused on one type of asset alone – such as European equities, emerging market debt or smaller companies.

When you invest in a single-asset fund, you're essentially investing in the specialist expertise of the fund manager: with an in-depth knowledge of the market they cover, the fund manager should be well placed to select investments that they believe have a good chance of outperforming against an appropriate benchmark.

Putting together a well-diversified portfolio using single-asset funds alone typically takes hard work on your behalf. You'll also need to choose fund managers and monitor their performance.

Multi-manager funds
Multi-manager funds are a type of actively managed fund, where a fund manager invests in different underlying funds run by different individual fund managers. In a nutshell, multi-manager funds are your ready-made route to a diversified portfolio.

One big advantage of multi-manager funds is that they give experienced fund managers the power to manage their specialist asset class – instead of one manager running a whole portfolio. This cuts down your exposure to manager risk, and means that your investments can benefit from industry insights that aren't always accessible to individual investors. However, because of the extra layers of management that come as part of the package, multi-manager funds often have higher charges.

Multi-asset funds
Multi-asset funds enable the manager to invest across several different asset classes to create a diversified portfolio that spreads risk and keeps the impact of market dips to a minimum. The fund manager builds your portfolio from a combination of different asset classes with the aim of achieving the fund's specific investment goals. This cuts down the decision-making from your side, but you're putting your trust in the accuracy of your fund manager's view on the market – and their ability to reflect that view in their investment strategy.

GO IT ALONE, OR GET HELP?

You'll need to decide if you want to choose and manage your investments by yourself, or with the help of a discretionary management service.

Self-managed portfolio
If you're happy with a hands-on approach, you can pick and choose your own investments to create a self-managed portfolio. Investing directly in equities on the stock market is one way to do this. But most investors choose the easier, cheaper option of investing through funds, where their money is pooled with other investors' money for cost-effective exposure to a broader range of assets.

On the other hand, if you put together your own investment portfolio, you'll typically invest in a mix of funds that focus on the types of investment you think will do well. These funds will invest in a particular market sector or asset, such as UK equities or global equities, with the underlying assets chosen by a fund manager. If you go down the multi-asset fund route, you might want to spread your investments across more than one multi-asset fund to reduce manager risk (see page 8).

Discretionary management services
If you prefer not to manage your charity's investments by yourself, you can set your goals and risk tolerance – and use a discretionary manager to invest on your behalf. Your portfolio will usually be invested across different funds and assets.

Using a discretionary management service should make it easy to see exactly where your money is invested. You also have the security of knowing that an expert is taking care of the day-to-day management of your portfolio.

You can manage your investments yourself or appoint a discretionary manager to handle the hard work for you.

GET INFORMED – AND STAY INFORMED

Investing is just the start of the story. Whichever route you take, it's sensible to monitor your charity's investments regularly to make sure they're still helping you to achieve your investment goals.

Once you've made your initial investment, you should monitor your funds regularly to stay up to speed with any big management changes that could affect the way your money is managed. Many investors find that investing through an online account is the easiest way to keep tabs on their portfolio.

If you invest in funds, it's important to base the investment decisions you make on timely, accurate information. That's why you need to check the performance of both the fund and its manager against relevant benchmarks. You also need to review the amount of risk that the fund is taking to achieve its objectives.

One of the most effective ways to keep track of what's going on with your funds is to check the fund/manager ratings and historical performance data produced by one of the dedicated research agencies.

Funds with a higher risk rating are typically more volatile and can suffer sudden shifts in value. This means that looking at funds over the longer term can give you a more accurate picture of performance. However, it's always worth remembering that a fund that has performed strongly in the past is never guaranteed to do so in the future.

Keep a close eye on your portfolio, monitoring for changes at fund manager and performance level.

CONTACT US

To find out more call our Charities team on 03000 123 444.

Different investments suit different investors, so it's important to get objective advice from an independent financial adviser.

To find one in your area, visit www.unbiased.co.uk

The value of investments may fall as well as rise. You may not get back the full amount that you originally invested. Past performance is not a guide to future performance. There is no guarantee about the level of capital gains or income that will be generated.

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Telephone calls may be monitored or recorded for security/training purposes. Lines are open Monday to Friday 9am – 5pm (excluding bank holidays).

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