We understand that everyone has different goals when it comes to their savings. When building your investment portfolio it’s important to understand asset classes. In this guide we’ll help you to do exactly that, as well as understand which asset classes could be appropriate for you.
INTRODUCTION.

Whether you’re investing as a one off or on a regular basis, it’s important to understand the differences between the main types of asset classes. This will help you to know what to expect when you’re investing, putting you in control of your portfolio.

ASSET CLASSES – YOUR INVESTMENT STRATEGY.

An asset class is a grouping or broad band of similar investments whose prices tend to move together. They can be defined on a very general level, such as company stocks or shares or on a more specific level, such as American silver producing companies.

The concept of asset classes is important to understand as one of the common goals when building an investment portfolio is to have a diversified portfolio made up of funds invested in different asset classes. This diversification will lower your overall exposure to risk as asset classes will tend to perform differently to each other in different market conditions. It is important to know what type of asset classes you are currently invested in or intend to invest in to see if your asset allocation (the amount invested in each asset class within your portfolio) is appropriate for your financial goals.

THE FOUR MAIN ASSET CLASSES ARE:

- **Company shares, also known as equities:**
  Shares buy you a small part of a company. This gives you a potential share of any profits the company makes, and might occur by a single or regular payment from the company, known as a dividend, or by the share price rising. Investing in shares is considered by many investment experts to be one of the best ways to achieve long-term growth.

  Shares can be broken down by:
  - Size – large companies to small companies.
  - Industry – such as health care, energy or technology.
  - Country – such as American companies or European companies.
  - Type – Value (shares that appear undervalued by the market based on common ways of assessing share prices) or Growth (shares with high growth potential).

  It’s important to note that over the short term, the value of funds investing in shares can go up and down a lot.

  Company share prices and dividend payments can also change dramatically in response to the activities and financial performance of individual companies, as well as being influenced by general market and economic conditions.
Fixed interest securities:
These are also referred to as bonds and are issued by a government or company wanting to borrow money. Fixed interest securities pay a fixed rate of interest, called the ‘coupon’, and promise to pay back the amount borrowed at the end of the stated loan period. Investors don’t have to keep bonds until the end of the loan period and very often buy and sell them to or from other investors.

The value of fixed interest securities is particularly sensitive to changes in interest rates. As a rule, the value is more likely to fall when interest rates are rising. This is because bonds, paying fixed coupons, become less attractive when interest rates go up and so investors will pay less for them. When interest rates fall bonds become more attractive and investors will pay more for them.

Your return from a fund investing in fixed interest securities comes from the interest the company or government pays and any change in the market value of the fixed interest securities.

Fluctuations in the price of fixed interest securities tend to be smaller than those of shares. They tend to deliver a more regular and reliable income than shares, although the potential returns are often lower.

Cash:
Some funds keep a proportion of your money in cash, an important asset in its own right. It can provide a stable low risk investment, but might not offer the same potential returns as other investments. Money is placed on deposit with banks and other financial institutions. Although any of these may suffer financial difficulty and be unable to pay interest or return the amount invested, cash is considered to be the safest asset class.

Property:
An investment in a property fund usually focuses on commercial property, meaning that you’re buying a share in the ownership of a number of buildings.

These buildings might be office blocks, shopping units, retail warehouses, industrial units and leisure centres.

Commercial property investments can provide growth in two ways:
– Through rises in the value of the property.
– Through rent paid by the tenants of the buildings.

Property prices tend to go up and down over longer time periods than many other asset classes and rental income will be impacted if tenants leave. These investments are considered to be longer-term and are not low risk.

ONE FURTHER ASSET CLASS IS OFTEN CONSIDERED

• Alternative Investments: These include commodities (such as oil, gold and grain) and derivatives. Derivatives usually give a commitment or right to buy or sell assets on specified conditions, for example on a set date in the future and at a set price.

Each of these general asset classes can be broken down to more specific asset classes.
MANAGING YOUR PORTFOLIO OF ASSETS TO MAXIMUM EFFECT.

The first principle of most investment portfolio management is asset allocation. Asset allocation means the proportion of your portfolio that you put into each asset class.

MANAGING RISK

One of the most important aspects of risk is the amount by which your returns are likely to move up and down, called capital risk. Different asset classes have different levels of risk. For example, cash (investing in things like savings accounts) has low capital risk.

In an ideal world, you’d get high returns from your savings and investments with no risk! Sadly, in the real world, there is a trade-off – to get higher returns, you have to accept higher risk.

The younger you are, the more risk you may be able to afford to take. This is because you have many years of working life ahead with opportunities to increase your savings and investments. When you are older, you have less opportunity to make good any losses on your investments, so you may want to move towards a lower risk portfolio.

Ranked in order of increasing capital risk over five or more years, the traditional asset classes generally, but not always, come out like this: cash (lowest risk), fixed interest securities, property, shares, alternative investments (highest risk). If you want a low-risk portfolio, you would aim to hold a high proportion of your investments as cash and fixed interest securities. A higher risk portfolio will have a relatively high proportion in shares.

DIVERSIFYING

If you own investments that all go up or down in price at the same time, then you are likely to experience larger increases and decreases in your portfolio (known as volatility). Ideally most investors want the highest return or profit with the least amount of volatility. Owning a variety of asset classes (diversification) is often the preferred method of investing.

Each asset class reacts differently to different points in the economic cycle. Shares typically do well when corporate earnings are strong and the markets are going up. Yet, under these conditions, the bond market is likely to do worse. On the other hand, when interest rates fall, the bond market is prone to do well. Although a well-balanced portfolio may help spread the risk during market fluctuations, it does not ensure you a profit or protect against loss in a down market.
HOW MUCH TO HAVE IN EACH ASSET CLASS

Owning a portfolio that consists of investments in a variety of asset classes can help reduce your overall exposure to risk. If you are not confident choosing your asset allocation or which funds to invest into then you should speak to a financial adviser.

HOW TO INVEST IN AN ASSET CLASS

Whenever you choose a particular savings account or specific shares you are building up your asset allocation. For example, if you have all your money in bank and building society accounts, you automatically have a 100% cash allocation. So, one way to invest in asset classes is to be mindful of the type and amount of particular savings and investments you choose.

A popular way of accessing funds that invest into different asset classes is through pooled investment funds such as Unit Trusts and Open Ended Investment Companies (OEICs). You can also hold them in an ISA.

AUTOMATIC ASSET ALLOCATION

With some investments you can leave the asset allocation decision to experts. For example, some investment funds, typically called ‘mixed investment’, aim to hold a specified proportion of the fund in shares. A ‘mixed investment 0-35% shares’ fund would be a relatively cautious portfolio holding no more than 35% of its investments as shares, while a ‘mixed investment 40-85% shares’ fund would be much more aggressive with up to 85% of the portfolio in shares.

Another example of automatic asset allocation is where you invest in a pension. If you do not say how you want your contributions invested, they will usually automatically go into a default fund. Generally this will be some sort of ‘lifestyle’ fund, where the proportion invested in shares will be high if you are young and will automatically shift to the safer asset classes of cash and fixed-interest as your retirement date approaches.

SLEEP AT NIGHT FACTOR

It can be difficult to watch your portfolio value move up and down significantly every time the markets move, especially if you have a clear idea of what you would like to use the money you’ve invested for at the end of your chosen investment period. Over longer periods, a diversified portfolio including multiple asset types may provide the best return for the risk that you’re willing to take. In addition, lowering the amount of risk in your portfolio by increasing the number of investments you have in what are generally considered to be safer asset classes may help you sleep better at night.

As with all investment principles, it is important to regularly review your investments and personal circumstances to make sure where your money is invested is still appropriate.

FURTHER INFORMATION

If you have any questions about the information in this brochure or anything relating to planning for your financial future, you should speak to a financial adviser.