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INVESTOR GUIDE
INVESTING FOR INCOME

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PLEASE READ THIS IMPORTANT INFORMATION.

This guide explains some of the options that may be available to you and the reasons why you may wish to invest for income. It includes sections on checking whether you are ready to invest, how to invest, plus detail on the income-producing assets available.

Past performance is not a guide to future returns. The value of investments, and the income from them, can go down as well as up and you may not get back what you put in.

Columbia Threadneedle Investments is unable to provide financial advice and you should not interpret anything in this guide as advice. If you are unsure about anything you should speak to a financial adviser. For details of one in your area please go to www.unbiased.co.uk - please note we do not endorse this website or the advisers found on it.

The material in this brochure is for information purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

To help your understanding of specific terms, we have also included a glossary of terms on page 11.

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WHAT DO WE MEAN BY INVESTING FOR INCOME?

People often invest their money because they have a specific target in mind, whether that be a long-term goal they need to save for – such as a child's future university fees – or ongoing requirements such as generating a regular income from their investments.

Investing for income is when people invest in the hope their investment will generate regular cash, usually either a monthly or annual sum. Equities and funds can be a good option for this type of investor because some of them produce income in the form of a regular dividend (a payment made to shareholders from part of a company's profits) or return from the fund.

Even when people do not need an immediate income, they may still wish to invest in income-producing assets as they do not need to take the income and can request for this to be reinvested. This strategy grows the initial investment and aims to boost the returns they generate in the future. This can also have the benefit of smoothing returns due to the reinvested income ironing out the peaks and troughs of market movements.

However, the choice of assets that are capable of generating an income is huge and every potential investor needs to analyse their own attitude to risk and how comfortable they are with investments, before taking the plunge.

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WHY CONSIDER INVESTING FOR INCOME?

Everyone needs an income. During their working lives, most people obtain an income from their salary, but sometimes individuals and families need to supplement this income with extra work or from their savings; to pay for luxuries or even to help with the basic costs of everyday living.

As we get older and enter retirement, we usually need to generate an income to replace our salary – either through a pension, savings or other types of investment.

In retirement, generating an income is crucial for those with an outstanding mortgage or rent to pay, while all of us will need some kind of income to pay bills, pay for hobbies, travel and all the other essentials of everyday life.

The questions everyone needs to ask are: how much income do I need? And: what savings or investment products might help me achieve that level of income? Only then will you be able to ask yourself whether you can afford to take on the risk involved with income-producing assets and investments.

How seriously you approach tackling your income needs will also depend on what you need the income for: whether that's as a supplement to your salary, to boost your pension or merely for holidays and treats.

INCOME IN RETIREMENT

In the March 2014 Budget the Chancellor unveiled changes to the way people can access their retirement income. When people with a defined contribution pension enter retirement, they need to decide what to do with the money they have built up during their working life. Prior to this announcement, many were required to purchase an annuity policy by the time they reached 75, paying them an annual income for the remainder of their life.

The new annuity rules now provide people with access to savings in a more flexible way providing retirees with more options with what to do with their pension pot. It will no longer be a requirement for people to automatically take out an annuity policy. The changes also mean that the drawdown limit minimum thresholds have been altered. It may still be that an annuity is the best option, but the new legislation provides people with more choice.

ANALYSING YOUR ATTITUDE TO RISK

Whatever your background and whatever your circumstances, understanding risk is crucial when trying to generate a set amount of income without placing your finances under unnecessary threat. Generally, the more risk you are prepared to take with your money, the better return you can potentially generate. You do, however, also have to be prepared for any potential fall in value.

Paying money into investments that can rise and fall in value is always going to be daunting – particularly if you are relying on your investment to provide an income.

It is for this reason that it is generally recommended you do not invest in the stock market unless you are entirely comfortable with the inherent risks, or can afford to tie your money up for a reasonable length of time.

That said, with the right guidance from your financial adviser and research it is possible to choose investments that have the ability to provide a steady consistent income, without you losing sleep.

Before you choose any savings or investment plan you need to know what you're trying to achieve with your money, as the exact nature of your financial goals will determine your strategy.

For longer-term savings goals (for example, your retirement or your child's university fees) where you have a decade or more before you need the money, you are much more likely to achieve your goal with a well-planned investment strategy.

With time on your side there are steps you can take to reduce risk, particularly in the final years before you need the money as your focus shifts from capital growth to capital protection.

In order to achieve your financial goals you can build a balanced portfolio incorporating a variety of different investment types (including cash and funds that invest in everything from corporate bonds to FTSE 100 companies, smaller companies and companies based in numerous countries across the world) or you can simply pick one fund that is in itself a balanced portfolio and offers you access to a broad spread of investments through one single plan.

However, if you are seeking income from your investment straight away, you may need to ensure your investments immediately generate the sum you need, so it's worth factoring this in to any decision-making. It may well be that your decision does not involve whether or not you should invest in the stock market, but which particular stock market investment will help you generate the income you need.

Like any type of investor, an income investor will still want to reduce risk, sensibly constructing a portfolio that is spread among a number of different investment types (also known as assets). Asset allocation – the practice of dividing your investment portfolio among different assets such as cash, equities, bonds, property and commodities – is a key to reducing risk, even for income investors.

After all, just because you are investing for income, doesn't mean you want the capital value of your investment to fall, so income investors should also be concerned with preserving the capital value of their investments.

THE BENEFITS OF REINVESTING INCOME

While many people investing for income will bank any dividend income generated by their investments, you don't have to take out the income.

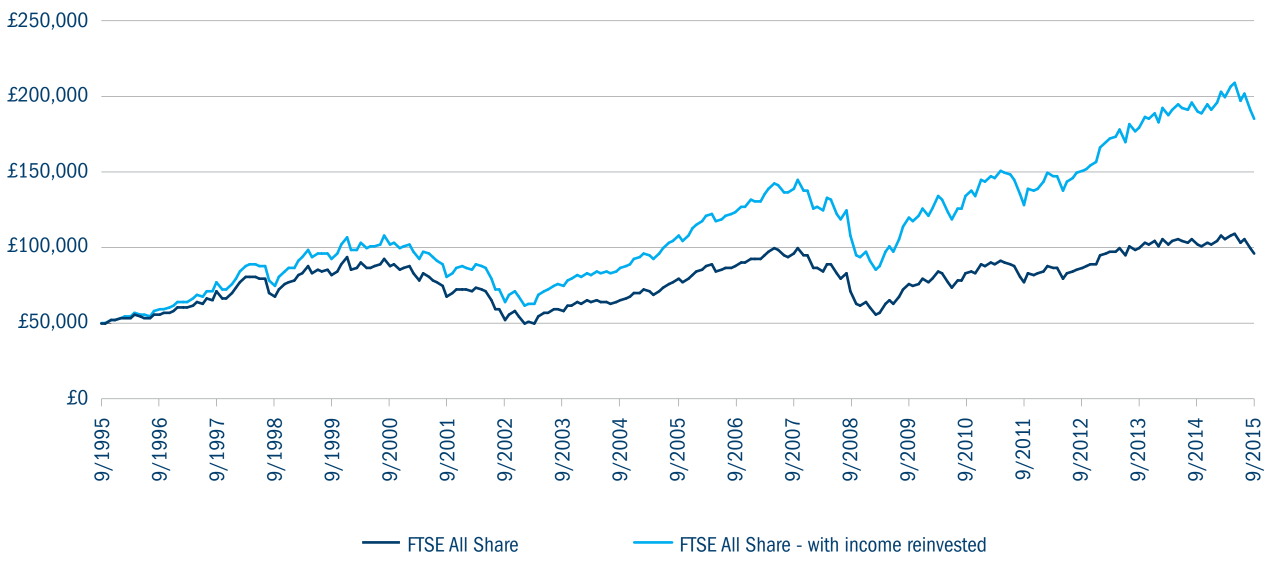
Instead, it is possible to generate even more money over the long term by reinvesting dividends into your chosen fund.

For example, if you have a £50,000 investment with a yield of 5%, you would generate £2,500 in income a year. If you took this income and the yield remained the same, in year two you would bank another £2,500 from your £50,000 capital. However, if you reinvested the original £2,500 into the fund, in year two you would earn £2,625 in income. In year three this would rise to £2,756 and so on.

Clearly, the more you reinvest and the longer you continue to reinvest for, the greater chance you have of enhancing your long-term returns, although this is, of course, not guaranteed.

The chart below illustrates the benefits of reinvested dividends on a lump sum investment of £50,000 invested over 20 years, demonstrating that income has accounted for a significant proportion of total returns from UK equities over the long term trying to achieve with your money, as the exact nature of your financial goals will determine your strategy.

The value of £50,000 invested over 20 years



Source: Thomson Datastream and Columbia Threadneedle Investments as at 30.09.2015 UK shares represented by FTSE All Share Index, capital return only. UK shares with dividend income reinvested represented by FTSE All Share Index, with dividends reinvested. For illustration purposes only.

03
ARE YOU READY TO INVEST?

If you are not prepared to take any risk with your money, you can deposit your cash in a typical high street bank or building society savings account.

Cash savings accounts are considered relatively risk-free – the bank would have to go bust before your cash was at threat, and even then savers are protected to the tune of £85,000, per authorised firm, by the Financial Services Compensation Scheme.

Investors can save £15,240 in cash, stocks and shares or a combination of the two in an ISA in the 2015/2016 tax year. A cash ISA shelters your money from income and capital gains tax, so for low risk investors it can be an attractive option.

However, before you rule out stocks and shares, it pays to consider that ploughing all your money into cash is not necessarily a risk-free strategy. Be aware there is a very real risk that your savings will be eroded by inflation.

In the last 10 years alone the costs of goods and services has risen by almost 37.6%, according to the Office of National Statistics. This means that to achieve the buying power of £1,000 in 2004 you will now need £1,376 and, for £1,000 saved over that time period, you will have needed to have achieved an average savings rate of 3.4% a year for it to have kept pace with rising costs. If not, you will have effectively lost money.

04 TYPES OF INCOME PRODUCING INVESTMENTS

Investors can choose to invest in anything from savings accounts and property, to the stock market and fine wine. Only by learning about each can you make an informed decision as to which investment type you feel most comfortable investing in. In this section we look at types of income producing asset classes and look at their income potential.

BONDS

DEFINITION

Bonds are loans to companies, local authorities or the government. So you lend your money to a company or government and you are paid interest in return. They usually pay a fixed rate of interest each year (known as the coupon) and aim to pay back the capital at the end of a stated period (known as the maturity date). This is why bonds are sometimes referred to as fixed interest.Clearly, the more you reinvest and the longer you continue to reinvest for, the greater chance you have of enhancing your long-term returns, although this is, of course, not guaranteed.

The chart below illustrates the benefits of reinvested dividends on a lump sum investment of £50,000 invested over 20 years, demonstrating that income has accounted for a significant proportion of total returns from UK equities over the long term trying to achieve with your money, as the exact nature of your financial goals will determine your strategy.

MAIN CHARACTERISTICS

Corporate bonds are issued by companies such as Tesco and BT Group as a way of raising money to invest in their business. Government bonds are issued by a government – in the UK these are known as gilts. Once a bond has been issued, it can be traded on a stock exchange, where the price will rise or fall based on supply and demand; while it can also be influenced by the wider interest rate trend.

RISKS

You will usually receive less interest from institutions that are more creditworthy and more interest from those less creditworthy, reflecting the higher risk that they might not pay you back. The amount of interest a bond or gilt pays is fixed, which means that if interest rates fall they become more attractive; though if interest rates rise they become less attractive.

To help you form a judgement about a company's prospects, specialist credit agencies such as Standard & Poor's look at each one and award a rating based on their assessment of its ability to pay back the sum borrowed. The most trusted are given a triple A (written as AAA) ranking, then it goes down on a sliding scale through AA, A and BBB.

Anything rated BBB or above is classed as investment grade; bonds with a rating below BBB are known as high yield or non-investment grade bonds. Typically, however, private investors access bond markets through a bond fund, rather than individual bond holdings.

INCOME POTENTIAL

These investments can provide a strong degree of capital security and pay a steady income to investors, usually above inflation. The advantage of investing in bonds is that they tend to have higher yields and be less volatile than equities, but growth prospects are limited.

It's also possible to obtain a high level of income if you invest in more risky high yield bonds or even some overseas fixed-interest holdings.

EQUITIES

DEFINITION

An equity, also known as a share, gives investors a stake in a company. If the company does well the value of the shares may rise and you may be able to sell them at a profit. However, they may also fall, making them a high-risk asset. Shareholders are also entitled to share in any profits made by a company, which are usually distributed in the form of a dividend payment.

MAIN CHARACTERISTICS

Investors can make a return when the price of a share goes up (though some sophisticated investors can actually bet on a share price falling) and can also generate an income if the company distributes a share of its profits through payments called 'dividends'. Not all companies that make a profit pay dividends, however – they may choose, for example, to reinvest that profit in the business.

Equities can be bought and sold on stock exchanges around the world – in the UK alone there is a vast array of shares to choose from. You can also buy equities listed on stock exchanges around the world, from the more developed markets of the US, Europe and Japan to developing markets such as Brazil, Russia, India and China.

RISKS

A company's share price can be affected by a huge number of factors, from the number of products a company sells to issues that affect whole national economies – making equities a risky investment. If the company doesn't

do well, you may not get any dividends and the value of the shares could fall or, in some cases, cease to have any value at all. If the company went bankrupt all shares are likely to be worthless. As there is a chance you might not get your money back, equities are considered higher-risk investments. However, they also have the potential to make a generous return, making them a popular choice of asset for most investors looking to invest for the long term, whether directly or via a collective investment fund.

INCOME POTENTIAL

High, if you invest in stocks that are more likely to pay dividends (or collective funds that do) you can generate an inflation-busting return. Moreover, in any period where you do not need to take an income, you can reinvest your dividends, further boosting returns. So the ability to generate rising dividends is a key factor in the appeal of equities from an income investor's point of view. A profitable business should be able to grow its dividends over time, providing income investors with a degree of inflation-proofing that conventional bonds cannot match.

To help you work out whether an equity is well-placed to deliver income you should look to the yield on the shares. The yield is merely the income return on an investment, expressed as an annual percentage of the cost. So if you invested £100 in a stock market-listed company with a yield of 4%, you might expect to earn £4 in dividends by the end of the year.

PROPERTY

DEFINITION

Investors can invest in the buy-to-let market or commercial property – shops, offices and industrial warehouses, usually accessed via a collective fund of some type rather than directly. Investors benefit from rental income and the price of the property itself should it rise in value.

MAIN CHARACTERISTICS

Commercial property is very different from residential property (i.e., the houses we buy, sell and live in) and does not always rise and fall in line with residential property market movements.

RISKS

The value of the property itself could fall in value, while buildings might remain empty, meaning there will be no tenants to pay rent. Moreover, commercial property is not a 'liquid' investment, meaning it can be difficult to buy and sell property quickly and easily. But many investors like to include some property in their portfolio because it helps them to diversify: for example, investors might still receive rental income even if equity dividends fall and vice versa.

INCOME POTENTIAL

Reasonable. If you invest in funds or stocks that have exposure to property and pay income, you could benefit from the rental income that those investments produce.

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HOW TO INVEST FOR INCOME

Instead of buying assets – such as equities or bonds – directly, many investors pool their cash with others by investing in a collective investment fund. They invest across a wide range of companies, sectors, countries, and, often, other funds.

Collective funds allow investors to diversify their assets at the same time as accessing the experience of a professional fund manager. Investors can invest lump sums of as little as £1,000 or set-up regular savings plans from as little as £50 a month. Please note that these sums may vary between groups – always check before investing.

Collective funds are sometimes grouped into geographical areas such as the UK, Europe, the US or Far East, and can be further categorised by their investment strategy such as Growth or Income. There are thousands of funds split into many different sectors.

The most common type of collective investment is a collective investment scheme such as a unit trust, open ended investment company (OEIC) or investment company. These all work in a similar way, in that they invest in assets and spread risk. Investment trusts are considered slightly higher risk than unit trusts and OEICs.

For income investors, however, investment trusts do have one exciting perk – they can retain up to 15% of the income they receive each year and put it into their reserves to pay out in more difficult years when companies may struggle to maintain dividend payments. This process is known as “dividend smoothing”, and can mean a more consistent income for trust investors.

Further information about Collective Investments and exactly how they work can be found in the Threadneedle Guide to investing or at www.threadneedle.com.

It is important to note that with Collective Funds fees may either be charged to the capital or the income of the fund. This will have an impact on the value of the income paid out. You should contact a financial adviser for further information.

INVESTING IN A BALANCED PORTFOLIO

Funds can invest in equities, bonds, property or commodities. With all these different potential sources of income on offer, and each route carrying its own risks and benefits, investors need to consider their options carefully.

Any decision must be based on an individual’s income and total return requirements as well as their attitude to risk.

If you don’t have a large sum to invest and don’t have an aggressive attitude to risk you might like a one-stop shop fund which provides an instant balanced portfolio with investments in cash, bonds and equities.

These funds come with a range of risk profiles. At the lower risk end of the spectrum are funds in the Mixed Investment 0-35% Shares sector, which cap investment in stocks and shares at 35%. Then for balanced or medium risk investors there is the Mixed Investment 20-60% Shares sector where between 20% and 60% of the fund is invested in shares. Mixed Investment 40-85% Shares is for investors who want their money to be invested across the asset classes but want to maximise returns with greater exposure to equities. Fund managers can change how much they have invested in the different asset classes as economic conditions change, so long as they stay within the sector's agreed parameters.

Alternatively, if you want to be fully invested but have money spread across the world you can go for a global fund – with investments in developed and developing economies.

Another way of increasing diversification is to use multi-manager funds – where rather than buying shares of individual companies, they buy stakes in other funds. However because they invest in lots of funds, charges are higher than the typical unit trust, and this can eat into your returns.

If you plan to build your own balanced portfolio of funds you'll have to think a bit more carefully about where to invest. UK is the obvious entry point for most investors, but there is still a huge variety of funds to choose from.

Funds that specialise in the emerging markets and specialist industries such as healthcare and pharmaceuticals are popular and have rewarded investors well over the years but they are at the upper end of the risk spectrum. This means such funds should only be considered by investors who can afford to take a sizeable risk, likewise they should only make up a small portion of your overall portfolio.

Within corporate bonds there are few sectors to choose from – you can go for corporate bond funds (which must be 80% invested in lower risk investment grade corporate bonds) or high yield bond funds (which must be 50% invested in riskier higher yielding bonds). Strategic bond funds have more flexibility to decide which types of bonds they buy – meaning they are better able to adapt to changing economic circumstances – while global corporate bond funds must have 80% of their assets invested overseas.

Your financial adviser will be able to help you clarify your own situation and recommend an appropriate investment strategy. If you do not have a financial adviser, please visit www.unbiased.co.uk for details of one in your area.

06 GLOSSARY

ANNUITY – a type of insurance policy that provides a regular income in exchange for a lump sum.

ASSET CLASS – a generic type of investment, such as equities, bonds or cash.

ASSET ALLOCATION – the practice of dividing your investment portfolio among different assets such as cash, equities, bonds, property and commodities.

BALANCED PORTFOLIO – an investment portfolio that seeks to have a balance of risk and return by combining equity and fixed income assets.

BONDS – bonds are debt issued by governments or companies to raise money. Bonds promise a set amount of interest until the bond matures at a fixed date in the future.

CAPITAL – the total assets of a person or organisation minus their total liabilities.

CAPITAL GROWTH – an investment return generated by changes in the price of a share.

CLOSED-ENDED FUNDS – a company that invests in other companies or assets. With a closed-ended fund, such as an investment trust, there are a set number of shares and this number does not change regardless of the number of investors.

COLLECTIVE INVESTMENT FUND – a fund that combines the assets of various individuals and organisations to create a large, well-diversified portfolio.

CORPORATE BOND – a debt security issued by a corporation and sold to investors. The backing for the bond is usually the payment ability of the company, which is typically money to be earned from future operations.

COUPON – the agreed level of income paid by a bond.

CREDIT RATING – the independent rating given to an issuer's bonds. They run from the highest rating AAA through to the lowest D. The higher the rating, the lower the risk of default – i.e. an investor not getting their original investment back.

DIVERSIFICATION – spreading investments across different assets in order to reduce risk.

DIVIDEND – a payment made to shareholders from part of a company's profits.

DIVIDEND YIELD – valuation measure defined as the dividend divided by the share price.

EQUITIES – ownership of a company in the form of a stock, traded on stock exchanges.

FINANCIAL SERVICES COMPENSATION SCHEME (FSCS) – the UK's statutory compensation scheme for customers of authorised financial services firms.

GOVERNMENT BOND – a debt security issued by a government to support government spending, most often issued in the country's domestic currency. Government debt is money owed by any level of government and is backed by the full faith of the government.

HIGH YIELD – the bonds issued by less secure companies.

INFLATION – the rate at which the general level of prices for goods and services is rising.

INVESTMENT GRADE – the bonds issued by relatively well-financed companies.

INVESTMENT TRUST – a closed-ended company (see closed-ended funds).

MANAGED FUND – a portfolio made up of several underlying funds that invest in various asset classes. Also known as fund of funds.

INDIVIDUAL SAVINGS ACCOUNT (ISA) – a tax-efficient way to save/invest. An annual investment allowance is set with limits on the cash and investments elements.

OEIC (OPEN-ENDED INVESTMENT COMPANY) – a type of open-ended fund, with a single price.

PROPERTY – in an investment sense, this normally means commercial real estate such as offices, retail units or distribution warehouses.

REVENUE – proceeds of a company's sales.

SECTOR – way of grouping companies according to the industry that they operate in.

TOTAL RETURN – the return on an investment, including income from dividends and interest, as well as appreciation or depreciation in the price of the asset, over a given time period, usually a year.

UNIT TRUST – a type of open-ended fund, with a single price.

VALUATION – way of assessing the cheapness of company shares. Examples include price to earnings ratio and dividend yield.

VOLATILITY – the extent to which the value of an investment fluctuates over time.

YIELD – the income return on an investment.

NOTES

To find out more visit
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* Please note we record calls for your protection and to improve our standards

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