

Guide to Investment Trusts

Investment trusts are collective investment funds structured as companies quoted on the stock exchange. Investment trusts invest mainly in shares, aiming to generate returns through capital growth or income or a mix of the two.

A professional fund manager is employed to invest the funds in the shares of a wider range of companies than most people could practically invest in themselves. There are more than 300 investment trusts responsible for the management of billions of pounds' worth of assets on behalf of investors.

As a quoted company, an investment trust is a 'closed ended' fund with a fixed number of shares in issue. Conventional investment trusts issue only one class of ordinary share. These usually give shareholders a right to dividend distributions and offer the opportunity of capital growth to increase the value of their investment.

Income or Growth?

Some investment trusts are structured to offer high income while others focus on growth or a mix of growth and income. Some specialise in certain countries or regions. Others target specific industry sectors.

Each investment trust sets out its investment policy when it is launched and this will be reiterated each year in its annual report. A trust can ask shareholders to agree a change in investment policy. Some specify a date on which they will be wound up and the proceeds from the sale of investments returned to shareholders. Others hold a vote at regular intervals to decide if the trust should wind up or carry on.

All investment trusts invest in other companies. What varies between different investment trusts is what those other companies are, where they are based and what they do. When you are deciding which investment trust to invest in, the first thing you need to do is consider your investment objectives and the investment objectives of the investment trust company - what and where it is invested in and whether their aims are the same as your aims.

Sectors

There is a wide range of investment trusts with exposure to different industries and regions of the world. Their objectives also vary. Investment trusts are grouped by the Association of Investment Companies (AIC) into 36 different sectors:



- Country Specialists: Europe
- Country Specialists: Asia Pacific
- Europe
- European Emerging Markets
- European Smaller Companies
- Asia Pacific excluding Japan
- Asia Pacific including Japan
- Global Emerging Markets
- Global Growth
- Global Growth & Income
- Global High Income
- Global Smaller Companies
- Hedge Funds
- Japan
- Japanese Smaller Companies
- Latin America
- North America
- North American Smaller Companies
- Overseas Growth
- Private Equity
- UK Growth
- UK Growth & Income
- UK High Income
- UK Smaller Companies

Sector Specialists:

- Biotechnology / Life Sciences
- Endowment Policies
- Environmental
- Financials

- Liquidity Funds
- Commodities & Natural Resources
- Property
- Debt
- Smaller Companies Media Communications & IT
- Technology, Media & Telecommunications
- Venture Capital Trusts
- Zero Dividend

Investing

Will you be investing a lump sum or on a regular savings basis? One of the advantages of regular saving is pound-cost averaging: you avoid the risk of buying all the shares in one go when the price may be high and your average purchase price may actually work out to be lower than the average price over the period in which you buy your shares (it's a mathematical quirk resulting from the fact that you buy proportionately more shares when the price is lower).

Next, think about risk and how well a particular trust would fit in with your existing investment portfolio. Broadly speaking, the level of risk you are prepared to accept will depend on how long a view you are prepared to take.

However, there's more to risk than that with investment trusts. Although they have a finite number of shares and thus a finite amount of money to invest, trusts are allowed to borrow to buy more assets (this is known as gearing). The profit they make on these extra assets is intended to cover the interest on the loan, and leave an additional profit for investors. But, the more an investment trust borrows, the more risky it is. What if the extra assets perform badly?

One measure you will see discussed many times in relation to investment trusts is volatility. The aim of this is to provide a yardstick of the historic performance of the trust's shares and offer a method of assessing the uncertainty around the future expectations for your investment, i.e. how risky is it?

Deciding to invest

Never buy an investment trust purely on the basis of past performance. However, that doesn't mean you should ignore it either. Some star performer fund managers have

a substantial following among investors. What happened in the past is no guarantee of success in the future but if a trust has performed consistently well, the chances are that it has a skilled manager or team whose investment strategy is working well.

Investment trust shares tend to trade at a discount. This means the share price of the investment trust company is lower than the value of the underlying assets held by the trust. The latter is expressed as the net asset value (NAV) per share. There can be a number of reasons why this is so.

The first is a simple structural point - in theory you could buy the same portfolio of shares yourself directly in the market without having to pay the trusts fees / management charges, so the discount first of all reflects this extra cost that you pay.

The other major factor affecting the size of the discount is the popularity or otherwise of the investment trust in question. Investment trust share prices are set by supply and demand and the relationship to the value of the underlying assets can be elastic. It is worth remembering that a discount can be useful to you. A 10% discount would allow you to purchase 100p worth of assets for 90p; meaning more assets working for you to provide dividend income and potential capital growth.

Tax

You may make your investment decisions without recourse to financial advice. However, you may find it useful to go to a professional independent financial adviser, who will give you advice on what to invest in either via direct shareholdings, or via a regular savings scheme. If you have invested in an investment trust via a stocks and shares ISA, you will not have to pay any further tax. Income from investments held within ISAs does not have to be declared on your tax return.

If you are investing in an investment trust outside an ISA and you receive a dividend distribution, you will receive a tax voucher from the fund manager showing both the amount that you are getting and the amount of tax on the distribution that has already been paid by the manager. Dividend distributions are paid net of 10% tax.

On the sale of investment trust shares there may also be a Capital Gains Tax liability. However, an investment trust

held within an ISA would be sheltered from any further tax liability.