The stock market: is it time to invest?

With turmoil in markets around the world, how should you decide where to save your money?

TAKING A LONG-TERM VIEW

Colin Loth *33, recruitment consultant*

Colin is a keen investor. He invests through a stocks and shares Isa (which protects his investments from tax) mixing lower- and higher-risk investment funds.

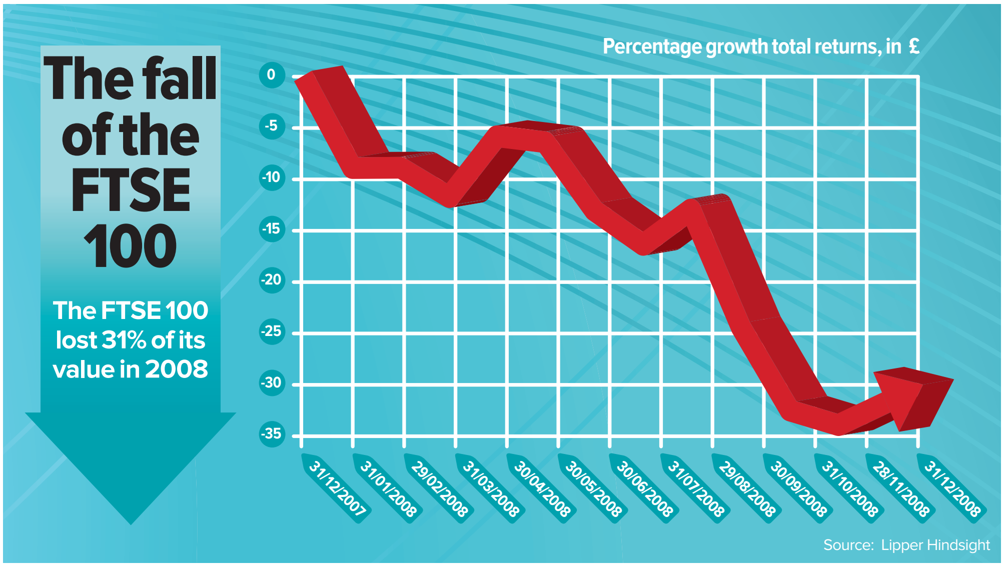
He said: 'I'm in this for the long-term so the current problems in the market don't worry me and I'll continue to invest.'

After making sure that he'd spread his risk Colin decided, with a friend, to invest £2,000 each in riskier investments.

'Our strategy was to go for short-term investment in risky and speculative shares. After nine months, our investment had grown to £6,500. But we started to lose money in the middle of last year and sold at £5,000. Unfortunately we made the fatal decision to re-invest in September and we're now down to just £2,000.'

They have considered selling but have instead decided to leave the money where it is to see what happens.

PHOTOGRAPHY DARREN FILKINS, ALAMY



You might wonder why we're writing a guide about investing in the stock market when last year saw the biggest drop in the FTSE 100's value since it began in 1984.

While a nose-diving stock market doesn't inspire confidence, remember that markets by their nature will go up and down. And savings rates are suffering, too. The average interest rate paid on a cash Isa, for example, fell from 5.29% to 2.1% in 2008.

The important thing is to choose the savings or investments that suit your goals and time of life. And the questions you need to ask yourself remain the same in times of boom or bust.

THE RIGHT CHOICE FOR YOU

Have I sorted out the basics?

Think about the following questions. If you answer 'no' to any of them, investing isn't for you at the moment.

- Are you free of debt (other than your mortgage)? Debt is expensive and is likely to cost you more than you could earn by investing your money.
- If you have dependents, do you have enough life insurance in place?
- Have you protected your income in case you become ill or injured?
- Have you built up an emergency fund? You need three to six months' salary in an accessible savings account such as an easy–access cash Isa.
- Do you have a lump sum or surplus cash to invest each month?

What am I saving for?

It's useful to brainstorm your goals and group them as short (fewer than five years), medium (five to 10 years) or long-term (10 years or more). In particular, prioritise saving for retirement through a pension.

- **Short-term goals**

For anything less than five years, stick to cash savings. A Best Buy cash Isa is perfect for this. See Money Monitor, p14.

Don't invest – if your investment falls you might not have time to recover your losses before you need the money.

- **Medium and long-term goals**

Investing is an option for medium-and-long-term goals. The alternative is to put your money in a savings account where it will be safe (providing you make sure it's within the limits covered by the Financial Services Compensation Scheme). However, the lower the risk you take with your money, the lower the return you can expect. And the danger is that over time your savings could be eroded by inflation especially if the interest is taxed, and your money doesn't grow fast enough to meet your goals.

Do I understand the risks?

With stock market investments your capital isn't safe – you may get back less than you originally invested.

If you can't afford to lose your capital or it would give you sleepless nights, then stock market investment isn't for you.

But if you're investing for long-term growth, you can afford to take some risk with your capital because if anything does go wrong there should be time to recover your losses.

Investing for the medium-term is riskier especially in the current climate. No one knows what the stock market will do but it could fall further and five to ten years might not be long enough for you to recover your losses.

Tax-free saving choices
www.which.co.uk/savingsandinvestments

MANAGING RISK

Taking some risk with your capital for long-term goals is a sound strategy, but you must control risk by diversifying.

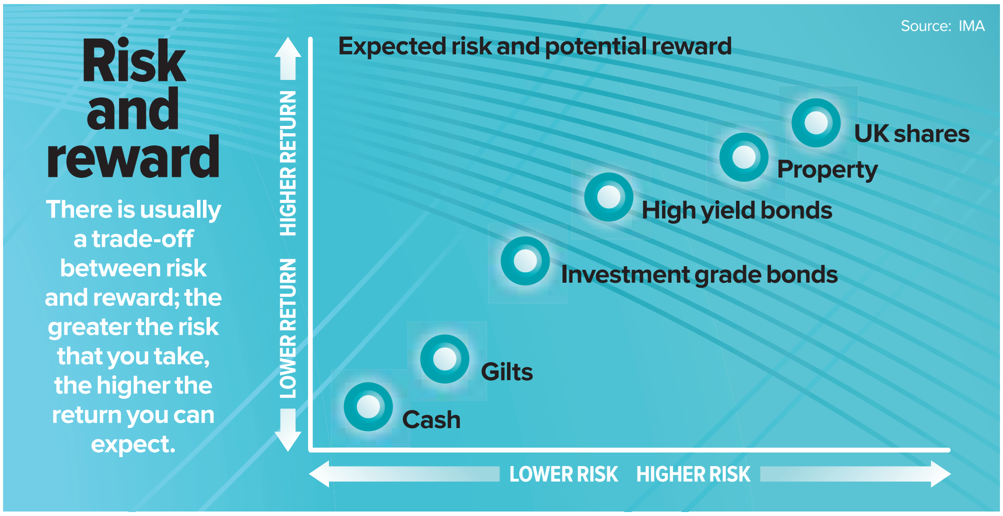
- Invest in one company and you could find that its share price plummets or it goes bust. It's better to have a spread of investments in a wide range of companies. The simplest way to do this is through a unit or investment trust or OEIC (open-ended investment company). These are collective investment funds, which combine money from many investors to buy shares in a large number of companies.
- Don't invest in one sector of the market or country. You can achieve a spread through a collective investment fund.
- Don't invest all your money in one go. Timing your investment right is almost impossible. You can avoid risk by investing regularly – you won't always be investing at the lowest point but you'll also avoid investing at the highest.
- Don't invest in just one 'asset class'.

AN ALTERNATIVE TO INVESTMENT

If stock market investment is not for you, you could pay extra towards your mortgage.

If the interest rate on your mortgage is higher than the net rate (the amount after tax) your savings earn, it makes sense to pay off more of your mortgage rather than keep the money in the savings account. Unlike stock market investment, you get a guaranteed return.

Always check with your lender first to make sure your mortgage allows you to pay extra without paying a penalty charge.



YOUR INVESTMENT CHOICES

There are four main asset classes. Cash is the least risky, shares the most risky, while property and fixed interest investments fall somewhere between.

Shares

You can invest in shares directly or through a unit trust, OEIC or investment trust (known as collective investment funds). You can buy a unit trust or OEIC through an IFA or directly from a fund manager or discount broker.

To buy an investment trust, you go through a stockbroker or what is called an execution-only dealing service. Charges tend to be lower than for unit trusts or OEICs, but they do vary.

For all but the most wealthy, investing directly is a bad idea – building your own portfolio of shares is expensive in terms of dealing charges if you're only investing modest amounts.

By using a collective investment fund you can invest in a large spread of companies and put in as little as £1,000 as a lump sum or £50 a month. There are a wide range of funds, some with capital growth and others with income as their main objective. Risk levels vary.

Property

You can invest by buying residential property and letting it out to earn rent. Depending on when you sell you may or may not achieve capital growth.

Alternatively, you can invest through a property investment fund. These invest directly or indirectly in commercial property like shopping centres, offices, factories or the shares of property firms.

Property, like shares, can be volatile, so treat it as a long-term investment.

Fixed-interest investments

Gilts and corporate bonds are the two main investments in this category.

With gilts you're essentially lending money to the UK government and with corporate bonds you're lending to a company. If all goes well, you receive interest (fixed at the start) and on a set date you get your capital back.

With corporate bonds there is a risk the company will fail to pay back your money or make the agreed interest payments (this risk is higher with so-called 'high yield bonds' which are issued by less secure companies than 'investment grade' bonds). Gilts are seen as less risky as the government is unlikely to default. You can sell gilts or bonds on the stock market but prices rise and fall so you may get less than you invested.

You can buy corporate bonds and gilts individually or through an investment fund. If you do the latter, be aware its value can go down as well as up. Treat it as a medium- to long-term investment.

Cash

Bank and building society savings accounts, cash Isas, guaranteed income and growth bonds and National Savings & Investments accounts are forms of 'cash.'

The only risk of loss is if your bank or building society collapses. To protect your savings make sure you invest no more than £50,000 (including any accrued interest) with each authorised provider to ensure your savings would be refunded through the Financial Services Compensation Scheme. For more see www.which.co.uk/protectyoursavings.

If you invest in cash through a money-market fund, check where your money is invested as your capital might not be completely protected. For more see p13, 'Cash fund confusion.'

PICKING YOUR PORTFOLIO

Choosing how much to invest in each asset class will depend on how much risk you want to take, how much time you've got to reach your goal and whether you want capital growth or income.

Unless you're very confident, consult an independent financial adviser who specialises in investments and who has higher qualifications than the minimum.

How can you get financial advice you can trust?

www.which.co.uk/financialadvisers

Review your portfolio once a year. You may, for example, move to more cautious investments as you near your goal.

WHAT IF MY INVESTMENTS HAVE FALLEN THROUGH THE FLOOR?

It depends on how much time you've got. If you're not saving for a particular reason and can sit tight, that's probably the best idea – providing you take a 10-year view at least. If you cash in the investment, you lose the chance to recoup losses. But if you're losing sleep over it, you may be happier if you get out. If you're within five years of needing the money, it's trickier because it's unlikely investments will recover in time. You may have to take advice or change plans.

Contacts

To find an independent financial adviser
Unbiased.co.uk www.unbiased.co.uk

Investing for the time of your life

The stage of life you have reached plays a major part in deciding where to place your money. We asked Mark Dampier, head of research at independent financial services provider, Hargreaves Lansdown, to suggest strategies for people of different ages

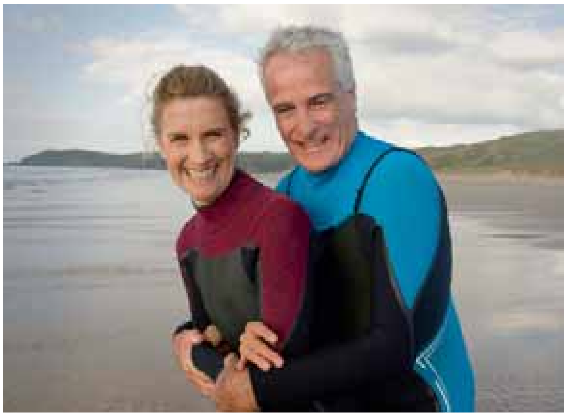
Are you in your 30s or 40s?

If you are this age and have a sum of money you can afford to set aside regularly, you can think about investing for the long-term and taking some risks. Your aim is to accumulate as much money as possible and to do that equities are your best bet.

A unit or investment trust in a tax-free Isa is a good option for a regular saver. Don't be too cautious – you could even consider funds in emerging markets such as Asia. Remember that you need to take a long-term view (10 years or preferably longer) so don't panic if your investment falls in the early years. You won't have invested much at that stage so you won't benefit from growth in the same way as you will later on.

Are you in your 50s?

The first alarm bells should start ringing when you're 10 years from retirement. By this point you'll hopefully have built up a reasonable amount and you'll need to go into capital preservation mode. That doesn't mean shifting everything into cash. You'll still need investment growth but look at moving into less risky funds. Equity income funds – which aim to combine capital growth and income – are a good choice. At the moment gilts and corporate bonds could be worth considering too as they're looking reasonably attractive. But they won't always be suitable – they're not safe if inflation and interest rates go up.



Are you retired?

If you retire with a final salary pension you might not need extra income. If so, you can move investments into cash where it will be safe. Inflation may increase again, though, so keep this strategy under review.

If you don't have a final salary pension, you'll need your investments to provide income to top up your pension. And you may need that income for a long time as you could easily live 20 years past retirement age. A substantial part of your portfolio should be in cash, but this won't give the long-term growth in income you'll need, so keep some money invested. Choose equity income funds as the bedrock of these investments: they pay dividends and give some capital growth to protect you against inflation. Gilts and corporate bond funds are also worth considering.