The STAR Guide to Equity Investment

Section 4 – Alternative Equity Options for Private Investors in the UK

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4 Alternative equity options for private investors in the UK

Management alternatives for smaller investment pots

Not everyone wants, or is able, to invest enough money to build up their own portfolio of individual shares – at least initially. Buying shares, even in the low-cost medium of the trading platforms such as Hargreaves Lansdowne and Interactive Investor, incurs fees, arbitrage costs (the difference between buying and selling price) and duties. For smaller sums it may therefore be advisable to invest initially in some form of collective investment fund.

The business of financial advice, wealth management and specialist investment management has grown massively over the past decades in line with the increasing globalisation of business and investment not to mention the ever-increasing complexity of personal taxation. The downside of these trends is the growth in management and advisory charges that are levied by most of the professional services involved in this lucrative sector of the modern economy.

The annual management charges for complete management vary from less than 1% of the value of the total assets under management up to 2% although other costs relating to dealing and security may increase the total costs levied. If the value of the whole portfolio is rising by 10% or more each year these costs may seem worthwhile but if asset values are static or falling and the annual income from the whole portfolio is, say, no more than 3% then the charges may well be absorbing up to half the total return in any one year.

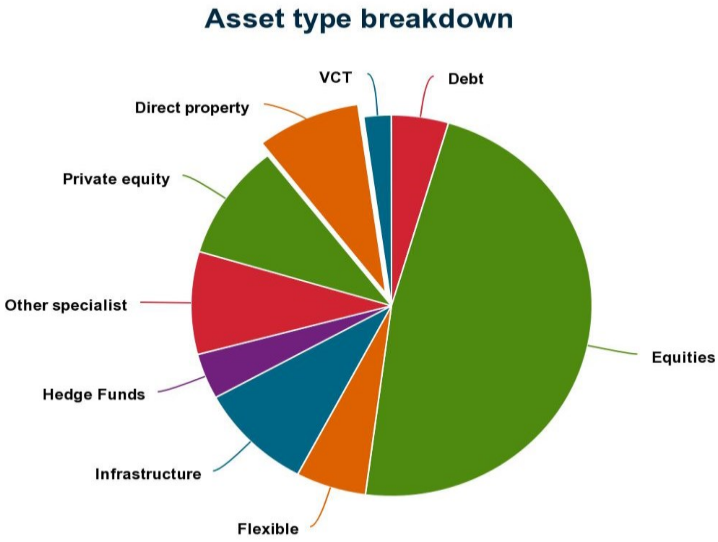
Honing in on the specific types of collective funds that are available in the UK for private investors, there are, in essence, two types; closed ended and open ended.

Closed ended funds – Investment Trusts and Venture Capital Trusts

This term refers to corporate entities whose sole purpose is to invest in a portfolio of listed, or occasionally unlisted, businesses and in which investors purchase shares, in the same way as any other company listed on a regulated stock market. They are closed ended because investors increase or decrease their holding through the purchase or sale of shares that are already traded on the market. The price of the fund is thus determined by the supply and demand for the trust's shares rather than the value of the underlying assets. It is thus possible for the share price of a quoted fund, whether an investment trust or a venture capital trust, to be traded at a premium or discount to value of the underlying shares and businesses in which the trusts are invested.

There are several large UK-listed investment trusts such as Foreign & Colonial (F & C), Alliance Trust and Witan that have been established for more than 100 years. In fact, it is generally considered that the F & C Investment Trust, which started life in March 1868, is one of the oldest such investment companies in the world. In similar vein Alliance Trust was first listed in 1888. These trusts, each with assets of more than £3billion, enable investors to take an indirect interest in businesses throughout the world and receive dividend payments quarterly.

The UK-based investment fund industry is very well established with almost 200 specialist management groups with total assets under management of some £200 billion as at end 2020.



Breakdown of Investment Trust assets by Sector

Sources of information

The body representing investment trusts is the Association of Investment trust companies. Their very helpful Website may be found at: www.theaic.co.uk

Information is also available free of charge on the websites of the investment platforms such as Hargreaves Lansdown, Interactive Investor and the management companies themselves

Open ended funds – Mutual Funds, Unit trusts and Exchange Traded Funds

This is a huge investment sector, estimated to have global assets of more than $50 trillion. Open-ended funds trade under the term of mutual funds in the USA, Unit trusts (UTs) and open-ended investment companies (OEICs) in the UK and also include Exchange Traded Funds (ETFs) that offer similar exposure and tend to mirror market indices. All these funds are managed by professional managers and operate by creating or liquidating new units each time investors buy or sell their holdings.

There are advantages and disadvantages to each type of these types of investment fund but all enable an investor to spread their risk by investing in a wider range of underlying holdings than would be practical or cost effective for someone without large cash resources. The main disadvantage is that all managers charge fees that have to be paid for by the investor and some managers levy substantial charges. Generally, the total charges tend to be higher for open-ended funds as there is often a spread of several percentage points between the buying and selling price of units which are directly related to the value of the underlying assets.

Sources of information

The body representing the unit trust industry in the UK is the Investment Association whose website is: www.theai.org

Information is also available free of charge on the websites of the investment platforms such as Hargreaves Lansdown, Interactive Investor and the management companies themselves. For website addresses of the main investment platforms and brokerages see section 6 on data sources

Advantages of collective funds

1 Spreading risk through many holdings
2 Access to knowledge that is not readily available to private individuals
3 Entry to national stock markets that are difficult or expensive for private investors.

Disadvantages of collective funds

1 Investors in collective funds are distanced from the companies in which their money is invested
2 The charges levied by some management groups are substantial and thus may reduce total returns
3 It may be difficult to sell when markets suddenly turn negative

Direct Share ownership

Although it is possible to acquire and own shares in companies whose shares are not listed on any public market the vast majority of equities owned by private investors are dealt with through established stock exchanges such as the London Stock Exchange and other national stock markets.

Shares in listed companies were traditionally held in the form of paper certificates with the name of the owner and the number of shares printed in their name on the certificate and registered on the company's share register.

Different countries now have different systems of managing share ownership records but since the "Big Bang" in Britain in 1986 the majority of shares are now held electronically by agents on behalf of the beneficial owners.

It is still possible for private shareholders to own shares directly with their names registered with the company in which they are invested but to do this each investor has to have their Crest account which is not an easy option for small investors. Furthermore, investors whose holdings are held in tax efficient wrappers such as Individual Savings Accounts (ISAs) and Self Invested Pension Plans (SIPPs) are required to have the accounts managed by registered stockbrokers and to hold them in digital format.