



A Guide to Collective Investment Schemes

HARGREAVEHALE

contemporary thinking with traditional values

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Collective Investment Schemes (CIS)

Collective Investment Schemes (CIS) are funds that have a pool of money which is professionally managed to achieve the best possible return for investors. The idea is that by combining your money with other people's, you can spread it between a wider range of companies than if you were investing alone. This lowers the risk of your investment, this doesn't mean there is no risk to your capital, as the risk will vary depending on where the fund is invested.

Funds tend to be invested around themes. For example, focusing on a particular sector, geographical location, producing income or providing capital growth.

There are many different types of funds, but the main ones you will probably encounter are:

- Unit Trusts
- Open Ended Investment Companies
- Hedge Funds
- Investment Trusts
- Venture Capital Trusts
- Enterprise Investment Schemes
- Tracker Funds
- Exchange Traded Funds

This guide offers a brief introduction to these types of investments. Our experienced professionals would be happy to explain any of these concepts in more detail.

Risk Warning: Hargreave Hale services may not be suitable for everyone. Invested capital is at risk, before investing in the stock market, please bear in mind that the value of investments and the income generated from them can fall as well as rise. Investing in the stock market should be done for the medium or longer term, and should be a part of personal financial planning which may also involve considering levels of debt and cash resources as well as pension provision and tax planning.

Types of Collective Investment Schemes

Closed Ended Funds

This type of fund is a publicly traded investment company that raises a fixed amount of capital through an Initial Public Offering (IPO), and is listed and traded like an equity on a stock exchange. Unlike regular stocks, where the company has its own business activities, buying a share in a Closed Ended Fund represents an interest in the underlying specialised portfolio of investments, which is actively managed by investment advisers. Closed Ended Funds do not have any business activities, other than investing in other companies. The share price of a Closed Ended Fund fluctuates according to market demand as well as the value of the underlying securities.

Types of Closed Ended Funds

Investment Trusts

The name is somehow a little misleading given the fact that an Investment Trust is not in fact a trust in the legal sense but a Public Limited Company (PLC). The share price does not always reflect the value of the underlying securities held in the portfolio, therefore Investment Trusts normally trade at a discount to their Net Asset Value (NAV). They sometimes trade at a premium, compared to the share price, but this occurs less often. A main difference between an Investment Trust and a Unit Trust, aside from the factors that affect pricing, is that an Investment Trust manager is legally permitted to borrow funds to purchase shares, hence increasing leveraging. This can make an Investment Trust more risky than Unit Trusts.

Venture Capital Trusts

Venture Capital Trusts (VCTs) are quoted, or listed, funds similar to Investment Trusts. The aim of VCTs is to encourage private individuals to invest through professionally managed funds in unquoted businesses in the UK. VCTs are designed to provide private equity capital for small expanding businesses. Investing in smaller unquoted businesses is generally considered to be high risk, and as a result there are certain tax relief benefits available to investors who invest in VCTs.

Enterprise Investment Schemes

An Enterprise Investment Scheme (EIS) is an investment into a single company which is unquoted and privately held. Like VCT's, Enterprise Investment Schemes carry a higher risk due to the small size of the companies in which they invest. An EIS can also be highly illiquid, which means there is no guarantee of releasing your funds from this investment. For taking on this level of risk an EIS provides certain tax reliefs to investors.

Types of Collective Investment Schemes

Open Ended Funds

This type of fund does not have restrictions on the amount of shares the fund will issue. If demand is high enough the fund will continue to create shares no matter how many investors are involved. When investors wish to sell their investment, the fund is able to buy back the shares.

Types of Open Ended Funds

Unit Trusts

With Unit Trusts, the fund is divided into units, each of which represents a tiny share of the overall portfolio. Investors can buy units in many different ways; for example, directly from the fund manager, through a financial adviser, through a fund platform or through a fund supermarket. The unit price fluctuates depending on the value of the investments held by the fund. Unit Trusts are priced daily, usually midday, and are dual-priced – that is, there is a different price quoted for buying units and selling units.

Open Ended Investment Companies

Open Ended Investment Companies (or OEICs) are a mixture of a Unit Trust and an Investment Trust (see the section on Investment Trusts). OEICs issue shares rather than units but have a different pricing structure to Unit Trusts. OEICs are based on a single price structure which means buyers and sellers receive the same price.

Hedge Funds

Hedge Funds are aggressively managed portfolios of investments that use various advanced investment strategies such as gearing, long and short and derivative positions. The aim of Hedge Funds is to generate high returns. A very large initial minimum investment is required from investors in Hedge Funds, and these funds are open to a limited number of investors. Hedge Funds are suited to the more experienced investor as they are not regulated in the same way as other Collectives. Hedge Funds do bear some similarity to other types of Open Ended Funds as the funds are pooled and professionally managed, however they differ from Unit Trusts and OEICs in that they are more flexible and use advanced investment strategies.

Types of Collective Investment Schemes

Tracker Funds

These types of funds are designed to track the performance of a particular index. This can be done in a variety of ways and how successful the fund is at achieving this goal can be quantified by its tracking error. The most straight forward approach to tracking an index would be to buy every share in the index at exactly its weighting in the index. However, this approach is very costly trying to keep up with companies entering and leaving a particular index. Tracker funds use sophisticated strategies that involve buying a smaller number of holdings without deviating from the index performance.

Exchange Traded Funds

An Exchange Traded Fund (ETF) is a security that tracks an index, a commodity or a basket of assets, like an index fund, but trades like an equity on a stock exchange. Exchange Traded Funds offer an investor the diversification of an index fund as well as the ability to sell short, buy on margin and purchase as little as one share. They are much cheaper than other investment funds as they are less actively managed. Depending on the strategy used to replicate the underlying index this can also reduce costs.

What are the advantages of Collectives?

The main advantage to private investors of investing in Collectives is the diversification they offer if an individual has limited funds available for investing. They can be an effective method of investing in the stock markets or asset classes without investing directly.

The diversification available within Collectives can also help to reduce risk within an investor's investment portfolio.

Finally, investors benefit from the expertise and knowledge of a professional fund manager who will actively manage the fund on investors' behalf.

Some funds provide tax benefits but this normally comes with taking higher risk in more adventurous Collectives.

Charges

When investing in any of these funds, be sure to understand the different charging structures. With some Collectives there can be an initial charge, an annual management fee and an exit fee.

Exchange Traded Funds tend to be cheaper as there is less active management involved and employ a more passive investment strategy.

The costs incurred from investing in Investment Trusts are normally deducted from the income the trust produces before this is distributed to shareholders.

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