Looking for a little bit more?

How investment companies can help deliver a higher income

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www.theaic.co.uk

With interest rates falling to record lows in recent years, finding income has probably never been harder.

And as people now have freedom over how they spend their pension savings, more and more are looking to their investments to provide them with a regular income in retirement.

This guide explains some of the unique features that give investment companies a head start over other funds when it comes to delivering income.

New to investment companies?
Read ‘A guide to getting started’ to learn the basics

Available at www.theaic.co.uk or by calling 0800 707 707

Introduction

When it comes to looking for an income from their savings, many people would think first about deposit accounts and other similar investments which pay interest. These provide a secure income, and protect your capital, but falling interest rates in recent years mean that these often pay a very low income.

Investment companies can deliver a higher income in the form of dividends. How often they pay them varies, but most pay dividends twice a year or quarterly. Some investment companies aim to produce a high level of immediate income. Others try to grow income over time. Some offer a mixture of income and capital growth. Whichever you are looking for, it's worth understanding how investment companies can help meet your income needs.

Because your money is exposed to risk, investment companies are not a substitute for deposit type investments. You should not invest in investment companies if you need a guaranteed income or if you cannot afford to lose your capital. However, if you can accept the risks, investment companies offer something different as part of a balanced, long-term income portfolio.

The right mix
Investment companies can offer a mixture of income and capital growth to meet your needs

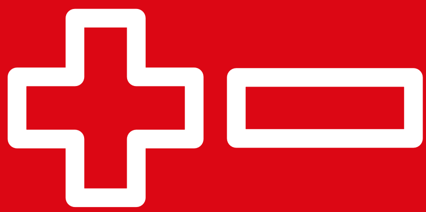
Why use investment companies for income?

Investment companies offer a unique combination of features that can make them very attractive to income seekers.

Access to a wider range of investments

Many open-ended funds are restricted to investing in certain types of shares and securities. Investment companies have no such restrictions and can invest in a wide range of other investments that can generate a higher income.

Assets like commercial property, infrastructure and renewable energy can all offer a higher level of income and, being illiquid, are better suited to being held in a closed-ended fund like an investment company.



The ability to smooth dividends

Many open-ended funds are required to pay out all their income each year. Investment companies can hold back some income in good times to pay it out in leaner ones. This means that investment companies can maintain or increase their dividends even at times when the companies they invest in are reducing theirs.

Want to know the difference between an open-ended and closed-ended fund? See the Glossary on the AIC website

The ability to gear

Investment companies, unlike open-ended funds, can borrow money to purchase additional investments (‘gearing’). If this is invested in assets which produce income, this can help to boost the dividends you receive.

Gearing increases the risks to income and capital. However, not all investment companies use gearing, and most only use modest levels.

Paying dividends out of capital profits

Investment companies, unlike many open-ended funds, don’t have to pay dividends just out of the income they receive from investments. They can also use the profits they make when they buy and sell investments.

As this flexibility will reduce the capital profits you might make, it tends to be used quite sparingly. However, it can be a useful tool to maintain or increase dividends in more difficult times.

Things to consider

When thinking about using investment companies to generate income, there are a few basic questions you should ask yourself:

How much risk are you prepared to take?

Investment companies come with risk to income and capital. They are not a substitute for deposit type investments or annuities. If you need a guaranteed income, or cannot afford to lose capital, you should not invest in them.

Generally, the longer you are investing for, the more risk you can take on, as your investment has longer to ride out the ups and downs in the market. This can make investment companies very suitable for pensions, where you may be investing over decades.

You should find out whether an investment company is going to use gearing to boost income, as this will increase the risks.

Do you want a high income now, or a growing income?

Generally, the higher the level of immediate income an investment company pays, the less chance it will grow significantly in the future. This means that, over time, inflation is likely to reduce its purchasing power.

If you can afford to start with a lower level of income, you might want to consider an investment company which aims to grow its dividends over time. You should bear in mind, however, that there is no guarantee that the income will grow and keep up with the rate of inflation.

Be prepared
Asking a few basic questions can help you get the results you want

Do you want capital growth as well?

All investment companies come with risk to capital, but some actively try and grow it in addition to providing an income. This is likely to mean that the income you receive will be lower, but it might be worth considering if you want to grow capital over time, perhaps to hand on to your children.

Remember, even if you don't need the income today, you shouldn't ignore investment companies that pay dividends, as many of these have performed well over the long term. You can use the dividends you receive to buy more shares. Some wrapper schemes make this easy for you by offering to reinvest the dividends automatically.

Finding out more

Taking advice

If you are not sure whether, or which, investment companies are suitable for you, you should consider taking independent financial advice.

Managing income in retirement can be complicated, as you need to consider your income needs, how these might grow due to inflation, how long you might need this income for and whether you want to hand on assets after you die. This could mean that another option, such as an annuity, might be better for you.

A financial adviser can talk all this through with you and recommend a portfolio tailored to your needs. You should ask them whether they use investment companies or not.

Create your own Watchlist on our site to keep track of your chosen investment companies

Take your pick
The AIC website can help you narrow down your search for an income-producing investment company

Doing your own research

The AIC website can help you narrow down your search for an income-producing investment company.

The 'Find and compare investment companies' section of our site lets you sort investment companies according to your investment needs. If you are looking for income, you can search by 'Income' or 'Growth and Income'. You can then refine your search by geographical area, asset class or management group.

One figure that you might be interested in is the 'Dividend yield'. This is the most recent annual dividend paid by an investment company expressed as a percentage of the current share price. The dividend yield can give you an indication of the level of income you might get from an investment company share. However, depending on the performance of the company, future dividends may be higher or lower than indicated by the current dividend yield.

Once you have a few investment companies that might be suitable, you can click through to the individual company pages for a wealth of other information.

Visit the Glossary on the AIC website for simple explanations of key terms

Choosing the right level
The dividend yield can give you an indication of the level of income you might get

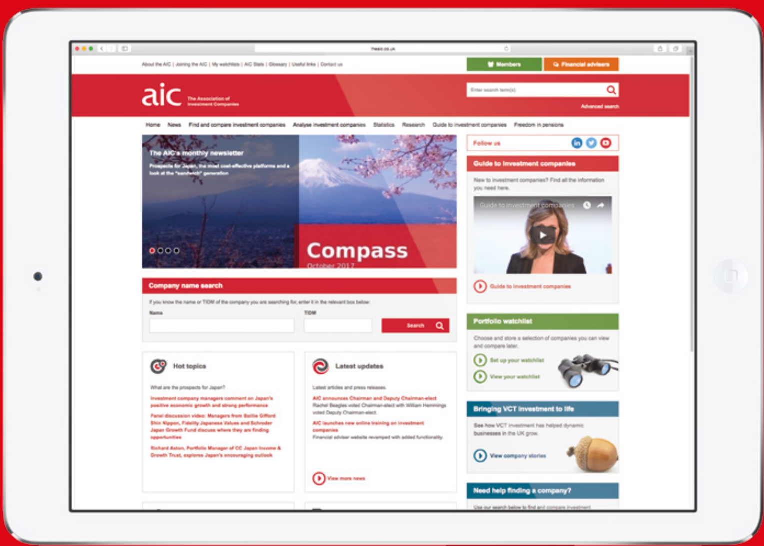
Key things to remember

- Investment companies have some unique advantages over other funds when it comes to delivering income.
- They can invest in a wider range of income-producing assets.
- They can smooth dividends over time, and even pay dividends out of their capital profits.
- They can use gearing to boost dividends as well.
- Investment companies can grow income over time to offset some of the impact of inflation.
- They are intended as long-term investments and you should therefore be prepared to invest for at least 5 years, and preferably 10 or longer.
- Your income, and capital, are at risk, and can fall as well as rise, and so they are not a substitute for deposit type investments and annuities.
- You should not invest in investment companies if you need a guaranteed income or if you cannot afford to lose your capital.

Don’t forget
When it’s time to deliver income, investment companies have some unique advantages

Visit the AIC website for news, statistics and comment on investment companies

www.theaic.co.uk



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