Unit 11: Other Investments

<https://quizlet.com/gb/897261394/unit-11-other-investments-flash-cards/?i=24ef59&x=1qqt>

ETF: Key Features

Traded on exchanges.

Mainly passive.

Wide range of assets: stocks, bonds, alternatives.

ETF: Stamp Duty?

None

ETF Structure

Open-ended

ETF Regulation.

Generally follow UCITs rules but not bound by them.

ETF Pricing

Real-time priced

Constantly changing.

Physical ETFs

Fund buys underlying assets.

Shares in each FTSE 100 firm.

Synthetic ETFs

Use derivatives to match return of index.

Synthetic ETF Cons

Counter party risk as derivative is a contract.

Inverse ETFs

ETF is inverse to commodity its tracking.

Leveraged ETFs

Commodity price movements are multiplied by factor of 2/3 etc.

Magnifies returns.

Exchange Traded Notes

Unsecured bonds issued by banks.

No Coupon

Synthetic: Normally used to rack currencies.

How are Exchange Traded Notes different from normal ETFs.

Unsecured Bonds.

Don’t provide an income- ETFs can.

Subject to credit risk of issuer.

Three Forms of Private Equity

EIS : Enterprise Investment Scheme

SEIS: Seed Enterprise Investment Scheme

VCT: Venture Capital Trust

EIS Criteria: Max Employees

Less than 250 full-time employees

EIS Criteria: Max Assets

Gross Assets £15m before get money from scheme (£16m after)

\*Different for ‘knowledge intensive firms.

EIS: Does it have to be actively trading?

Yes.

EIS: What sectors are excluded?

Land/farming

Commodities

Financial instruments

Hotels/ nursing homes

EIS: Can firm be listed?

No but can be on AIM.

EIS/SEIS: Individual or Pooled investments.

Invest directly into individual qualifying companies.

Receive shares.

SEIS Criteria: Less than…

25 employees

Gross assets 350k.

3 years old.

Venture Capital Trust: What is it?

Form of investment trust (close ended)

\*Must have 80% of assets in ‘qualifying companies’.

Venture Capital Trust: Pros

Collective investment: less risky than EIS/SEIS

Other 20% can invested in other things.

Venture Capital Trust: Cons

Can be illiquid as tax breaks apply on purchase.

But some VCTs have buy back facility- provider buys back off you at discount from NAV.

EIS/SEIS/VCT Tax Relief Formula

Investment x Tax relief %.

This can be deducted from taxable income.

100k investment x 30%. Can take 30k off taxable income.

EIS/SEIS/VCT: Over-investing

Can only reduce tax liability to zero.

Beyond that pointless.

EIS/SEIS/VCT: Who can ‘carry back’.

EIS/SIS can use last year’s allowance if not used.

Could get tax rebate.

EIS/SEIS/VCT: Max Contribution

EIS: £1m (more for knowledge intensive)

SEIS/VCT: £200k.

EIS/SEIS/VCT: Min Holding Periods

EIS: 3

SEIS: 3

VCT: 5

EIS/SEIS/VCT: What happens if sell within holding period?

May get tax bill for previous tax relief.

\*Exception if transfer to spouse/ or investor dies.

EIS/SEIS/VCT: Do they produce an income?

Unlikely as young growing firms.

EIS/SEIS/VCT: Which dividends are tax free?

VCT.

EIS/SEIS: Taxable.

VCT: CGT

None. Always exempt.

Not no loss relief etc.

ESIS/SEIS: CGT

None after 3 years.

Loss Relief

If sell EIS/SEIS for a loss.

Can offset that against other gains.

Deferral Relief: Where does apply?

EIS.

Deferral Relief: What is it?

If facing a CGT bill, can either pay now.

Or

Reinvest in another EIS and pay CGT in 3 years (rates may be higher at that point).

\*Amount re-invested is on top of normal limits.

Re-investment Relief: What is it?

SEIS.

Deferral Relief: What is it?

If reinvest taxable gain into SEIS. Pay 50% CGT now/ 50% later.

EIS/SEIS: IHT

100% business relief after 2 years as they are unlisted shares.

VCT: IHT

Normal Rules.

Stocks & Shares ISA: What can you put in it?

Shares/Bonds on recognised global exchanges.

Unit Trusts/ OEICs

Investment Trusts/ REITs

Stocks & Shares ISA: Self-select

Where you pick individual stocks.

Stakeholder Stocks & Shares ISA: Charges

1.5% first 10 years.

1% after.

Min investment £20.

Stakeholder Stocks & Shares ISA:

Max 60% in shares/property.

Do ISA managers have to allow all transfers?

Have to allow all transfer out.

But not all transfer in.

Transferring Existing ISA Balance

Existing = Monet invested from previous years.

Can be transferred in full/ part.

Doesn’t impact current years allowances etc.

Transferring Current years ISA Balance

Must be transferred in full.

Within 15 days for cash ISAs

Within 30 days for stocks & shares ISA

ISAs v VCTs

VCT viewed as ISA on ‘steroids’.

Both no Income Tax/ CGT.

But VCT can put in 200k a year and get 30% tax relief.

Tax Advantages of pensions whilst invested.

Tax free growth on authorised investments.

SIPP Pros/Cons

Wider investment choice.

But higher MGMT costs.

FSCS for Pensions

Personal Pension Plan: 100% accumulated fund.

SIPP: £85k per person per firm.

Pension Annuity v Purchased Life Annuity

Pension: from pension fund.

PLA from any source - lottery etc. (can also come from 25% lump sum)

Pension Annuity Tax

Treated as eared income

Taxed at marginal rate.

Purchased Life Annuity (PLA ) Tax

Part tax-free. Rest deemed savings income (PSA)

Net income is higher on PLA than pension annuity.

What is a derivative?

Not an asset as such.

A contract where you can benefit from fluctuations in asset prices.

Underlying asset- called the ‘Underlying’.

Derivative Risks

Counter-party risk: contract with 3rd party.

Can be mitigated by using a recognised exchange- London Metal Exchange- standardised contracts etc.

Simple Example Derivative Contract

You bet John price of gold goes up.

If it does, he pays you some cash.

If it doesn’t, you pay him.

Future Contract

Obligation to buy something at a set price at set date.

Unlimited Liabilities.

Forward Contract

Same as a future but ‘over the counter’.

Options

Option (not obligation) to exercise contract.

Options: Long v Short

Buyer: Long position

Seller: Short position.

Option: Strike Price

Agreed fixed price to buy/sell an asset.

Put Option:

Option to sell.

Protect yourself from falling prices.

Call Option:

Option to buy.

European v American style options

European: Set date to exercise.

American: Can exercise any date until it expires.

Derivative Uses

Hedging: protect portfolio from price fluctuations.

Speculating

Diversify portfolio

Hedge Fund Strategies: Long/ Short

Long: Buy & hold

Short: Short selling

Hedge Fund Strategies: Relative Value

Arbitrage (Market neutral)

Needs market movements – doesn’t work if no liquidity.

Hedge Fund Strategies: Event- Driven

Exploit pricing inefficacies due to corporate events

M&A, insolvencies etc.

Needs a Bull market- more activity.

Hedge Fund Strategies: Tactical trading.

Long/ short approach with wider range of assets

Bonds, Forex etc.

Absolute Return Funds/ Total Return Funds Goal

Positive return regardless of market conditions with low volatility.

\*Most funds are just judged against a benchmark. Even in downturn, if beats benchmark still viewed as successful.

Absolute Return Funds: How is volatility measured?

Measured against cash.

Low standard deviation.

Sharpe Ratio.

What are Structured Products?

Composite products set up to meet specific aim: e.g. guaranteed income.

Fixed term.

Two Types of Structured Product

Structured Deposit

Structured Investments

Structured Products & FSCS

Structured Deposit – covered as bank will be covered.

Structured Investments – not always.

Structured Products: Max Term

5-6 years.

May have ‘kick-out feature’- can end early.

Structured Products: Guarantees

Can be mis-leading.

May only be guaranteed if can meet all obligations or covered by FSCS.

Structured Products: Protections

Hard protection: 100% capital protected.

Soft protection: e.g. 80% protection, 20% capital at risk.

\*Good for risk averse inventors.

Structured Products: Returns

Linked to index- but don’t get full actual return.

e.g may get 30% of growth if FTSE 100 is up after 5 years.

Structured Products: Kick out feature.

Provider can end early- linked to certain criteria.

If FTSE is certain amount, get money back plus 10%.

Structured Products: Counter-party risk.

Provider may combine several elements such as a zero-coupon bond and call option etc.

Bond would be subject to counter- party risk.

Structured Products: Pros

Degree of capital protection: Hard/soft.

Hands- off for investor.

Wide choice.

Structured Products: Cons

Limits upside growth.

Kick-out feature.

Illiquid.

Not always covered by FSCS.