



# FINANCIAL LLP

Independent advice from a leading firm of chartered financial planners

## GUIDE TO **INCOME INVESTING**

INCOME-PAYING FUNDS  
– AN ALTERNATIVE TO  
CASH-BASED SAVINGS



SEPTEMBER 2017

### **SHEFFIELD**

WFI House,  
2 Queens Road,  
Sheffield, S2 4DG  
T: 0114 275 8882  
F: 0114 275 8001  
E: info@wfillp.co.uk

### **DERBY**

5 Brunel Business Park,  
Brunel Parkway, Pride Park,  
Derby, DE24 8HR  
T: 01332 296 222  
F: 01332 296 333  
E: derby@wfillp.co.uk

### **LINCOLN**

Greetwell Place,  
Limekiln Way, Greetwell Road,  
Lincoln, LN2 4US  
T: 01522 548 070  
F: 01522 548071  
E: lincoln@wfillp.co.uk

### **GRIMSBY**

27 Louth Road, Scartho,  
Grimsby, North East Lincolnshire,  
DN33 2ER  
T: 01472 278800  
F: 01472 276422  
E: grimsby@wfillp.co.uk

### **LONDON**

11 Bruton Street,  
London,  
W1J 6PY  
T: 0203 763 5837  
E: london@wfillp.co.uk

# GUIDE TO INCOME INVESTING

## Income-paying funds – an alternative to cash-based savings

Investing for income means choosing assets that are able to provide you with a regular income. This is in contrast to investing for growth, which focuses on how much your assets could gain in value. In our *Guide to Income Investing*, we consider the main investment asset classes that are used to generate a regular income.

People are living longer. Simple demographics mean that supplementary income is no longer a luxury – it's a necessity. With historic ultra-low interest rates on savings, many investors over the past decade have turned to income-paying funds as an alternative to cash-based savings.

Changing life plans and priorities mean we now encounter varying income needs and goals throughout our life, and, when investing, certain innate behavioural traits will influence our decision-making. For many people seeking to generate income from savings, the years since the financial crisis in 2008 have been a major challenge.

### SEEKING INCOME

Our reasons for seeking income tend to shift through life. Shorter-term goals like supporting a business start-up or funding children's education may be a priority in earlier years, and then make way for a longer-term focus on boosting retirement income and providing an adequate cushion for later life. The key is working out how much income you need at each stage, and then finding an appropriate investment strategy to help you meet your goals.

### CLEAR OBJECTIVES

It's essential to work out what you need to achieve and set clear objectives. Your savings objectives should reflect the aims of your income plan. If you would like to enjoy a reasonable standard of living in retirement, for example, a useful rule of thumb is to try to save enough to provide an income of between half and two thirds of your final salary. While some of your expenses may fall when you stop working, such as the cost of commuting and servicing a mortgage, the retirement years could bring greater spending on utilities and healthcare, amongst other things.

### REDUCE RISK

It's important to aim for an income solution that's truly appropriate for your circumstances, objectives, risk attitudes and capacity for loss, rather than simply sticking to what you're familiar with. Considering a broad range of investments can help you to reduce risk and increase your chances of achieving your objectives.

### USEFUL ALTERNATIVE

Interest rates on savings accounts have plummeted. In the UK, bank base rates fell to 0.5% in 2009 and stayed there for seven years

until they fell even further, to 0.25%, in 2016. Government and corporate bonds have offered a useful alternative, but overwhelming demand has driven prices up and yields down. Investors in shares have generally fared much better thanks to rising company dividends. Although some companies had to cut back their payouts after the financial crisis, dividends as a whole have risen in recent years.

### INCOME CHOICES

There are various ways in which capital can be used to generate income. Each has its pros and cons, and for most people the ideal solution, where possible, is to spread money among several different types of investments, providing a balance and diversifying risk.

### BANKS AND BUILDING SOCIETIES

Savings accounts have traditionally been a clear favourite for many people who rely on the interest payments as a supplementary income. Deposits are seen as a secure option because the monetary value of savings does not go down, and there is protection under the Financial Services Compensation Scheme for deposits up to £85,000 in any one institution should they not be able to meet their commitments.

However, interest rates fluctuate, so the income from savings accounts cannot be relied upon to remain stable. Not only do the returns depend upon the general level of interest rates (which has only fallen over the last decade), but banks and building societies are also able to apply their own discretion to the interest they pay on their accounts. Rates are often inflated by introductory bonuses which then fall away, typically after a year. Inflation can also erode the value of cash on deposit.

## PROPERTY

In recent years, there has been a growing demand for rented property as the cost of housing has risen. Many investors have profited from the buy-to-let market, buying residential property that they then let out in order to generate a rental income. However, property is not as liquid an investment as some others. There is also the risk of periods without income between lets and the ongoing costs of maintaining the properties.

More significantly, the taxation burden on UK buy-to-let investors and the properties themselves increased in 2016 following a government rule change. There was a sharp increase in stamp duty payable by homeowners purchasing a second home, as well as an increase in the level of taxation faced by landlords buying to let. These changes, together with stricter lending criteria imposed by lenders and wider economic uncertainties, stand to make investing in property less attractive than it may have been.

## FIXED INCOME SECURITIES/BONDS

A bond is a loan that the bond purchaser, or bondholder, makes to the bond issuer. Governments and corporations issue bonds when they need to raise money. An investor who buys a bond is lending money to the government or corporation.

## A BOND IS A LOAN THAT THE BOND PURCHASER, OR BONDHOLDER, MAKES TO THE BOND ISSUER. GOVERNMENTS AND CORPORATIONS ISSUE BONDS WHEN THEY NEED TO RAISE MONEY. AN INVESTOR WHO BUYS A BOND IS LENDING MONEY TO THE GOVERNMENT OR CORPORATION.

Like a loan, a bond pays interest periodically and repays the principal at a stated time, known as the 'maturity date'. Certain government securities are regarded as the most secure, though corporate bonds can pay higher rates of interest depending on the deemed creditworthiness of the issuing companies. Over the long term, shares have tended to provide a greater total return, but bonds are generally regarded as less risky. In the event of bankruptcy, a bondholder will get paid before a shareholder.

## EQUITIES

By investing in equities, savers can back companies which have potential to pay out significant dividends – a share in the profits – to shareholders. There are many such companies which have historically provided not only reasonable dividends but a track record of growing profits and consequently improving those dividend payments over time.

It is also possible to grow your original capital if the share price increases in value over the time you are invested, although it may go down as well as up along the way. Investments in equities can be volatile. Their values may fluctuate quite dramatically in response to the results of individual companies, as well as general market conditions.

### DO YOU HAVE AN HONEST UNDERSTANDING OF WHAT YOU WANT TO ACHIEVE?

As yields from cash and term deposits remain near historic lows, the search for income is a top priority for many investors. Income-seeking investors continue to face the dilemma: in a low-interest-rate world, where do I generate the income yields I need? There are a number of different investments available that could produce an income for your requirements. To discuss which is right for you, please contact us.



# LOOKING TO ACHIEVE A BETTER RATE OF RETURN THAN YOU CURRENTLY RECEIVE FROM YOUR SAVINGS ACCOUNT?

To achieve a better rate of return than you would typically get from a savings account, you need to accept more risk. That means getting comfortable with the fact that your investments can go down as well as up and the original capital is at risk.

To discuss your income-generating options,  
please contact us.

This guide is for your general information and use only, and is not intended to address your particular requirements. The content should not be relied upon in its entirety and shall not be deemed to be, or constitute, advice. Although endeavours have been made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough examination of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of the content. Thresholds, percentage rates and tax legislation may change in subsequent Finance Acts. Levels and bases of, and reliefs from, taxation are subject to change and their value depends on the individual circumstances of the investor. The value of your investments can go down as well as up and you may get back less than you invested. All figures relate to the 2017/18 tax year, unless otherwise stated.