INVESTMENT OPTIONS AND RISKS

What is risk?

When investing, there's always the risk that your investment could fall in value as well as rise. This means you could get back less than you invested. There are lots of things that can affect the value of investments – from external factors like war, interest rates, and economic and political climate, to risks with companies, like bankruptcy.

All types of investment involve some risk – this guide is to help you understand the different types of investment we offer, the risks involved, and how they might affect you.

Before you invest, you should always do your own research and make sure you understand what you're investing in. There's more information about your Investment Options and the risks involved on our website. If you're not sure, you should seek professional advice.

Shares

What are they?

A share is a stake in an individual company. This gives you rights in the company and a share of any dividends that are paid out of the profits.

What are the risks?

- **Company risk**: when you buy shares in a company, you share in its potential for profits and losses. In an extreme case, if a company went bankrupt, you'd lose your investment.
- **Price risk**: share prices are unpredictable and can go up and down quickly.
- **Dividend risk**: any dividends will be affected by how the company performs and may be reduced or not paid if the company makes losses.

Funds

What are they?

A fund pools together money from many individuals. The fund manager then uses it to invest in a broad range of assets which are selected based on the objectives of the fund. They include Unit Trusts and Open-Ended Investment Companies (OEICs) and invest in other assets, like shares, bonds or other investments.

What are the risks?

- **Capital risk**: the money you've invested isn't guaranteed so you could get back less than you invested.
- **Rate of return**: what you get back may depend on specific conditions being met and even professionals may not be able to predict this accurately.

Bonds

What are they?

Bonds are loans to companies made by investors. The bond has a maturity date when it's repaid in full and you'll get interest payments, known as coupons, during the loan.

What are the risks?

- **Credit risk**: the value of a bond will fall if the company defaults or their credit rating is reduced. The company may become permanently or temporarily insolvent.
- **Interest rate risk**: if interest rates rise, the value of the bond will fall.

Gilts

What are they?

Gilts are very similar to bonds, except that they are loans to the UK government. They also have a maturity date and offer interest payments during the loan.

What are the risks?

- **Interest rate risk**: if interest rates rise, the value of the gilt will fall.

Physical Exchange-Traded Commodities (ETCs)

What are they?

Physical ETCs give investors exposure to a wide range of underlying commodities, like gold, other precious metals, or other industrial metals like steel, in the form of shares. They track the value of the commodity by investing in the actual commodity itself.

What are the risks?

- **Price risk**: worldwide demand for commodities can be very volatile, which is reflected in the volatility of the ETCs.
- **Exchange rate risk**: as commodities are often priced in dollars and ETCs priced in sterling, there may be an exchange rate difference.
- **Taxation risk**: some ETCs are manufactured offshore and may be subject to different tax rules to the UK.

Exchange-Traded Funds (ETFs)

What are they?

ETFs are a type of fund that's traded on a stock exchange, and tracks an underlying benchmark or index.

What are the risks?

- **Tracking error risk**: the return of the ETF might differ from the index if it holds different stocks, which don't perform as well as the stocks in the actual index.
- **Taxation risk**: some ETFs are manufactured offshore and may be subject to different tax rules to the UK.

Investment Trusts/Investment Companies

What are they?

Investment Trusts or Investment Companies are companies in their own right that invest in other companies' stocks and shares. They aim to maximise performance for shareholders.

What are the risks?

- **Gearing risk**: 'Gearing' means borrowing money to invest, and is an investment strategy that magnifies price movements of assets in the fund. This can lead to sudden and large falls in value.
- **Valuation risk**: the share price may not accurately reflect the value of the investment company's assets (net asset value). At any point, the shares may be worth less than the value of the company's assets (discount to net asset value), or worth more than the value of the company's assets (premium to net asset value). The amount of discount or premium may change independently to the movement in the price of the assets held in the company and you should understand the level of premium or discount before choosing to invest.
- **Diversification risk**: Investment Trusts are allowed to hold a less diverse portfolio of assets at any one time compared to other fund types.

Complex Instruments

Our regulator (the Financial Conduct Authority (FCA)) classes certain types of investment as complex. This includes some types of corporate debt, exchange-traded commodities and structured products.

They're classed as complex because they are harder to understand and carry a higher risk of loss. If you choose to invest in any of these types of investment, we'll check your understanding to make sure you're comfortable with the risks. If you're in any doubt, always seek professional advice before investing in any complex instruments.

Synthetic Exchange-Traded Commodities (ETCs)

What are they?

Synthetic ETCs give investors exposure to a wide range of underlying commodities, like gold or wheat, in the form of shares. They are designed to be held short-term only.

What are the risks?

- **Price risk**: worldwide demand for commodities can be very volatile, which is reflected in the volatility of the ETCs.
- **Exchange rate risk**: as commodities are often priced in dollars and ETCs priced in sterling, there may be an exchange rate difference.
- **Tracking risk**: the return of the ETC is derived from the futures market, so the price might differ from the commodity it tracks.
- **Counterparty risk**: if derivatives are part of the ETC, there's a risk that the provider may not be able to honour its commitments.
- **Compounding risk**: some ETCs apply gains or losses over more than one time period to the sum invested. This can magnify any price movements for short and leveraged ETCs.

Subordinated Bonds

What are they?

Subordinated bonds are a type of loan to a company made by investors. The investor ranks lower down the pecking order than normal in the event that the company fails.

The bond has a maturity date when it's repaid in full and you'll get interest payments (coupons) during the loan.

What are the risks?

- **Subordination risk**: if the company becomes temporarily or permanently insolvent or even bankrupt, subordinated bondholders are less likely to get their money back than ordinary bondholders if this happens.
- **Interest rate risk**: if interest rates rise, the value of the bond will fall.
- **Credit risk**: the value of a bond will fall if the company defaults or their credit rating is reduced.
- **Early redemption risk**: if interest rates fall, you may be able to redeem the bond early but this can affect the amount you get back.

Perpetual Bonds

What are they?

Perpetual bonds are loans to a company by investors, which have no specified maturity date. As well as the risks of normal bonds, perpetual bonds have their own risks.

What are the risks?

- **Redemption risk**: there is never a set date on which repayment at par value will be achieved.
- **Volatility risk**: because there is no maturity date, prices can be more volatile than normal bonds.

Callable/Puttable Bonds

What are they?

Callable bonds are loans to a company by investors, where the company can redeem the bond before its maturity date.

Puttable bonds are loans to a company by investors, where the investor can redeem the bond at par value before its maturity date.

What are the risks?

- **Redemption risk**: when the company redeems the bond, the market price may have been higher than par value.

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