COLLECTIVE VS. INDIVIDUAL INVESTMENT

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Once you have decided on an appropriate **target asset allocation** (see our separate note on Risk and Asset Allocation), you must then decide exactly how to invest in those asset classes.

Investment can generally either be made in individual stocks and shares **directly**, or **collective investment vehicles** can be used to access a 'ready-made' portfolio of stocks or shares. Here we look at how to decide which route might be best for you.

SUMMARY

For many individuals, direct equity, bond or property investment may be inappropriate in some or all areas, due to the **costs** of such investment or a lack of **time** to make **difficult investment decisions**. Such individuals may nonetheless still require exposure to these asset classes and will be best able to achieve this by investing in collectives.

The term **"collectives" describes investments such as Unit Trusts, Investment Trusts and Open Ended Investment Companies (OEICS)**. These are all investment vehicles that invest in a spread of underlying equities, bonds, cash style deposits or properties.

A further option for investment is using Life Assurance policies; these are not considered below, please see our separate Research Note for details on this area.

This note gives a summary of the major factors to be considered when deciding on collective versus direct investment.

PORTFOLIO SIZE: DIVERSIFICATION AND COST

For investors with smaller portfolios, it may be difficult to achieve the required diversification in a cost-efficient manner with direct investments. Collective investments can provide a diversified portfolio for very small sums (tens of pounds), at a relatively low cost. In addition, the use of collectives enables investors to gain diversification of investment managers and styles, which may not be possible or practical with direct investment.

For individuals with limited amounts of capital to invest, it is very difficult to acquire enough underlying equities to ensure adequate diversification.
For example, well-constructed equity portfolios will contain shares in all the main sectors (e.g. Oil, Pharmaceuticals, Telecoms, Retail, IT) and in smaller, larger and medium sized companies. In many cases, a portfolio will contain more than one share from each sector. For an individual to acquire enough shares to be adequately diversified would require a significant number of purchases at a significant cost. Generally, unless such an individual has at least £100,000 to invest (some commentators say £1million) then it is difficult to construct a sufficiently diversified equity portfolio. A collective vehicle, investing in equities, will own many shares in different sectors and will thus provide a sensible level of diversification.

Similarly with bonds, to obtain exposure to different maturities, different credit risks and possibly different currencies, many purchases would be necessary precluding all but the wealthiest of investors. A collective can deliver such diversification to investors with amounts as low as £500 to invest.

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INVESTOR'S PERSONAL SITUATION: TIME AND EXPERTISE

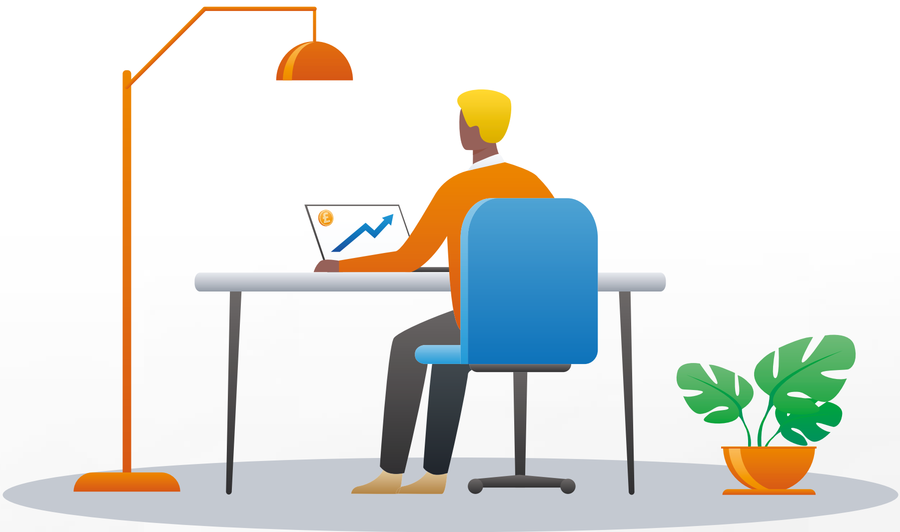
Individual investors rarely have the necessary combination of time, expertise and preference to manage their own portfolio, and so will usually employ somebody to manage it on their behalf – either a private client stockbroker, or the managers and teams of the collective investments chosen. To follow global markets effectively is very time consuming and only professional investors can realistically do this.

If a client wished to be more involved with the decision making process within their portfolio, then a direct investment through a private client stockbroker may be preferable to them. Alternatively, if they wish to remain less directly involved, then a collective portfolio may be the answer.

TAXATION EFFICIENCY

Within authorised collective investments, such as unit trusts, sales by the fund manager of the underlying assets normally do not create immediate capital gains tax (CGT) consequences for investors within the fund. However, changes in the assets of direct equity portfolios do create immediate CGT consequences for the investor. This may result in the sales of the underlying investments within a direct equity portfolio being deferred or avoided in order to avoid tax liabilities. Portfolio activity can often suffer stagnation and investment performance could be affected as a result.

It is important to note that gains in directly held qualifying corporate bonds and gilts are currently exempt (but losses are not allowed). However, this does not apply to holdings in collective investments investing in these areas.



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SPECIALIST AREAS

The costs of investing in some specialist areas, again, will preclude all but the wealthiest investor. Examples include smaller companies in the UK, overseas developed and especially emerging markets. Collectives can access these areas on behalf of smaller investors, even where they have direct holdings in more mainstream areas.

Some areas require particular expertise, especially foreign investment. This can only be achieved by having professionals on the ground in the appropriate countries or regions, finding opportunities for investment. This type of research is not available to the individual investor unless they have significant funds available to finance it with.

Commercial Property investment is realistically only available to individuals with significant capital, especially if there is to be sufficient diversification in different sectors (office, retail, industrial) and geographic areas. Again collectives can deliver a diversified property portfolio for very small investments.

UNIQUE USES

Some collectives provide facilities that may not be easily available to the direct investor. For example, investment trusts can use gearing to enhance returns (and risk), or split capital trusts can provide different types of shares aimed at different investors' requirements. Tracker funds are available to track an index in a very cost-efficient manner. In addition, structured products can provide underlying guarantees for income or capital (although please read the small print as to what "guaranteed" means in each case). These areas are covered in our separate Research Notes on the subjects.

On the other hand, direct investment in corporate bonds and gilts provide a repayment of a fixed sum at maturity. Collectives investing in this area cannot provide this security.

ADMINISTRATION

A portfolio of collective investments can result in significantly less administration for an investor - for example, fewer contract notes and dividends to reinvest.

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THE TREND TO ENSURE CONSISTENT PERFORMANCE AND RISK MANAGEMENT

Increasingly, leading discretionary fund managers are being directed to invest via the prevailing house style, under which "model" portfolios are created into which a client is placed. Any changes to the "house" view are often reflected as far as possible within individual client portfolios. Where changes in the "model" portfolio are not made to individual portfolios, this may be due to CGT constraints, rather than investment rationale. The reason for the adoption of this investment approach is to ensure adequate risk management controls are in place and to ensure a disciplined and consistent investment strategy is adopted. If this were viewed as positive, then there is an argument for investing instead in the investment house's collective investments, which reflect the house view exactly.

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