CAMPBELL & McCONNACHIE

chartered financial planners

Fixed-interest investments

Alternative options for investing with less risk.

When you look for an investment opportunity, you want something that will earn the best possible returns with the lowest possible amount of risk.

The no-risk investment is a pipe dream – no such product can ever exist, and the value of any investment can rise or fall over time.

Regarded as a step up from cash but not quite on the same level of risk as investing in shares, fixed-interest securities offer ways to invest in governments, companies or other official bodies.

You can buy gilts (or gilt-edged securities) if a government seeks to raise money by borrowing from investors, or you can purchase corporate bonds in companies trying to do the same.

In exchange for lending money to these institutions, you will be entitled to receive regular payments and usually full repayment of your loan at the end of a set period of time.

You can sell your fixed-interest investment on the stock market at any time after purchase, but you cannot cash it in before it officially matures.

These types of investment usually carry a fixed rate of interest, have a fixed redemption value, and are repaid after a fixed period at the redemption date.

However, conditions can vary depending on the type of investment you go for.

What are fixed-interest securities?

The easiest way to look at fixed-interest investments is to view them as a loan to government bodies or companies.

In return, you should receive a steady income in the form of interest over a set period of time, after which your loan is repaid in full.

It's important to know that these types of investments are designed to give you a steady flow of income over a period of time through interest payments.

The most common types of fixed-interest securities are gilts and corporate bonds.

How do gilts and bonds differ?

Gilts are fixed-interest stocks issued by the UK Government and are considered the safest investment of this type as it is unlikely the UK Government will go bust or renege on a debt.

Gilts are usually issued in nominal units of £100, although you should note the buying price will often be different. You can buy as many units as you want.

They follow strict naming conventions – for the purpose of an example, let's take '6% Treasury Stock 2028'.

The 6% is the rate of interest payable on the nominal value, the Treasury is the Government department, and 2028 is the year your investment will be repaid.

This naming convention also applies to **corporate bonds**. For example, 'Sports Direct Ltd 4% 2023' translates as company, coupon and redemption date respectively.

Corporate bonds are usually offered by smaller companies that seek investment, and what you get in return for your loan if it matures is essentially an IOU.

You lend money to a company which should be paid back over a fixed term, usually five or 10 years, at which point your loan is repaid in full. Alternatively, you can sell your bond at any point.

You also get a coupon which offers an attractive fixed percentage of interest to cover the cost of the bond and is paid every year.

If you were to buy a 10-year corporate bond worth £20,000 with a 5% coupon and hold it until maturity, you would get £1,000 a year from the coupon and your £20,000 back after 10 years.

It's important to note that your bond is only as safe as the company you're investing in, and you would not be covered by the Financial Services Compensation Scheme if the company went bust.

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What are fixed-income funds?

Fixed-income funds operate in a similar way to collective investment schemes, which predominantly invest in large volumes of gilts and bonds.

They spread the risk in the same way as collective investment schemes, and aim to provide you with quarterly returns on your investments if everything goes according to plan.

Buying gilt funds is straightforward as you will be purely investing in gilts issued by the Government, while there are four types of corporate bond fund to choose from depending on your appetite for risk.

Corporate bond funds invest in bonds used by reputable UK companies and are considered low risk, while **global bond funds** expand that to invest in bonds from high-quality firms around the world.

Strategic bond funds invest in a mix of high and low-quality companies and **high yield bond funds** offer potentially the best returns but are also the most risky as they invest in less stable companies.

It's important to understand your attitude to risk before you invest as, remember, the value of your investment can rise as well as fall. Always seek professional advice before investing.

What returns can you expect?

As far as gilts are concerned, you know what return on your investment to expect when you loan money to the UK Government.

Using the previous example of '6% Treasury Stock 2028', if you bought 10 gilts worth £1,000 (10 x £100) you would expect 6% in annual interest (£60).

With 10 years until the gilt matures in 2028, you could expect a further £600 (£60 x 10) in interest on top of getting your £1,000 investment back in full to give you a redemption yield of £1,600.

With corporate bonds, there are far more variables to consider before your return on investment can be determined.

If you invested in a high yield bond fund, you would usually stand to receive the best returns if the bond matures, but that's a big if, and the risk of losing your money is far greater as a result.

The other thing to consider is the coupon you hold on your corporate bond. If you have a 5% coupon, you would get 5% annual interest on your investment.

The coupon will be considerably lower on funds that carry the lowest amount of risk, with corporate bond funds considered to be the least risky.

However, all fixed interest investments, whether direct holdings or via funds, carry different risks which are important to understand before you invest.

Are they right for you?

Fixed-interest securities, particularly ones issued by UK Government bodies, are less likely to leave you out of pocket than other investments.

For instance, investing in gilts and corporate bonds is usually safer than buying shares, even if corporate bonds typically carry slightly more risk than gilts.

Investing in fixed-interest securities can therefore be seen as an opportunity to help balance your portfolio where it contains chancier investments.

This type of security normally provides a stable, regular income from its interest payments, although it is prone to be affected by changes to inflation and interest rates.

How popular are they now?

With interest rates remaining stagnant at 0.5% from March 2009 until increasing slightly to 0.75% in August 2018, the coupon you earn from corporate bonds is relatively low.

The same can be said about some Government bonds, which have fallen from a June 2008 high to an August 2016 low – but are recovering slowly.

Securing a steady income remains important in a time of rising inflation, but you should seek professional advice to fully understand all your options before you invest.

Talk to us before you invest.

Important information

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change.

This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any investment decisions based on its content.

The value of fixed interest investments can fall as well as rise, and you may not get back the amount you originally invested.

While considerable care has been taken to ensure the information contained in this document is accurate and up-to-date, no warranty is given as to its accuracy or completeness of any information.

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