The Association of Investment Companies

Looking for a little bit more?

How investment trusts can help deliver a higher income

www.theaic.co.uk

Interest rates have risen from record lows, providing welcome relief for many cash savers. However, these higher rates may not last forever. While cash savings are very secure, they are unlikely to grow over time to keep pace with inflation.

This guide explains some of the unique features that give investment trusts a head start when it comes to delivering income.

New to investment trusts?
Read 'A guide to getting started' to learn the basics

Available at www.theaic.co.uk or by calling 020 7282 5555

Introduction

When it comes to looking for an income from your savings, many people would think first about savings accounts and other similar investments which pay interest. But savings accounts offer little or no scope for a growing income, and no prospect of growing your capital.

Investment trusts, however, can deliver income in the form of dividends that can grow over time. How often they pay them varies, but most pay dividends twice a year or quarterly. Some trusts aim to produce a high level of income right now. Others pay a lower level but try to grow it faster over time. Whichever you are looking for, it's worth understanding how investment trusts can help meet your income needs.

Because your money is exposed to risk, investment trusts are not a substitute for savings accounts. You should not invest in investment trusts if you need a guaranteed income or if you cannot afford to lose your capital. However, if you can accept the risks, investment trusts offer something different as part of a balanced, long-term income portfolio.

The right mix
Investment trusts can offer a mixture of income and capital growth to meet your needs

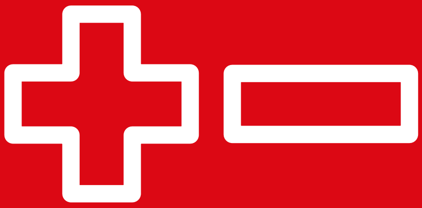
Why use investment trusts for income?

Investment trusts offer a unique combination of features that can make them very attractive to income seekers.

Access to a wider range of investments

Many open-ended funds are restricted to investing in certain types of shares and securities. Investment trusts have no such restrictions and can invest in a wide range of other investments that can generate a higher income.

Assets like commercial property, infrastructure and renewable energy can all offer a higher level of income and, being illiquid, are better suited to being held in a closed-ended fund like an investment trust.



The ability to smooth dividends

Many open-ended funds are required to pay out all their income each year. Investment trusts can hold back some income in good times to pay it out in leaner ones. This means that investment trusts can maintain or increase their dividends even at times when the companies they invest in are reducing theirs.

Want to know the difference between an open-ended fund and a closed-ended investment trust? See the Glossary on the AIC website

The ability to gear

Investment trusts, unlike open-ended funds, can borrow money to purchase additional investments ('gearing'). If this is invested in assets which produce income, this can help to boost the dividends you receive.

Gearing increases the risks to income and capital. However, not all investment trusts use gearing, and most only use modest levels.

Paying dividends out of capital profits

Investment trusts, unlike many open-ended funds, don't have to pay dividends just out of the income they receive from investments. They can also use the profits they make when they buy and sell investments.

As this flexibility will reduce the capital profits you might make, it tends to be used quite sparingly. However, it can be a useful tool to maintain or increase dividends in more difficult times.

Things to consider

When thinking about using investment trusts to generate income, there are a few basic questions you should ask yourself:

How much risk are you prepared to take?

Investment trusts come with risk to income and capital. They are not a substitute for savings accounts or annuities. If you need a guaranteed income, or cannot afford to lose capital, you should not invest in them.

Generally, the longer you are investing for, the more risk you can take on, as your investment has longer to ride out the ups and downs in the market. This can make investment trusts ideal for pensions, where you may be investing over decades.

You should find out whether an investment trust is going to use gearing to boost income, as this will increase the risks.

Do you want a high income now, or a growing income?

Generally, the higher the level of immediate income an investment trust pays, the less chance it will grow significantly in the future. This means that, over time, inflation is likely to reduce its purchasing power.

If you can afford to start with a lower level of income, you might want to consider an investment trust which aims to grow its dividends over time.

You should bear in mind, however, that there is no guarantee that the income will grow and keep up with the rate of inflation.

Be prepared

Asking a few basic questions can help you get the results you want

Do you want capital growth as well?

All investment trusts come with risk to capital, but some actively try and grow it in addition to providing an income. This is likely to mean that the income you receive will be lower, but it might be worth considering if you want to grow capital over time, perhaps to fund a large purchase in future or hand on to your children.

Remember, even if you don't need the income today, you shouldn't ignore investment trusts that pay dividends, as many of these have performed well over the long term. You can use the dividends you receive to buy more shares. Some online share dealing services make this easy for you by offering to reinvest the dividends automatically.

Finding out more

Taking advice

If you are not sure whether, or which, investment trusts are suitable for you, you should consider taking independent financial advice.

Managing income in retirement can be complicated, as you need to consider your income needs, how these might grow due to inflation, how long you might need this income for and whether you want to hand on assets after you die. This could mean that another option, such as an annuity, might be better for you.

A financial adviser can talk all this through with you and recommend a portfolio tailored to your needs. You should ask them whether they use investment trusts or not.

Create your own 'watchlist' on our site to keep track of your chosen investment trusts

Take your pick
The AIC website can help you narrow down your search for an income-producing investment trust

Doing your own research

The AIC website can help you narrow down your search for an income-producing investment trust.

The 'Compare investment companies' page on the AIC website helps you find investment trusts that suit your investment needs. You can refine your search by geographical area, asset class or management group. Once you have found a few investment trusts that might be suitable, you can click through to their information pages to find out more about them.

The AIC's 'Income Finder' (www.theaic.co.uk/income-finder) allows you to build a virtual portfolio of income-paying investment trusts. This gives you an idea of the amount of income you might receive each month of the year, though this income is never guaranteed.

One figure that you might be interested in is the 'dividend yield'. This is the expected annual dividend paid by an investment trust expressed as a percentage of the current share price. The dividend yield can give you an indication of the level of income you might get from an investment trust.

However, depending on the performance of the trust, future dividends may be higher or lower than indicated by the current dividend yield.

Visit the AIC's 'Income Finder' to research and analyse income-paying investment trusts

Choosing the right level
The dividend yield can give you an indication of the level of income you might get

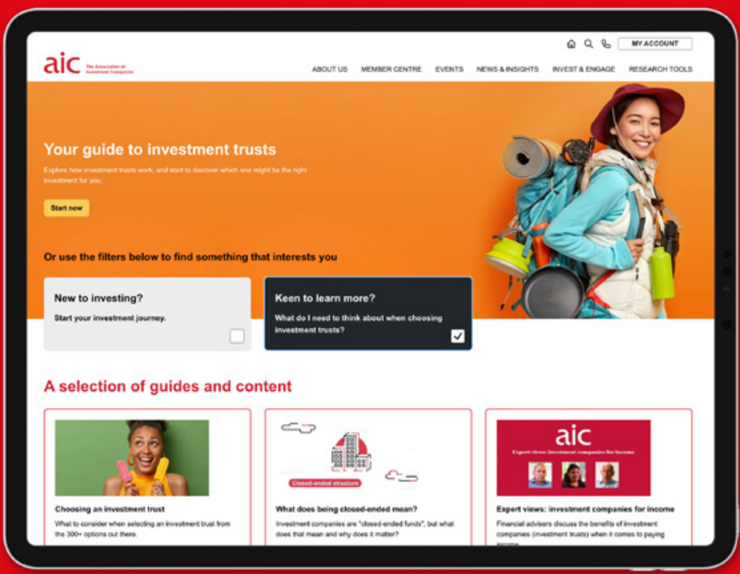
Key things to remember

- Investment trusts have some unique advantages over other funds when it comes to delivering income.
- They can invest in a wider range of income-producing assets.
- They can smooth dividends over time, and even pay dividends out of their capital profits.
- They can use gearing to boost dividends as well.
- Investment trusts can grow income over time to offset some of the impact of inflation.
- They are intended as long-term investments and you should therefore be prepared to invest for at least five years, and preferably ten or longer.
- Your income and your capital are at risk, and can fall as well as rise, so investment trusts are not a substitute for cash savings and annuities.
- You should not invest in investment trusts if you need a guaranteed income or if you cannot afford to lose your capital.

Don't forget
When it's time to deliver income, investment trusts have some unique advantages

Visit the AIC website for news, statistics and comment on investment trusts

www.theaic.co.uk



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