Investors' Chronicle

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By Chris Dillow

How should I grow my investments to fund my family's large expenses?

This investor wants to grow the value of his investments to fund large expenses. He should not sell more holdings out of his general investment account than have gains within the annual capital gains tax allowance. He could diversify his portfolio by adding wealth preservation, property and infrastructure funds.

Reader Portfolio - Graham and his wife 73

Description

General investment account and Isa invested in funds and shares, cash, residential property.

Objectives

Cover costs such as children's weddings and deposits to buy homes, large expenses, and travel; grow investments and build up cash savings; realise profits tax efficiently; move unwrapped investments into Isa; leave remaining assets to children.

Portfolio type

Investing for growth

Graham is age 73, and he and his wife are retired. He receives income of about £22,000 a year from the state pension and two former workplace defined-contribution pensions. His wife also receives the state pension and a former workplace pension, and their total annual income is about £35,000 a year.

He has two children in their thirties who are financially independent and his wife has two adult children from her first marriage.

Graham and his wife's home is worth about £400,000 and mortgage free.

“Our pension income is sufficient for our personal needs," says Graham. "We have day-to-day living expenses of about £1,500 per month or often less, so are able to save £200-£400 per month.

"This means that we are not dependent on the income or the growth of my investments. But I would like them to grow so that I can realise gains up to a value within the annual capital gains tax allowance, and use this money to cover costs such as my daughter's wedding.

“Of the £200-£400 we save each month, we put around half into my investments and the other half into our joint cash account which is currently worth about £20,000. We are building these as a reserve to fund future costs such as our health needs, helping children with wedding costs and deposits to buy homes, and our own large expenses and travel.

“I funded a private school education for my two children and consider that their inheritance. I will also leave them whatever is left of my investments and a portion of our house. My wife will pass on her share of our house to her children.

“I started invested when I inherited a portfolio of shares from my father. I hold my investments in both an individual savings account (Isa) and general investment account because we lived abroad for eight years, during which time I could not make contributions to an Isa. But I will now move the investments in general investment accounts into Isas.

“I have been investing for 12 years and think that my risk appetite is modest. But I am happy to hold about 10 per cent or more of my portfolio in speculative investments over the long term. I would be prepared to lose up to 10 per cent the value of my portfolio.

"So far, I have aimed to hold around a third of the investments in of funds and a third in direct shareholdings of FTSE 100 companies. The rest is in more speculative investments with varying degrees of risk. So most of my investments are ‘proven’ equities such as BHP (BHP), National Grid (NG.), Ceres Power (CWR) and ITM Power (ITM), or funds which invest in them. But I also hold some Aim-quoted companies such as Helium One Global (HE1).

"Recent trades include investing £5,000 in each of Alliance Trust (ATST) and Fidelity European Trust (FEV). And I am thinking of investing in Diageo (DGE) and adding to Greatland Gold (GGP).

"I put money into investments highlighted by investment commentators but also do my own research.”

Graham's Isa and trading account

Holding	Value (£)	% of the portfolio
Alliance Trust (ATST)	28,500	22.3
Fidelity European Trust (FEV)	15,800	12.36
National Grid (NG.)	15,000	11.74
BHP (BHP)	14,000	10.95
ITM Power (ITM)	13,400	10.49
Greatland Gold (GGP)	12,800	10.02
Ceres Power (CWR)	10,500	8.22
US Solar Fund (USF)	4,300	3.36
EQTEC (EQT)	4,000	3.13
AFC Energy (AFC)	3,400	2.66
Oxford BioMedica (OXB)	2,000	1.56
Helium One Global (HE1)	1,600	1.25
Powerhouse Energy (PHE)	1,500	1.17
Technology Metals Australia (AUS:TMT)	1,000	0.78
Total	**127,800**	

Chris Dillow, Investors' Chronicle's economist, says:

Your pension income means that, in effect, you have a massive holding of bonds. You don't need income from this portfolio. And you are sharing risk with your children because if your portfolio falls, they will lose as well as you. These things mean that you can take equity risk more than most investors.

"Can", however, does not mean should. Some risks don't pay, such as those of Aim shares. These are generally smaller, younger and more speculative than other stocks, so riskier. This means that you would expect them to do better. But they haven't. In the past 20 years, they have under performed the FTSE All-Share index by four percentage points with a total return of 2.3 per cent a year against 6.3 per cent.

By all means regard Aim stocks as a bit of fun, or a way of studying the interplay between investor sentiment and new technologies. But don't think of them as serious long-term investments.

The same is true for cyclical stocks such as BHP. These do badly in downturns and well in upturns, but overall its hard to expect them to out perform over the long-run. So given BHP's and commodity stocks' recent good run, be cautious about them.

Other risks, however, can pay. Defensive stocks are one such example: they have done well over the long-run, which is a case for favouring the likes of National Grid or Diageo. But a problem is that defensives can suddenly stop being defensive. National Grid, for example, looks defensive based on past price moves. But it may not be defensive with respect to political risk: as energy bills soar, there might be demands for a windfall tax on or nationalisation of utility companies.

It's tempting to think that holding ITM, Ceres Power and AFC Energy (AFC) is putting lots of eggs into the clean energy basket and concentrating risk. In recent months, they have largely risen and fallen together as investor sentiment has waxed and waned. So it looks as if you are under diversified.

However, in 2002-2003 I could have said the same about online retailers. But one of these – Amazon.com (US:AMZN) – broke away from the pack and so far is one of the best performing stocks in this century while other online retailers have failed. This shows that stocks which seem correlated in the short term may not be in the long run.

This may also be the case with clean energy stocks. Holding a basket of them is a way of increasing the chance that you hold one or two that are stellar performers, especially as you may not be able to predict which those will be. Economists such as Alex Coad and the late Paul Geroski say that corporate growth is largely random, so your investments might be better diversified in this sense than many think.

But don't neglect an easy and effective way to diversify – a global equities tracker fund. In effect, this is a cheap fund of equity funds so should be a default holding.

Adrian Lowery, analyst at Bestinvest, says:

Your investments are quite skewed towards mining, commodities, energy and utilities stocks, though the two funds provide some diversification. Some of these stocks are probably faring very well at the moment, as these sectors are to some extent the only ones which have made any headway in the past few months, with uncertainty on inflation and the crisis in Ukraine.

But your investments' biases heighten their risk. Some of your stocks could be vulnerable to an economic downturn or stagnation. Or they could do badly if the tide turns against energy and commodities in the medium to long term, for instance, because of a resolution to the Ukraine crisis and global supply chain problems.

It is right to move the holdings in your general investment account, which make up about 43 per cent of your total investments, into your Isa. As you 'bed and Isa' – sell investments out of your general investment account and repurchase them in your Isa – make sure that you do not sell more holdings in one tax year than have gains within the annual capital gains tax allowance of £12,300. As the annual Isa allowance is £20,000, it will take more than one tax year to migrate your unwrapped investments into your Isa anyway.

You could also transfer some of your unwrapped investments to your wife so that she could put them into her Isa. Interspousal transfers do not trigger any tax liabilities but your wife would become the legal owner of the assets.

But rather than repurchasing the same shares in your Isa, you could de-risk your portfolio by reducing exposure to some of the more adventurous direct shareholdings, in particular by disposing of some of the duplicate holdings. You could instead lock in recent gains by selling holdings in the general investment account which have done well. And you could reinvest in a couple of funds with more of a capital preservation mandate or higher yield to complement your growth strategy. Alternatively, you could adopt a more diversified allocation to global equities.

Consider investing in Personal Assets Trust (PNL) or RIT Capital Partners (RCP) (see chart), two of our preferred defensive multi-asset funds, to reduce your investments' overall risk. For adventurous growth, options include Scottish Mortgage Investment Trust (SMT) which has a 'go-anywhere' approach. It hunts for high growth companies globally in countries including the US and China. Although Scottish Mortgage Investment Trust is predominantly invested in listed businesses, it also provides exposure to unquoted companies which would further diversify your portfolio.

You could also diversify and get some income with a property fund such as TR Property Investment Trust (TRY) or infrastructure investment trust like HICL Infrastructure (HICL).