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Investors' Guide to ISAs

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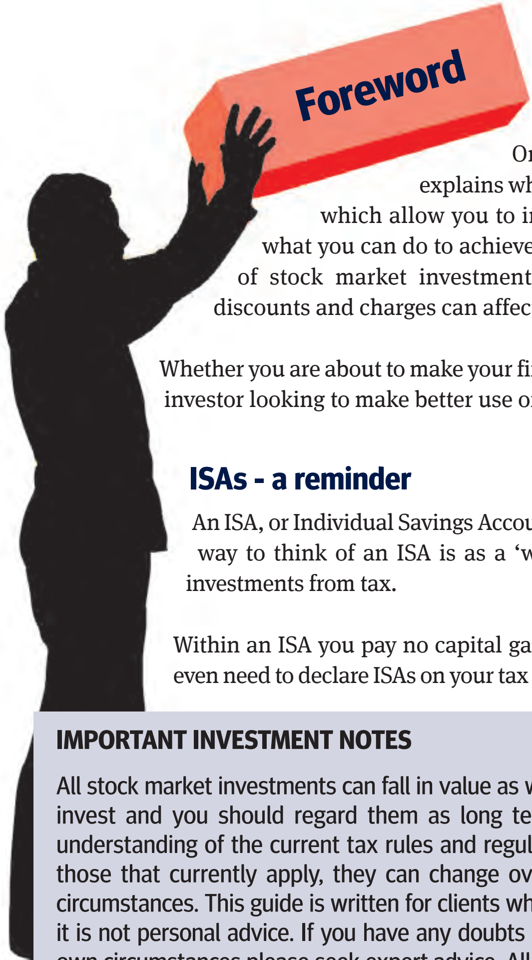


Foreword

The government offers generous tax breaks to encourage you to save.

One of the most popular are ISAs. This guide explains why, and how you can benefit. We look at the rules which allow you to invest up to £11,280 this tax year. We examine what you can do to achieve the best results for yourself, the pros and cons of stock market investments and cash, and explain how performance, discounts and charges can affect the value of your investments.

Whether you are about to make your first ISA investment or you are a more experienced investor looking to make better use of your ISA allowance, this guide is for you.

ISAs - a reminder

An ISA, or Individual Savings Account, is not an investment in its own right. The best way to think of an ISA is as a ‘wrapper’ in which you can shelter savings and investments from tax.

Within an ISA you pay no capital gains tax and no further tax on income. You don’t even need to declare ISAs on your tax return, and less tax means higher returns for you.

IMPORTANT INVESTMENT NOTES

All stock market investments can fall in value as well as rise, so you could get back less that you invest and you should regard them as long term investments. This guide is based on our understanding of the current tax rules and regulations. Whilst the tax benefits we refer to are those that currently apply, they can change over time and their value will depend on your circumstances. This guide is written for clients who like to make their own investment decisions, it is not personal advice. If you have any doubts about the suitability of an investment for your own circumstances please seek expert advice. All information correct as at 06/04/12.

Any UK resident aged 18 or over (16 for Cash ISAs) can invest. There is no upper age limit and you can withdraw your savings whenever you need to.

Best of all, it often costs no more to place cash or investments inside an ISA, so many investors receive these benefits free. Used regularly, your annual ISA allowance offers you the chance to create a substantial portfolio sheltered from the taxman, although remember tax rules can change, and the benefits will depend on your circumstances.

In fact, for those with the money to spare, there is little reason not to open an ISA. The cautious can simply use Cash ISAs as a secure place to hold their cash. The more adventurous can invest in the stock market through a Stocks & Shares ISA in search of superior returns. You can even do both by taking advantage of an ISA's flexibility to spread savings between different types of asset.

Investing for growth

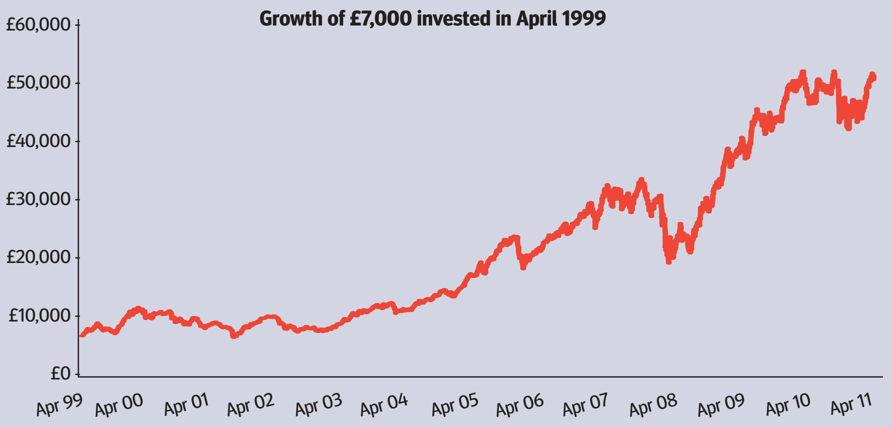
On most investments you pay tax; ISAs are different. Within an ISA you pay no capital gains tax and no further tax on the income.

The graph below shows £7,000 invested in a popular emerging markets fund in April 1999 (when ISAs were launched).

As at 1 March 2012 that investment would be worth £50,864, a gain of almost £44,000.

If you had made this investment outside an ISA and you sold today you could be facing a capital gains tax bill of over £12,000. Within an ISA you would pay no tax at all.

This fund has performed well and there are no guarantees this will be replicated in future, however this example shows just how valuable the ISA's capital gains tax savings can be.



Past performance is not a guide to future returns

How much can I invest in an ISA?

This tax year you can invest up to £11,280 in an ISA (a tax year runs from 6 April one year to 5 April the next). You can invest up to £11,280 in a Stocks & Shares ISA or up to £5,640 in a Cash ISA with the balance in a Stocks & Shares ISA.

You can withdraw your ISA subscription whenever you wish, although once withdrawn you can't put this money back into an ISA without it counting as a new subscription.

Cash or shares?

Whether you choose a Cash ISA or a Stocks & Shares ISA will depend on whether you're a saver or an investor. Many people will be a bit of both.

Cash - Cash should form the foundation of your overall portfolio - unlike stock market investments, cash savings can offer immediate access and your capital is guaranteed not to fall in value.

Cash ISAs operate just like a normal savings account except the interest is tax-free. Interest rates will vary, so shop around for the best deal using the best-buy tables which you can find in the press or online. Do watch out for headline-grabbing introductory rates or temporary bonuses though, as when these disappear you can be left with an unattractive rate.

However, with such meagre interest rates at present, you are paying a high price for security. In

Investing for income

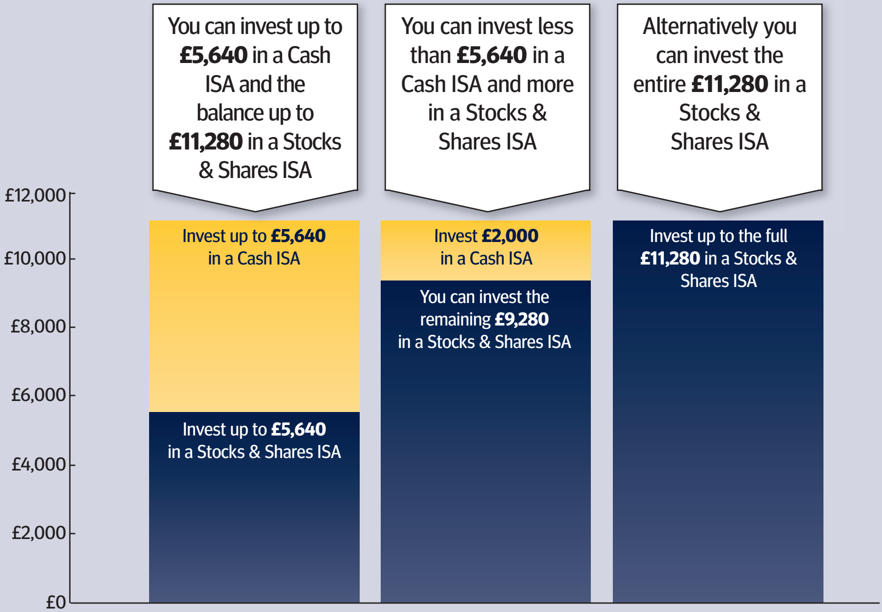
The graph below shows the income you would receive from £100,000 invested in a corporate bond fund, paying a 7% yield within an ISA, and the same income paid outside an ISA to basic, higher and super rate tax payers. Income from corporate bonds is taxed at the same rate at which you pay income tax.

Income from £100,000 invested in a popular bond fund

Yields, and therefore income, are variable and not guaranteed

ANNUAL ISA ALLOWANCE - £11,280

This tax year you can invest up to £11,280 in an ISA. You can invest up to £11,280 in a Stocks & Shares ISA or up to £5,640 in a Cash ISA with the balance in a Stocks & Shares ISA.



the long term opting for complete stability of capital can be a bad move, because low-risk, low-return investments will be disproportionately hit by inflation. Even low inflation of 3% will almost halve your spending power over 20 years. At a rate of 6% - the longer-term historical average - it halves every 12 years. So once you have built up some cash savings 'for a rainy day' it might be time to consider investing in other riskier assets which offer higher potential returns, although they can fall in value as well as rise.

Gilts and corporate bonds - Fixed interest securities, such as gilts or corporate bonds, are the one type of investment where investors know at the outset what their income and capital return will be – under the right conditions. These securities are essentially a loan to institutions who wish to raise finance. The term of the loan and repayment value is set at the outset, together with a predetermined rate of interest payable. Plainly, the security of the institution borrowing the money is of prime importance. There is none more secure than the UK government, which literally used to edge the loan certificates in gold, giving rise to the term 'gilt-edged securities'. The stronger the institution issuing the loan, the lower the return it needs to offer to attract finance. Conversely, less creditworthy companies and governments need to pay more to attract finance and therefore offer higher returns.

Shares - Shares allow individuals to share in the profits and growth of companies. They are generally more volatile than corporate bonds. However in the past they have offered the best potential for capital growth and a growing income from dividends.

The risk and return from individual shares varies. Some companies, water companies for example, with a secure customer base and steady dividend record, may trade in a fairly narrow range. Shares in technology companies offer significantly higher growth potential but carry more risk. Likewise, shares listed in emerging markets will typically rise, and fall, more dramatically than UK shares. In addition, changes in currency exchange rates will affect the value of overseas shares and this is not a factor with UK shares.

Investors who wish to generate income with the potential to outpace inflation, and/or growth which can increase their real wealth over time, will typically turn to shares.

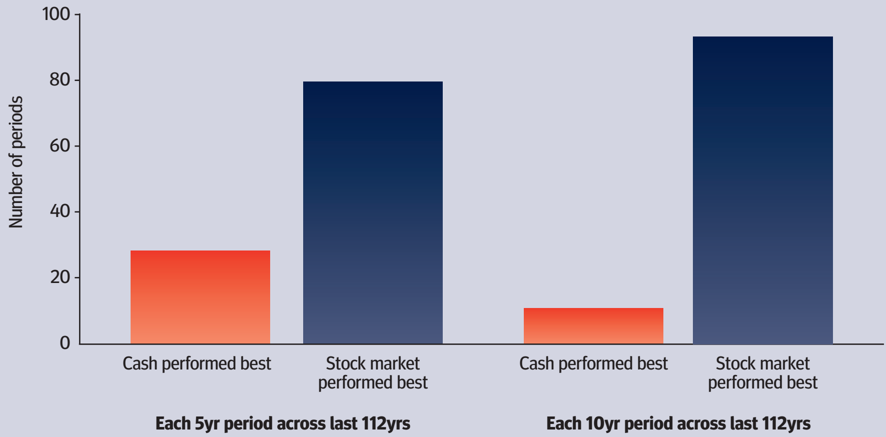
Within Stocks & Shares ISAs you can hold these investments directly or hold funds which invest in these asset classes.

Funds, such as unit trusts and OEICs, allow you to entrust the choice of the underlying investments to a professional fund manager. They pool your money with that of other investors, which enables you to spread your investments - and your risk - across dozens of different shares, bonds, gilts or property. Funds also allow you easier access to shares listed on foreign stock markets.

There are thousands of different investments available so you can take as much risk as you like and can switch between them whenever you choose, plus you never have to worry about creating

CASH OR THE STOCK MARKET?

Performance of the stock market and cash over 5 and 10 year periods



The chart above shows the number of 5 and 10 year periods that the stock market has outperformed cash and vice versa since 1899. The stock market has historically been the best performer and the longer the investment period the higher the probability of the stock market beating cash. That is not to say you can't make money in the short term, but the probability increases significantly the longer you invest, as the graph shows. Of course, there are no guarantees. Cash offers complete security of capital, so it's value won't fall, whereas stock market investments can fall in value as well as rise so you could get back less than you invest however long you invest for. Past performance should not be seen as a guide to the future.

Source: Barclays Equity Gilt Study 2012

a capital gains tax liability when you switch investments held in an ISA.

We aim to provide our clients with all the information they need to choose the right funds. On our website **www.hl.co.uk** we provide daily investment news, and research and performance information on over 2,500 funds.

We also publish an award winning newsletter, the Investment Times, which contains fund suggestions and comment from our experts making it an invaluable resource for investors who like to make their own decisions. For a free copy please call our Helpdesk on **0117 900 9000**.

How to invest

You might have a lump sum to invest – most providers will allow you to start an ISA with as little as £1,000. You can then top up your ISA, subject to the annual allowance, whenever you wish.

However, many ISA investors prefer to invest monthly. You can make monthly contributions from just £50 per month – an affordable way to invest, and small contributions can soon add up.

You could also choose to combine an initial lump-sum with subsequent monthly contributions – ISAs offer total flexibility.

The power of regular savings:

If you saved just £5 a day (£150 a month) into a top performing fund starting in 1999 when ISAs were introduced, your investment would have been worth £43,867 by the end of February 2012 (with dividends being reinvested) - almost double the amount invested. Remember past performance is not a guide to future returns.

What happened to PEPs and Mini & Maxi ISAs?

On 6 April 2008 the ISA rules were simplified:

- The Mini/Maxi ISA distinction was removed and all ISAs became either Stocks & Shares ISAs or Cash ISAs.
- PEPs became Stocks & Shares ISAs.
- It became possible to transfer Cash ISAs to Stocks & Shares ISAs – but not the other way around.

ISAs and Investment Supermarkets

The rise of investment supermarkets has revolutionised the way people invest.

In the past most investors bought ISAs (and before that PEPs) direct from a bank or fund manager, or via a discount broker to obtain a better deal. Either way, the ISA was administered by the same company which managed the funds.

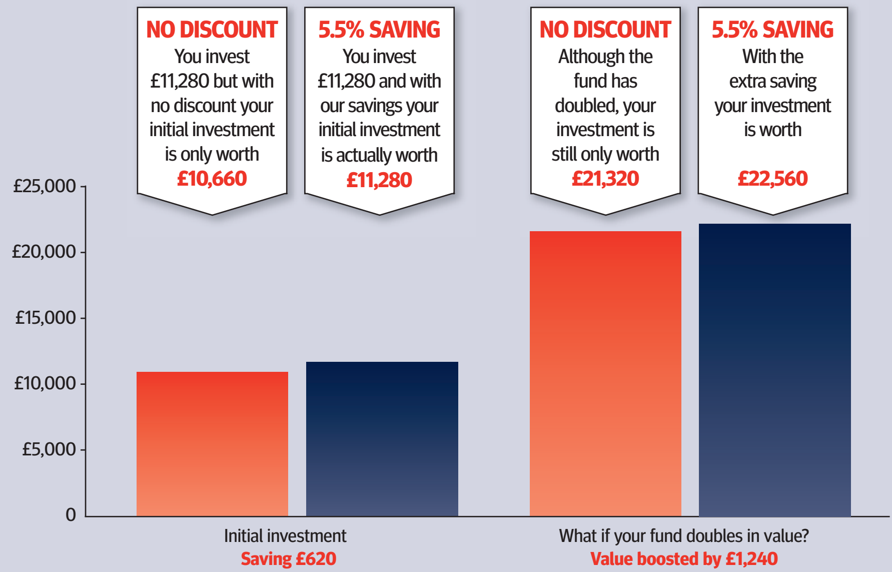
If you held, say, a Perpetual ISA, Perpetual managed the fund, administered the tax wrapper and sent you valuations. Your investment choice was also limited to Perpetual funds. To switch to a Jupiter fund, for example, you had to transfer your whole ISA to Jupiter.

This could take weeks at best, and the chances are you would have to transfer again when you next wanted to make a switch.

In addition, because ISA rules allow you to take out only one Stocks & Shares ISA each tax year, it could take several years to build up a diversified portfolio. Once you had done so, you would receive paperwork from each manager at different times of year, making it virtually impossible to keep tabs on your portfolio, and creating mountains of paperwork.

Investment supermarkets have changed all that.

HOW INITIAL SAVINGS CAN BOOST THE VALUE OF YOUR INVESTMENT



Remember investments can fall in value as well as rise.

Cutting costs

Invest with a good investment supermarket and you will be able to save up to 5.5% on initial charges - £620 on a £11,280 ISA. Some investment supermarkets also offer annual savings. Discounts can mean larger gains over time as more of your money goes to buy units in the fund, as the chart to the left shows.

Choice

Investment supermarkets also allow you to invest in any combination of funds, shares, investment trusts, corporate bonds and gilts in one account.

You can typically pick and mix from more than 2,500 funds, including top performers from the likes of Artemis, Invesco Perpetual, JPMorgan, Jupiter and M&G. The best investment supermarkets offer access to shares, investment trusts, ETFs, gilts or corporate bonds. They allow you to hold cash and then move back into the stock market when you feel the time is right. Not all investment supermarkets offer these options, so please check before you invest.

This flexibility means that you can easily spread your investments between different asset classes, sectors and fund management groups within one account. You can also make changes to your portfolio without excessive delays or charges, meaning that you can quickly react to the latest opportunities.

Simple dealing

Making changes to your portfolio within an investment supermarket is easy. You can usually give instructions by post, telephone or online. Some investment supermarkets make no charges to buy and sell funds, there are no transfer forms to fill in, and deals take days, not weeks, to complete. Easy dealing means you can quickly position your portfolio to make the most of up-and-coming investment areas and react to developments in the markets.

Reduce your paperwork

With all your investments in one place, you will benefit from receiving a single valuation for your investments. This will show you at a glance what you hold, which elements of your portfolio are performing and which are not.

Most investment supermarkets also offer a free online service through which you can monitor and manage your portfolio via a secure website 24 hours a day, 7 days a week.

Help when you need it

The best investment supermarkets will have a help desk which will answer your queries straight away.

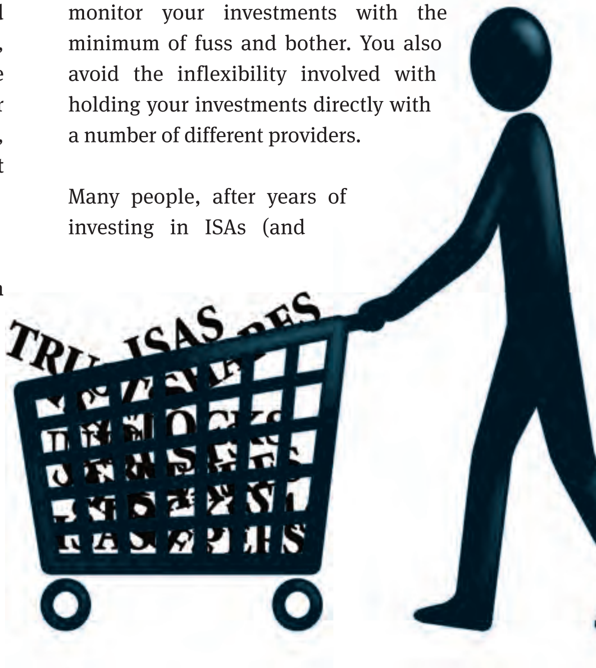
Free research

Leading investment supermarkets will also provide free, independent research to help you choose your own investments.

Best of all

Investment supermarkets allow you to hold all your investments under one umbrella. This convenience allows you to manage and monitor your investments with the minimum of fuss and bother. You also avoid the inflexibility involved with holding your investments directly with a number of different providers.

Many people, after years of investing in ISAs (and



before that PEPs) will have a hotchpotch of mismatched investments, all held in different places. Moving them to an investment supermarket can make it easier to see which areas need attention and make any changes that are required.

Not more, but less for these benefits
The economies of scale generated means that in most cases, investment supermarkets will charge you less, not more for all these benefits.

Make more of your existing ISAs

For investors who already hold ISAs, making the most of what you already have will be just as important as ensuring you use this year's allowance in full.

You can transfer ISAs from previous tax years between managers without losing the ISA 'wrapper' or affecting this year's ISA allowances. You can also transfer money from a Cash ISA to a Stocks & Shares ISA - but not the other way around. (See page 11 for details).

What next?

Hargreaves Lansdown offers its own investment supermarket – called the Vantage Service. It offers all of the features mentioned in the previous section, including market leading savings on funds of up to 5.5% when you invest. It is the only investment supermarket designed solely for clients to deal directly, without advice.

We also offer a Vantage Cash ISA, which aims to pay a competitive interest rate over the long term, and is pegged to the Bank of England Base Rate. As well as the variable rate Cash ISA we also offer higher fixed rates, typically for one or two year terms.

If you would like to open an ISA you will find everything you need to proceed on our website. You will find ISA investment ideas and application forms, or you could apply online in minutes with a debit card. Just visit **www.hl.co.uk**

If you hold ISAs with other companies, don't tolerate arrangements which restrict your choices and the ability to make the most of your investments, and don't sacrifice control.
Improvements in administration systems and technology should be making it easier for you to manage your investments. The Vantage Service lets you deal how you want and when you want - online, by post and by phone.

Knowing exactly what you hold will help you make better investment decisions. You will have greater control, a wider investment choice and you can cut costs to the bone.

If your current arrangements don't offer you the same benefits, you should consider taking action now.

Transferring an ISA is simple - all you need to do is obtain and complete a transfer form from us - we will then do the rest and arrange the transfer of your investments whilst preserving the ISA wrapper. You will find transfer forms and everything else you need to transfer an ISA on our

website **www.hl.co.uk**

If you are happy with the investments you already hold, you can normally just transfer them as they are. Alternatively, if you feel that it's time for a change, you can transfer your Stocks & Shares ISAs as cash, and reinvest the proceeds once the transfer is complete although remember while you hold cash you won't benefit if the stock market rises in value.

Whether you choose to transfer your holdings as they are or you decide to make a change, the ISA wrapper will be preserved.

Transferring Cash ISAs:

With interest rates at historic lows, a number of investors are transferring their Cash ISAs to Stocks & Shares ISAs.

This has provided a significant opportunity for investors who are willing to take more risk in pursuit of higher returns by purchasing, for example, corporate bond or equity income funds.

Of course, Cash ISAs and Stocks & Shares ISAs are different. Cash ISAs provide immediate access to capital and cannot fall in value. Conversely Stocks & Shares ISAs can fall in value as well as rise, so you could get back less than you invest. Please also remember that once you have transferred to a Stocks & Shares ISA you cannot transfer that ISA back to a Cash ISA. Also note that whilst you may hold cash in a Stocks & Shares ISA pending investment, interest on this cash is paid net.

If you are happy with the risks and want to take advantage, all you need to do is complete a transfer form from the new ISA provider.

We hope you have found this guide useful and informative, and that it will help you to maximise the potential of your ISA investment. For more information on how we can help, please don't hesitate to contact us on

0117 900 9000 or visit www.hl.co.uk

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