Aberdeen Standard Investments

A guide to investing for growth

Investing for growth

In investment terms, growth is simply a rise in an asset's value. For most people, this is why they invest. And, over the long term, patient investors can hope to grow the value of their money considerably. Growth is rarely a smooth process though. Investors need to prepare for the value of their investments to go down as well as up.

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Why growth matters

Put simply, growth is the best way to increase the value of your money. If you invest in assets that grow in value, you'll be richer. For example, if you buy an asset that increases in value by 10% a year, you'll have more than doubled your money in eight years.

Of course, growth isn't always quite as straightforward as that. Investments with the potential to grow rapidly tend to be higher risk than those bought for income or capital preservation. So their progress is rarely straightforward and could even result in losses rather than gains. But over the long term, you can hope to increase the value of your money substantially by investing in assets with good potential for growth.

Growth is particularly important in the early stages of saving into a pension. In the early part of your working life, you can afford to be patient with your pension investments. If they fall in value, you have time for them to recover. However, towards the end of your working life or in retirement, you may be more interested in receiving a regular income, or simply protecting the value of your savings or pension fund.

Risk vs reward

All investing involves some risk. The iron rule of investing is that the higher the potential reward, the more risk you have to take. The aim of growth investing is to make large gains. The risks are therefore potentially higher than if you're investing for income or to preserve your capital.

It's important to remember that investments can go down in value as well as up. The prospects for growth assets can be affected by financial markets, by the economic outlook and by circumstances specific to individual investments. Also, an investment that's successful in the long term may well drop in value in the short term.

Where to look for growth

Equities – also known as stocks and shares - are the most obvious choices for growth. But there are good growth prospects to be found in other asset classes too. These include property and bonds. These assets tend to offer fewer growth opportunities than equities. However, the income they provide can be used to help your savings grow if you reinvest it.

By reinvesting the income paid by your investments (whether dividends from shares, interest from savings accounts, regular interest payments from bonds, or the income from property), you can benefit even more from the power of 'compound interest'.

As an example, if you invest £100, any growth you get is applied to the £100, as well as any income you choose to reinvest. In the next year though, any growth is applied not only to your original £100, but also to the growth you achieved the previous year and any income that you reinvested. This happens year on year and a 'snowballing' effect occurs – every year the impact is slowly magnified.

This difference may be small over one year but, given time, compounding can build up significantly. Over longer time periods, it can make a significant difference to the value of your investment. This could help your money to grow significantly faster than if you took that income.

We'll now look at equities, property and bonds in more detail.

Equities

Equities are what most people think about when it comes to investing. Equities represent a proportion of the ownership of a company. So when you buy shares, you become a part owner of that company – a shareholder. Equities are usually traded on a stock exchange. You can track their value on the company's website, specialist investor websites or in a variety of major national newspapers.

The value of those shares will rise or fall according to perceptions of the company's success and future potential.

Equities have great potential for growth. As a company becomes bigger, more profitable and therefore more valuable, its share price usually rises. But as stock markets can rise and fall rapidly, they can be much more volatile than other investments. Many companies (although not all) also pay out part of their profits to investors in the form of a dividend. This can then be reinvested in shares, leading to a larger total return.

Not all equities offer the same growth prospects though. Shares in smaller, more entrepreneurial companies may have great potential to grow rapidly by offering innovative services or products. But they also run a higher risk of failure. On the other hand, larger, longer-established companies may be less likely to produce spectacular returns but are also likely to prove more stable. Nothing is guaranteed, of course: even the largest companies can suffer reversals or even be put out of business by existing competitors or new rivals.

Companies in certain industries are widely seen as 'defensive' – less likely to be affected by economic downturns. These companies tend to be in sectors such as utilities and consumer staples, which provide goods and services that people still need to buy even when times are hard. But even the most defensive sectors can sometimes suffer significant declines. And during the most extreme periods of stock market volatility, all sectors may fall heavily.

Nevertheless, the differing growth prospects of different types of companies allow investors to achieve a balance. For example, they might invest in some companies with the potential to grow fast and others that are more likely to provide slower and steadier returns.

For investors looking for growth, these are the most important characteristics of equities:

- Strong potential for growth
- More volatile (riskier) than many other investments
- Shares in higher-growth companies can produce exceptional returns but also bring a greater risk of losses.

Property

Investments in property can be either direct (buying a house or flat to rent out, for example) or indirect, through investing in property funds. These funds typically invest in commercial property, such as offices, warehouses or shopping centres. Investors benefit from the regular payment of rent by the properties' tenants, but can also benefit from capital growth as property prices rise.

Fund managers can also make the properties in their portfolios more attractive by improving or developing them. This can help them to command higher rents or to be sold on at a profit. For example, the manager of a property fund might repurpose offices in a desirable area as flats, and make significant gains by doing so.

Capital growth from property tends to be lower than that from stock markets, but it can be steadier. That's because selling property takes time. The difficulty of selling a property means that investors should be prepared to ride out the market's ups and downs. Property income tends to be more reliable than that from equities, although it's usually less secure than that from bonds. That's because properties can fall vacant if, for example in a commercial property like a shopping centre, the occupying businesses shrink or fail, and it can take time to secure new leases for empty units.

Most property managers regularly review the level of rent they charge their tenants too. This helps to ensure that the rental income isn't eroded by inflation. As that income can be reinvested rather than being taken, this is beneficial for growth investors.

For growth investors the most important characteristics of property investments are:

- Potential for both growth and income (which can be reinvested)
- Less volatile (less risky) than equities but riskier than bonds
- Rent reviews help to ensure that income isn't eroded by inflation

Bonds

Bonds are essentially a type of loan. They're issued by both governments and companies. When you buy a bond from an institution, you're effectively lending it money for a set period of time – 10 years, for example. In return, the institution promises to pay the bondholder regular interest payments and to return the amount borrowed at the end of the period. The bondholder can also sell the bond on the open market before that.

The value of the bond will go up and down according to supply and demand, which is determined by factors such as interest rates, inflation, and the perceived ability of the issue to make the payments due under the bond. But the movements in bond prices are usually much less sizeable than those in equities. That means that bonds tend to be less risky, but they also have less potential for growth.

Bonds are often referred to as 'fixed interest' or 'fixed income' investments. This is because the level of the regular interest payments are set and can't be changed or stopped at the discretion of the company as equity dividends can. As with equity dividends, the interest payment for bonds – known as the 'coupon' – can be reinvested.

Bonds issued by companies (corporate bonds) tend to pay higher coupons than government bonds, with the size of the payments rising according to the risk that the company will default (fail to make its payments). Bonds designated as 'non-investment grade' (also known as high-yield or 'junk' bonds) offer higher coupons to compensate for a higher risk of default.

Although bonds have limited potential for growth, they can play a useful role in a growth portfolio in two ways.

1. Holding government or investment-grade corporate bonds can help to offset losses made by higher-growth equities, which tend to be volatile.
2. Holding high-yield bonds (though riskier) can provide a higher level of income, which can be reinvested.

For investors seeking growth, these are the most important characteristics of bonds:

- Limited potential for growth but more dependable for income, which can then be reinvested
- Less volatile (less risky) than many other investments
- Corporate bonds are riskier than government bonds, but also tend to offer higher interest payments

How to invest

It's possible to grow the value of your money by simply investing directly in various assets. But doing this effectively can be time-consuming and labour-intensive. That's particularly true of equities and property, because these assets need to be monitored to make sure that their growth prospects remain intact. Those prospects can change rapidly in response to company-specific developments or changes in the economic environment.

That's why many people choose to invest in funds run by professional managers that specifically target growth. These funds pool investors' money together and then divide it between different investments. You benefit from the managers' experience and their knowledge of the risks associated with the different types of investments. There are many different kinds of growth funds to choose from. Some have stated growth targets, although there are no guarantees that these will be achieved.

Whichever route you choose, we'd always recommend that you speak to a financial adviser before you make an investment decision. If you don't already have a financial adviser and would like to find one in your area, take a look at www.unbiased.co.uk

Important Information

This information is to help you understand more about investing for growth and the risks.

The value of investments, and the income from them, can go down as well as up and investors may get back less than the amount invested. Past performance is not a guide to future results.

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