MeaningfulMoney Podcast - Session 67

Subject: Shares vs Funds

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Pre-music and Welcome

Hi folks and welcome to the Meaningful Money Podcast, Session number 67

This is the podcast dedicated to helping you put your finances in order. I'm Pete Matthew and I'm going to share with you everything you need to know, and everything you need to do to secure your financial future. I'm here to help you make sense of money.

Session Title Announcement

Here we are at session number 67 , and we're going to be talking about Shares vs Funds. I've said several times on this show that I much prefer investing in funds than shares, and even that I would never voluntarily hold shares if I could help it. But a reviewer on iTunes by the name of CF040PV called me out on his review and said that I have never really explained why I believe this to be the best option for most people. While I think I have given some outline reasons, I intend to address this shortcoming in this session.

After the main body I'm going to look at the most recent reviews that have been left by listeners, and announce the next session topic. If this show is of any use to you, it would help me massively if you would take the time to leave me a review on iTunes. This has a huge impact on keeping me near the top of the rankings, which in turns helps more people to find the show and to subscribe. I'll remind you again at the end of the show, but if you want to do it right now go to meaningfulmoney.tv/iTunes

But first…

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Introduction

Shares are one of the basic building blocks of any portfolio. They are just one of many asset classes, align with bonds, gold, property, commodities and the like. I covered asset classes in detail way back in session 10 [LINK].

These building blocks are pieced together in various ways to form a portfolio of investments designed - hopefully - to achieve a given aim, whether that be income or capital growth or a combination of the two.

But most people don't think their investments through as they should, so here are my reasons for feeling that a fund - which is a collection of shares and other assets wrapped in a tax-efficient mechanism - is the better way to invest for most people.

As we go through this remember that all the links I mention, plus a transcript of sorts is at the show notes for todays session. It's the only link you need to remember: meaningfulmoney.tv/session67

My experience with shares

As you know by now I am a financial adviser by trade though I prefer to call myself a financial planner because that's what I am. Traditionally, people like me never, ever sold shares. Why? Because there was no commission available on them. Funds, on the other hand, allowed us to build in a commission paid either up front or ongoing or both.

I've never been a particularly commission-hungry salesman, as it happens, but I have sold my fair share of funds in my time. I have also come across share portfolios of all shapes and sizes, from upward of £1million portfolios to small hobby holdings or shares inherited from loved ones.

But in my 16 years plus of advising clients, I can count on one hand those clients who have been able to stay on top of a portfolio of shares in a way which serves their plans constructively.

Here are the most common problems I see among those holding shares. Afterwards I'll cover the reasons why I think funds are the better way to go for the vast majority of people…

1 - Most people have no strategy for the shares they buy

Very few people have any kind of strategy for any investment they hold, if I'm honest. That's something I've tried to redress in previous sessions of this podcast, e.g. Session 41 [LINK]. So this particular point isn't limited to those holding shares but still it is very rare indeed.

Instead people build up portfolios of funds with no rhyme or reason. They will look for companies they find interesting or have read about and decide to buy in.

The ones who make this work are - in my experience at least - those who have amassed enough assets and income to be able to 'punt' on their share choices.

I have never come across someone who has made themselves wealthy this way. Instead it is a hobby for the already-wealthy.

I would say it is very difficult to be forward-thinking about building a share portfolio. I know that any stockbrokers listening to this will disagree, but for what it is worth, I have never seen a stockbroker portfolio which was well thought-out and well put together. Seriously.

If there's no strategy or reason for investing, I'm not sure it is worth investing at all.

2 - Most people with share portfolios have very concentrated risk

Shares represent just one asset class, albeit a fairly broad one. Shares come in all shapes and sizes. They are issued by large companies and small companies. Thriving companies and struggling companies. UK companies and companies form every other country in the world. In these days of the internet there are ways to invest in any share you like, within reason.

But they are all shares, and as such they have all kinds of characteristics in common. This means that if market sentiment is against shares, they will likely all suffer to a greater or lesser extent. Holding a portfolio of just shares then, would be considered high risk.

Spreading your money across many different shares is one way of mitigating this, but you need a decent size portfolio to get adequate spread and holding more shares means more dealing fees usually, which can get expensive very quickly.

I would define a balanced portfolio as being somewhere near 50% invested in shares. If your money is invested 100% in shares, then that is an adventurous portfolio by any measure. It would simply be a matter of degree as to whether it was adventurous or very adventurous or extremely adventurous. In my experience, very few people are adventurous investors when the rubber hits the road. They might think they are, but when I tell them that they might expect to lose 20, 30 or 50% of their money, they often temper their enthusiasm.

3 - Most people who hold shares fail to deal adequately with the paperwork and complain about it all the time

Shares cause an admin headache like you wouldn't believe. Even if you only hold a few different shareholdings, you will get twice yearly dividend information (possibly) plus a dividend tax voucher at the end of the year maybe. You'll get notices of annual general meetings with voting forms and proxy voting forms and all the stuff that goes with them.

If your company is bought or is looking to buy another company, there will be a prospectus for the sale and all manner of forms for you to fill in.

Every now and again, a share may be split, or changed in some other way, so the number of shares you hold may change. Then your certificate may be reissued, so you have to remember to destroy the old one. I've lost count of the number of times I've been sorting out someone's paperwork and I end up with a handful of share certificates, only to find that only one of them is the live one; all the rest are out of date. The client thinks they hold lots of shares but they don't at all!

Shares produce paperwork, even in this day and age. If you're the kind of person who leaves everything that comes through the door inside the envelope that it came in, and just bungs it in a drawer, share ownership is not for you. Listen back to session 46 [LINK] for how to deal with financial paperwork.

4 - Many people hold shares for sentimental reasons, against their better judgement

Now I understand this one, I really do. I frequently come across someone who holds shares because they were left them by their father, or more frequently because they used to work for the company whose shares they hold and they are loathe to turn their back on the shares.

Let's be clear though, sentiment is no reason to invest your money somewhere. Cold reality can show sentiment up to be a daft reason for investing.

For example I have a client who worked all his life for Cable & Wireless, travelling the world in a brilliant career. Through share options, awards and self-investment, he had amassed a portfolio of £150,000 worth of C&W shares by the time he retired. My predecessor at a previous employment who advised this client before me, had repeatedly advised the client to sell the shares over time, realising the gains in a tax-efficient manner and spreading the money more widely. He consistently refused to do so.

Then the technology bubble popped in the year 2000 and C&W was arguably mismanaged by a succession of poor boards. My clients £150,000 portfolio turned into an £8,000 portfolio. His widow eventually sold the shares a couple of years ago for £22,000.

Fortunately, he had a fantastic pension and other investments, but imagine if he hadn't. Those who are supposed to know what they are doing are not immune. One of my colleagues worked for Lloyds TSB for 20 years and when the credit crunch hit his shares, which used to be worth £10 each dropped to 30-odd pence. That's gotta hurt: a 97% loss.

Nothing wrong with sentiment, just don't bet the farm on it.

Summarise these reasons

So these are the reasons I've come to dislike direct share investment over my years as a financial planner. I can count on one hand the number of people who have thought it through, who can keep up to the volume of paperwork it generates, who have adequately spread the risk and who don't allow sentiment to get the better of them.

If that's you, then fill your boots. You'll probably end up a millionaire. For the rest of us, the easy-access alternative to all the benefits of share ownership comes in the form of collective investment funds such as OEICs, Investment Trusts and Unit Trusts.

So here's why I think that for the masses, funds are the better bet:

Why I think investing via funds is better than holding shares directly

Here are my top six reasons for preferring funds over direct investment in shares:

1 - Diversification

When buying a fund, chances are your money will be spread far more widely than it will be if you invest in a portfolio of shares yourself. Unless you have many tens or even hundreds of thousands of pounds, you're going to get your money spread ten ways, maybe a few more.

With an average fund, it is likely that there will be 30-100 individual holdings, so your get greater diversification that way. If you hold a multi-asset fund, which I recommend for those getting started with investing, then you could hold many hundreds of individual assets, indirectly through the fund, and also different TYPES of asset, spreading the risk further.

This has to make sense, right?

2 - Reduced administrative burden

All the hassle that comes from direct ownership of shares disappears when you own the shares via a fund. Because you own the fund and the fund owns the shares, you don't have to vote at meetings or deal with the raft of paperwork.

Instead you get all the benefits of share ownership, like capital returns (both down and up!) and dividends, with none of the grief. You'll get a statement from your platform or fund provider twice a year and a dividend statement once a year, and that's about it.

3 - Expert investment management or passive spread

A key reason to use a fund to invest in shares is that by doing so you should benefit from the expertise of the fund manager. Presumably, if you re going to pay the additional costs of investing in a fund, there should be some benefit, and the benefit in this case should be the added value given to you by using a manager that makes good decisions about which shares to buy and sell in his or her fund. Chances are, the fund manager has better access to the management team of any given company whose shares he may want to invest in, than you do.

Of course, it doesn't automatically follow that by investing in a fund you'll have a better return experience. You may pick a rubbish fund manager and be worse off. Consider investing in a passive fund then, through which you buy all the shares in whatever sector you're interested in and you track the market rather than trying to beat it. Your money will be spread more widely because the tracker fund will hold many more shares than you can personally.

Again, the benefit here is that off investing collectively through a fund - pooling your money with other fund investors to gain the benefit of economies of scale. There is a cost, but in my view, the benefits are worth it, particularly if you opt for the passive approach.

4 - Risk management

Generally speaking, a fund will have an aim or objective, e.g. To beat the performance of the FTSE100 index by choosing the best stocks from the index to buy and sell, or to track the performance of the FTSE All-Stocks index or whatever. That's the strategy that is generally so lacking in those choosing to invest in shares directly. The investment has a purpose both in itself, and more importantly, as part of your general planning.

Part of this will be an element of risk management, as funds want to rise to the top of their peer group but don't necessarily want to take silly risks to achieve it. Some funds manage risk, as measured for example by the volatility of the fund price, better than others. It is even possible to buy funds with risk characteristics in the name of the fund like the XYZ Balanced fund, or the ABC Cautious Managed fund.

Risk management is easier with a fund and it is also easier to fit a fund into the general aims of your financial plan, than it is to do so with a portfolio of individual shares.

5 - Access to higher-level investments

This is another benefit of pooling your money with the collective and the economies of scale that brings. There are plenty of investments available to mere mortals with a few thousand to invest, but there are far more available at the upper rungs of the ladder, where you need several hundred thousand or even several million to get a slice of the action.

Often these are called institutional investments and they are bought and sold by pension funds and university endowments who have billions to play with. By pooling your money with the other holders of a fund, you can have the scale to benefit from the lower costs of these types of top-tier investments, which you never could as an individual investor.

6 - Capital Gains Management

And finally, managing CGT is easier if you use funds rather than individual shares.

Let's say you want to invest in FTSE100 shares. Either you can buy and sell some chosen shares yourself, or you can buy a fund which invests in the same way. Whenever you sell a share for a profit, you have a capital gain which needs to be logged and if you make enough gains, you may need to pay tax on. When the fund sells a share, there is no tax burden on you, only when you sell out of the fund itself.

So small, day-to-day decisions to buy and sell can be exempt from CGT as far as you the individual investor is concerned. One less thing to think about along the way has to be worth considering.

Summary

I know that I sound very much against investing directly in shares here, but for the right people it can work. I covered the hows of getting it right back in session 54 [LINK]. There are pros to investing in shares, just as there are cons. But hopefully I've answered the constructive criticism from CF040PV on iTunes that I haven't explained why I have a preference for investing in funds.

I prefer passive funds to active ones as they are lower cost and reduce the risk of choosing the wrong fund manager. I prefer multi-asset funds as they do all the asset allocation and risk management for you.

If you're after a more involved, modular approach to building an investment portfolio, then different funds for different asset classes can work if you're prepared to put in the time to research the funds properly, and not just choose them because your mate down the pub has them.

Ultimately, this is the point: far too many people approach investing in a haphazard, not-thought-through way. Most people who own shares invest this way. Investing via funds can brings an element of discipline and structure to the process, which can only be a good thing.

What do you think, have I convinced you?

This week's reviews

[This is where I read the reviews]

Huge thanks to **Chori Chori, Paul7116** and **MissMoneyPocket** for your reviews this week. Leaving me a review on iTunes is the best way to show your appreciate for the show. It keeps me near the top of the rankings which in turns makes the show visible for other people to subscribe. Go to meaningfulmoney.tv/iTunes to leave a review or click the big red button below:

News

- **Weight Loss update:** Now standing at 16 st 11lbs meaning I have now lost a stone and a half since the new year. Find out what it is all about here
- **Survey:** I have launched my first listener survey - you can take it by clicking here. I hope to learn more about what makes my audience tick. It takes just five minutes - please help me by completing the survey soon!
- **New ISAs:** Fill your boots! £15,000 limit now on ISAs

Next Session Announcement

Next time we'll be talking about Finance for Students. I'll cover student loans, saving for university, likely costs, the best ways to save, and hopefully spending some time looking at what new graduates can do to get their finances in order. If you have a question on this subject, or any other financial query that you want answering here on the show, then the best way to do that is to leave me a voicemail at meaningfulmoney.tv/askpete

Outro

That's it for this session of the MM podcast, I hope it was helpful. If I missed anything or if you have any questions, please leave them comments section [below] at meaningfulmoney.tv/session67

I hope you enjoyed this session. Thanks for listening - I'll talk to you next time.