

A GUIDE TO INVESTMENTS AND RISKS



Merchant Securities



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INTRODUCTION

Merchant Securities Limited (“MSL”) is committed to developing a clear and shared understanding of risk with its clients. To open an account you will be required to select one of the five categories of risk set out within our client account opening forms. Within that category, your specific requirements can be met.

Please remember that the attitudes to risk of different investors can vary significantly and we encourage clients to contact us without delay if they have any questions or concerns relating to the risks to which their investments may be exposed.

MSL can provide you with advice on your options for managing the risk of your investments.

Our Guide

This Guide to Investments and Risks has been designed to explain general investment risks and provide a brief description of the nature and risks of the following range of investments:

- Shares – UK and overseas (Equities)
- Bonds – government and corporate fixed interest securities (Debt)
- Unit Trusts and Open Ended Investment Companies (OEICs)
- Investment trusts (Shares)
- Structured Products (we refer to these as ‘managed funds’)
- Warrants and Options (Derivatives)
- Contracts for Difference (CFDs) and Spread Betting (Derivatives)
- Exchange Traded Funds
- Unquoted investments (including AIM shares)

It is important that you understand that there is risk with all investment and that you may not get back the original capital invested. The value of your investments may fall as well as rise, and the past performance of investments is not a guide to future performance.

You should also understand that any investment, even cash carries risk, if risk is defined not by the face value of cash, but by its purchasing power. Inflation at only 3% erodes the purchasing value of cash by 50% in 23 years, whereas an inflation rate of 5% achieves the same effect in only 14 years and reduces it by almost 75% in 25 years.



GENERAL RISKS

A number of general risk factors affect the risk of all investment product types. These are summarised below. We have attempted to explain in simple language a number of technical terms and jargon used by us and other firms to describe such things as: volatility, leverage, margin and gearing.

Daily price changes

The day to day value of investments will fluctuate with supply and demand in markets. You may therefore be faced with the prospect of selling your investments at a time when prices are depressed. For example, you might need to raise money quickly to meet other financial commitments and not all investments are priced daily.

Certain types of investments, for example, redeemable preference shares, can be redeemed (bought back) by the company that issued them; the timing and price of the buy back may not be at a time or price that suits you.

Variability of income

Returns from investments in the form of income that is, **interest payments** and **dividends**, may go down as well as up. For example, A company may cut or fail to make a dividend payment, while a company in financial distress may fail to pay interest to the holders of its debt (Corporate Bonds).

Liquidity

Liquidity is the ability to buy and sell assets. Some investments, even though they are quoted on a stock exchange, are traded infrequently and as a consequence it may be difficult to buy or sell these within a particular timeframe or at a specific price. In some extreme cases, it may be difficult to establish any price for an investment where there are no buyers or sellers in the market.

Leverage, Gearing, Margin and Volatility

Leverage and **Gearing** are technical terms used to describe borrowing in the context of investments.

Borrowing in order to invest in derivatives such as CFDs increases both the “volatility” and the risk of the investment.

Volatility is the technical term used to describe the relative rate at which the price of an investment moves up and down. If the price of an investment moves up and down rapidly over short time periods, it has high volatility. If the price almost never changes, it has low volatility.



Margin. For certain types of investment, e.g. CFDs and spread bets (see 7 below) investors will be required to put up margin. Margin is usually a deposit, for example, 5% or 10% of the amount invested. This deposit is technically referred to as “margin”. Firms may raise their required margin at any time after you have invested (opened a position), which may force you to sell your investment (this is known as closing your position), or make a call on your other sources of cash (to keep the position open). Margin is therefore the amount of money you will need to deposit with a firm to cover your potential losses.

Foreign exchange

Your investments may be denominated in a currency other than sterling. Where an investment is denominated in a different currency you are exposed to fluctuations in the exchange rate of that currency as well as to the movement in the price of the investment itself. Changes in the exchange rate can cause the overall value of an investment to fall as well as to rise.

Taxation

The tax treatment of any investment is determined by the specific circumstances of each client and government legislation. Taxation may change during the lifetime of an investment. This may result in unanticipated tax liabilities. You should take tax advice in order to be aware of the potential liabilities before making an investment. If your circumstances change or you are uncertain of how an investment might affect your own tax position you should seek professional advice.

Overseas Investments: legal risks

Many emerging countries do not yet have a legal system comparable to those of more developed countries. Legal reforms may not always correspond to market developments, resulting in ambiguities and inconsistencies which increase the risk of investing in these countries. Legislation to safeguard the rights of private ownership and control as well as establishing intellectual property concepts may not yet be in place, and there is risk of conflicting rules and regulations. Laws and regulations governing investment in securities markets may not exist or may be subject to inconsistent or arbitrary interpretation or application. The independence of the judicial systems, and their susceptibility to economic, political or nationalistic influences, remains largely untested. It may be impossible to predict whether a foreign investor would obtain effective redress in the local courts in respect of a breach of local laws or regulations, or in an ownership dispute.

Settlement risk

The concepts of ownership of and procedures for the transfer of securities in emerging countries may differ radically from those in more developed markets. In some markets, for example, the term delivery versus payment ("DVP") does not imply that securities and cash move at the same time.

Registration of shares may not be subject to standardised procedures or to a centralised system, and may be effected on an ad hoc basis. The concept of nominee ownership is undeveloped and, in some cases, not recognised at all. As a result, registration can be administratively cumbersome and time consuming, leading to delays in settling trades, ownership disputes and constraints on trading.



The realisation of rights of ownership, for example the exercise of shareholders' rights, cannot be assumed. Moreover, in some markets the risk of conflicts of interest on the part of those responsible for the conduct of the registration procedures, and the risk of fraud (for example, in connection with physical certificates) or of a registrar refusing to effect registration without justification (or of a registrar deleting a registration once it has occurred, with a consequential total loss of investment) is higher in many cases than in more developed markets.

Insolvency

Although client money and investments are protected by the rules of the UK financial services regulator, the Financial Services Authority ("FSA"), and your assets are held completely separate from those of MSL, our insolvency, or the insolvency of any other broker with whom we deal on your behalf, may lead to positions being liquidated or closed without your consent. In certain circumstances you may not get back your original assets.

1. Shares

You can buy shares as part of a pooled investment or directly, when you buy through a Stock Exchange. Shares are also known as **equities** or **stocks**.

When you buy shares direct in a company, you are buying a part of that company, and you become a shareholder, which usually means you have the right to vote on certain issues. You can either buy new shares when the company starts up and sells them to raise money (through an Initial Public Offering), or buy existing shares which are traded on a Stock Exchange.

The aim is for the value of your shares to grow over the longer term as the value of the company increases in line with its profitability and growth. In addition, you may also receive **dividends**, which is an **income** paid out of the company's profits. Longer-established companies usually pay dividends whilst growing companies tend to pay lower, or no, dividends (with these you would typically be hoping for better capital growth).

Risk

The main factor determining the price of a share is the perception of its current value to its owner.

Another factor that affects the price of a share is a change in opinion as to how well the company is performing financially or could perform in the future. This opinion is usually based on predictions about demand for company's products or services and the economic conditions in which a company is operating.

If you are investing in shares you should expect the value of your investment to go down as well as up, and you should be comfortable with this. Holding a limited number of shares that do not provide adequate diversification can result in this risk being exacerbated, and investors in individual equities should be particularly aware of the risks inherent in such an investment strategy (i.e. the specific risks of those securities). MSL categorises single equities as higher risk, and equity investment, by way of a diversified portfolio of equities as either Medium/High or Higher risk.



If you have a wide range of shares and other investments (a diversified portfolio) you are very unlikely to lose all your money. It is important to stress that unless you are trading or speculating for the short-term, you need to be looking to the medium to long term when investing in shares. Medium term is often regarded as 3 to 5 years and longer term as at least five years, but preferably longer.

Foreign shares: If you are investing in overseas companies, you will also be subject to Currency risk as a result of exchange rate fluctuations. For example if you buy US dollar denominated stock and the dollar declines against the pound, then the sterling value of the stock will decline, even if the actual dollar share price remains the same. This can therefore impact the performance of your portfolio as a whole.

2. Bonds or Fixed Interest Securities

A **Bond** is a loan to a company, government or a local authority. Generally, interest is paid to you as the lender and the amount of the loan repaid at the end of the term. There are many other names for this type of investment, for example:

- loan stock
- debentures
- debt securities
- gilts (loans to the government), and
- corporate bonds (loans to companies)

The main benefit of these investments is that you normally get a regular stable income. They are not generally designed to provide capital growth.

Bonds may be traded on the bond market, but the price you pay for a bond may be more or less than its original issue price. There are several reasons why the price might vary from the original issue price, for example:

If a bond is issued with a fixed interest rate of, say, 6% and general interest rates then fall well below 6%, then 6% will look like a good yield and depending on the creditworthiness of the issuer, the market price of the bond will tend to rise – perhaps from £100 to £110 or £120.

The reverse is also true. If interest rates rise, the fixed rate of a particular bond might become less attractive and its price could fall below £100.

Ratings agencies, such as: Moody's, Standard & Poors and Fitch, whose job it is to rate the financial strength of companies and government bonds, might take the view that a particular company's bond or government bond no longer qualifies for a high rating. The agencies use AAA, AA etc to rate the strength of the company / issuer, where AAA is the highest rating and D the lowest. For example, if a company is not performing as well as it was when the bond was issued, then the rating and price of the bond might fall. On the other hand, the company's rating may be upgraded leading to a price rise.

The inflation rate might start to go up and the interest rate on some bonds might start to look less attractive compared with other investments.



Risk

If you ignore the inflation risks outlined above, bonds are generally less risky than having a share in a company because in the event of a company being put into administration, the bondholders will rank higher for a repayment of their loan than ordinary shareholders. Any repayment will usually be made to bondholders and secured creditors first. One of the main risks is that the company you have lent money to can't pay the interest due or cannot pay the money back at the end of the term (maturity).

A government is expected always to pay in full – though there have been instances of certain countries having been unable to repay. Government bonds are also rated by the ratings agencies and the lower the rating, the higher the return should be, reflecting a higher risk of default.

Companies have different credit ratings and a company with a high credit rating e.g. AA is regarded as safer than a company with a lower credit rating e.g. BB. Companies with a lower credit rating will have to offer a higher rate of interest on their bonds than companies with the top credit rating, simply to attract investors and to compensate for the higher risk.

Many bonds can be bought and sold in the market (like shares) and their price can vary from day to day. A rise or fall in the market price of a bond does not affect what you would get back if you hold the bond until it matures. You will only get back at maturity, the issue price (nominal value) of the bond in addition of course to any interest or income payments to which you've been entitled during your ownership of the bond, irrespective of what you paid for it. If you paid less than the issue price then you will have made a capital gain when the bond matures; and a capital loss if you paid more than the original issue price.

This only applies if you buy a single corporate bond. It doesn't apply to bond funds because these invest in many different bonds so there is no single maturity date for your investment.

3. Unit Trusts and Open Ended Investment Companies (OEICs)

Unit trusts and OEICs are the most common form of Collective Investment Schemes in the UK. These are funds run by fund management companies. In Europe they are called UCITS schemes, (*Undertakings for Collective Investment in Transferable Securities*) which are permitted under European legislation to be sold in the UK.

They are called **open ended** as the number of units/shares in issue increases as more people invest and decreases as people take their money out. As an investor, you buy units/shares in the hope that the value rises over time as the prices of the underlying investments increase. The price of the units/shares depends on how well the underlying investments perform.

You might also get income from your units/shares through dividends paid by the shares (or income from the bonds, property or cash) that the fund has invested in.

Charges: When you buy units/shares in a fund, you usually pay an initial charge.



For some unit trusts, you buy units at the “offer” price and sell them at the “bid” price. The bid price is lower than the offer price and the difference is called the “bid/offer spread”. These funds are referred to as being **dual-priced**, however, most now adopt a **single price** and therefore there is no bid/offer spread. The initial charge is usually included in the bid/offer spread or single price, which can often be around 5%.

Some funds have no initial charge, but there may be an exit charge instead when you withdraw your money by selling units/shares.

For OEICs, there is no difference between the buying and selling price of units and they are therefore single-priced. If there is an initial charge, it is added to the single price when you buy units.

The fund management company takes an **annual management charge** (“AMC”) directly from the investment fund. There are also other costs – buying and selling within the fund, custodian fees, etc. These costs, along with the AMC, are called the **total expense ratio** (“TER”). The TER is therefore an estimate of the total ongoing costs of the investment.

Risk

Open-ended investment funds generally invest in one or more of the four major asset classes - shares, bonds, property and cash. Some funds will spread the investment risk and have, for example, some in shares and some in bonds. This can be useful if you are only taking out of one investment and want to spread your investment across different asset classes.

The level of risk will depend on the underlying investments and how well diversified the open-ended investment fund is. For example, a fund which invests only in one industrial sector, such as technology, will invariably be more risky than funds that invest across the whole range of companies in a market.

Some funds might also invest in derivatives, for example Options and Warrants, which may increase the risk profile of a fund. However, fund managers often buy derivatives to help counterbalance the risk involved in owning assets or in holding assets valued in other currencies.

Your money in an open-ended investment fund is subject to oversight by a trustee or depository who ensures the management company is acting in the investors' best interests at all times.

As with shares, if the fund you invest in is denominated in a currency other than sterling, exchange rate movements will impact upon the value.



4. Investment Trusts

An investment trust issues shares as opposed to units and is another form of collective investment. Unlike an open-ended investment fund, an investment trust is **closed-ended**. This means there are a set number of shares available, and this will remain the same no matter how many investors there are. This can have an impact on the price of the shares and the level of risk of the investment trust. Whereas open-ended investment funds create and cancel units/shares to suit the number of investors, closed ended investment funds do not. To sell the investment, a seller needs to do so in the market.

Charges: Because of the need to match buyers and sellers, the shares of an investment trust are generally traded on a Stock Exchange, in the same manner as the shares of any other quoted company. You usually pay dealing commission when you buy and sell investment trust shares.

The difference between the prices at which you buy and sell (the bid/offer spread) is a different charge from that of open ended funds. The bid/offer spread is the price that certain firms standing in the market are prepared to buy and sell investments. These firms are regulated by the FSA and are called **market makers**. The market makers provide the **liquidity** to the market and make their money by the difference between the buying price and the selling price on quoted securities.

Risk

The price of the investment trust shares depends on two main factors:

1. The value of the underlying investments. In this respect it works in the same way as open-ended investment companies.
2. The popularity (or unpopularity) of the investment trust shares in the market.

Investment Trusts are closed-ended – they have a fixed number of shares. If there is a high demand for a particular investment trust's shares, then it will be possible to sell them at a higher price than if there are few people willing to buy them.

The result is that investment trust shares do not simply reflect the value of the underlying investments, they also reflect their popularity in the market. The value of the investment trust's underlying investments is called the **net asset value** ("NAV"). If the share price is exactly in line with the underlying investments then it is called **trading at par**. If the price is higher as the shares are popular then it is called **trading at a premium** and if lower, **trading at a discount**. This feature may make them more volatile than other collective investments (assuming the same underlying investments).

Gearing: Investment Trusts are also able to borrow money to invest, which is called **gearing**. Gearing improves a trust's performance when its investments are doing well. However, if its investments do not do as well as expected, gearing lowers performance – for example:

If the investment trust is made up of £50m of investors' money and £50m of borrowing then the total fund available for investment is £100m. Say the NAV of the fund goes down by 10% as a result of losses in the market – the NAV falls from £100m to £90m. However, bear in mind that the borrowing is still £50m and so the remaining £40m belongs to the investors. Although the overall NAV went down by 10%, the investors' money has gone down by 20% (ie from £50m to £40m). So gearing boosts gains, but also magnifies losses.



Not all investment trusts are geared and deciding whether to borrow and when to borrow, is a judgement the investment manager of the investment trust makes. A gearing figure of 100 means that an investment trust is not geared. Any figure over 100 shows the proportion of its total investments that is borrowed. For example, a gearing figure of 120 means that borrowed money amounts to one-sixth of a trust's total investments.

An investment trust that is geared is a higher risk investment than one which is not geared (assuming the same underlying investments).

5. Structured products

Structured investment products can be any one of a wide range of investments and can offer income, capital growth, or a combination of both. Most structured products tend to be open to new investment for a short period of time. Your money will then usually need to be tied up for between one and ten years until the product matures, but most structured products offered by Merchant Securities can be bought and sold before maturity in the secondary market. Structured products can give investors exposure to investments that would otherwise prove difficult or expensive to access, for example, to emerging markets, oil, gold, etc.

How do they work?

Structured products offer returns based on the performance of underlying investments. Many products are linked to a stock market index such as the FTSE 100, or the MSCI Emerging Markets Index.

A typical structured product will have two underlying investment components:

a note – (a type of debt security issued by a bank). This component is used to provide capital protection. It may pay interest at a specified rate and interval, and may repay some or all of your original money at maturity; and

a derivative – (a financial instrument linked to the value of something else, such as a stock market index or the price of another asset, such as oil or gold). This component is used to provide the potential growth element that you could get at maturity, or in the secondary market if you sell before maturity.

Is your capital protected?

Even if a product offers 'capital protection' the issuer (bank) of the product can sometimes fail, causing you to lose some or all of your original money. You might consider therefore spreading your investment between several products which rely on different financial institutions (banks) to protect your money. You should always know which financial institution is ultimately responsible for offering any 'capital protection' and Merchant Securities is committed to making this clear in any promotional literature it publishes.



Risks

You could lose some or all of the money you put in to these products, so make sure you understand the risks before investing.

The following list is not exhaustive and not all risks or features are applicable to each type of structured product.

Credit risk – a product may be designed and marketed by Merchant Securities, but the returns and guarantees are generally provided by a third party (the issuing bank). If that third party goes bankrupt, you could lose some or all of your money, even if a product is called ‘protected’ or ‘guaranteed’. You may not be covered by the Financial Services Compensation Scheme if this happens. Some products try to mitigate this risk by holding collateral (additional money in other assets) in case the third party fails. If this is the case, you should check that you understand how this collateral is treated and how safe it is.

Market or investment risk – if the return of your original money depends on the performance of a stock market index or asset, then if the level of that index or asset falls during the term of the investment you may lose some or all of your original money.

Liquidity risk – the benefits offered (such as capital protection) are usually only available if the product is held for the full term i.e. until maturity. It may be difficult or expensive to access your money before the end of the investment term, but most products designed and marketed by Merchant Securities, can subject to the issuer making a market in the product, be bought and sold in the secondary market.

No dividend income – even if a product is linked to the performance of a stock market index, you will not receive any dividend income from the companies which make up that index. This can mean that returns are lower than on other stock-market-linked investments.

Capped returns – many products restrict or cap the level of the return you can receive, so if an index or asset price rises above the level of that cap, you do not receive additional returns.

Averaging – the return offered by some products can depend on several measurements of index levels or asset prices during the life of the investment. While this can protect you from short-term falls in an index level or asset value, it may also prevent full exposure to any gains.

Limited participation – many products only offer a proportion (for example 50%) of any gains made by the index or asset to which they are linked.

Inflation – even where a product is marketed as ‘100% capital protected’, the real value of the capital can suffer significant erosion by inflation over the term of the investment.



6. Warrants & Options

Please note, you will not be able to trade in warrants, options or futures unless we are satisfied that you have adequate knowledge and experience to fully understand the nature and risks of these investments (derivatives). If you are interested in these types of investments please contact one of our investment advisers for further information.

Warrants: A warrant is a time-limited right to subscribe for shares, debentures, loan stock or government securities and is exercisable against the original issuer of the underlying securities.

It is essential for anyone who is considering purchasing warrants to understand that the right to subscribe which a warrant confers is invariably limited in time with the consequence that if the investor fails to exercise this right within the predetermined time-scale then the investment becomes worthless.

Transactions in off-exchange warrants may involve greater risk than dealing in exchange traded warrants because there is no exchange market through which to sell your investment, or to assess the value of the warrant or the exposure to risk. Bid and offer prices need not be quoted, and even where they are, they will be established by dealers in these instruments and consequently it may be difficult to establish what is a fair price.

Options: these are securities that convey the right, but not the obligation, to engage in a future transaction on an underlying security at a fixed price. For example, a call option provides the right to buy some amount of a security at a set strike price at some time on or before the expiration date, while a put option provides the right to sell. The decision on whether to exercise the right to buy or sell will depend upon the value of the underlying security at the time and whether this will result in a profit or not.

Risks

Buying options involves less risk than writing options because, if the price of the underlying asset moves against you, you can simply allow the option to lapse. The maximum loss is limited to the premium you will have paid to open a position plus any commission or other transaction charges.

If you write an option, the risk involved is considerably greater than buying options. You may be liable for **margin** to maintain your position and a loss may be sustained well in excess of any premium you will have received for writing the option. By writing an option, you accept a legal obligation to purchase or sell the underlying asset if the option is exercised against you, however far the market price has moved away from the exercise price. If you already own the underlying asset which you have contracted to sell (where the options will be known as 'covered call options') the risk is reduced. If you do not own the underlying asset ('uncovered call option') the risk can be unlimited. Only experienced persons should contemplate writing uncovered options, and then only after securing full details of the applicable conditions and potential risk exposure. **We will not accept transactions for 'uncovered' call options.**

7. Contracts for Difference and Spread bets

Please note, you will not be able to trade in CFDs or Spread bets unless we are satisfied that you have adequate knowledge and experience to fully understand the nature and risks of these investments (derivatives). If you are interested in these types of investments please contact one of our investment advisers for further information.



CFDs: these are geared or leveraged instruments. When trading a share via a CFD, instead of paying the full consideration a **margin** payment from as little as 5% of the value of the contract may be paid. Consequently you can hold a position up to 20 times greater than would be possible with a traditional investment. Anticipating the right price movement will magnify profits. Conversely, losses can rise commensurately if the price moves against you.

CFDs are available on the shares of most listed companies in the UK and major economies around the world as well as indices, gold, silver, energies, commodities, interest rates, foreign exchange and more.

CFDs are leveraged products that can lead to large gains but can also quickly result in losses that exceed your initial deposit. CFDs may not be suitable for everyone, so please make sure that you fully understand the risks involved. The potential risks mean that our CFD service is only available to those clients with a sufficient level of investment experience and understanding.

In addition to buying an equity CFD and “going long”, investors can sell shares they don’t actually own, or “go short”, in anticipation of buying back at a lower level and profiting from a price fall. Other than some shareholder privileges, a CFD reflects all corporate actions affecting the underlying share. For example, the net dividend is paid to the holder of a long CFD on the ex dividend date, while holders of short CFDs pay the net dividend.

Risks

CFDs are leveraged products that can lead to large gains but can also quickly result in losses that exceed your initial margin. CFDs are not suitable for everyone, so please make sure that you fully understand the risks involved. The potential risks mean that our CFD service is only available to those clients with a sufficient level of investment experience and understanding.

Spread bets: Spread bets are by their nature high risk investments. They are based on a simple concept. If you think that a financial market (for example, the FTSE 100 index) or share will rise in value, then you may want to buy it (go long). If you think that a certain financial market or share will fall in value, then you may want to sell it (go short).

Once you have bought a financial market or share that you believe will rise in value, then in due course, if your prediction is correct, you can sell the market or product for a profit. (If you are incorrect and the value falls, you make a loss.)

Once you have sold a financial market or product that you believe will fall in value, then in due course, if your prediction is correct, you can buy the market or product back at a lower price, for a profit. (If you are incorrect and the value rises, you make a loss.)

The spread is the difference between the buying and selling price of a financial market or product. It represents the spread bet firm’s potential profit on a transaction.

Risks

Spread betting carries a high level of risk, therefore you should only speculate with money you can afford to lose. Financial spread betting prices can be very volatile and any resulting losses may require further margin payments to be made. It is not suitable for all investors and requires that you fully understand the risks involved. The potential risks mean this service is only available to those clients with a sufficient level of investment experience and understanding.



8. Exchange Traded Funds (ETFs)

ETFs are shares that are traded on a stock exchange and whose assets mirror the price movements of the underlying share portfolio of an index, sector or commodity, such as the FTSE 100, water sector shares or gold etc. In the UK, ETFs are traded on the London Stock Exchange.

In the European markets, there are roughly half a dozen issuers of ETFs which can be traded on Euronext Paris, Euronext Amsterdam, SWX Swiss Exchange, Frankfurt, Borsa Italiana and Virt-X.

What is the difference between an ETF and an index tracker fund?

These two vehicles are similar in that they both aim to mirror an underlying index, but the difference is that an ETF is a share which can be traded at any time of the trading day, whereas an index tracker fund is a unit trust which can only be traded at one point in the trading day.

There are also differences in charges. To buy an ETF, you only have to pay a stockbroker's commission and significantly, no stamp duty, whereas with an index tracker fund, you pay both initial and annual management charges, as well as stamp duty being charged within the fund itself.

Both unit trusts and ETFs are open-ended funds which means they do not suffer from the problem of investment trusts, which can trade at a discount to the value of their underlying assets.

This means that the price you pay to buy or sell an ETF is usually close to the value of the underlying assets of the fund.

Can I invest in ETFs via an ISA, Child Trust Fund or pension?

Yes, you can place an ETF within any of these tax free 'wrappers'. One of the reasons why ETFs have failed to catch on in a big way with UK retail investors is that they do not pay commission to intermediaries, so they tend not to be mentioned by commission-biased IFAs.

Charges

The charges on an ETF can be slightly lower than those associated with index tracker funds. The annual total expense ratio (TER) for an equity-based ETF is typically around 0.4 per cent pa which can be slightly lower than the annual charges on some unit trust tracker funds, but not all.

Risks

As with any share, the price depends on the perception of its current value to its owner. The main risk is to adverse price movements of the underlying share portfolio of an index, sector or commodity that the ETF holds or tracks. Some underlying assets will be higher risk than others. For example, an ETF investing in emerging markets is a higher risk than one that tracks the FTSE 100 index.



9. AIM Shares

AIM is the London Stock Exchange's market for smaller and growing companies. Companies listed on AIM can be traded by investors who wish to buy and sell AIM shares. AIM provides an opportunity for companies to raise capital for expansion, a market for their shares and a way of establishing a market value for their companies.

Risks

AIM investments typically carry a higher degree of risk than investing in more liquid shares of generally larger companies listed on the main market of the London Stock Exchange. As with all investment in equities, there is a risk that you could lose the entire amount of your investment. Also, AIM companies tend to trade on wider bid/offer spreads than companies on the main market, and liquidity can be a problem.

10. Unquoted Investments

There are shares (usually in small companies) which are not listed on a Stock Exchange. Unquoted investments are also referred to as private equity investments, where the shares tend to be held by a limited number of shareholders.

Risks

Unquoted investments cannot be bought or sold on a market; sellers must find a buyer and this may prove difficult due to a lack of liquidity in the shares. As there is no market price it may prove difficult to establish a value for the shares.

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