Financial Planning and Insight

By Berkshire IFA

GUIDE TO

BONDS VS EQUITIES

Getting the right portfolio mix to create a well-diversified portfolio

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GUIDE TO

BONDS VS EQUITIES

Welcome

Welcome to our *'Guide to Bonds vs Equities'*.

UK investors seeking income often face the challenge of deciding between bonds and equities for their investment portfolios. Each asset class has unique benefits and risks, making it crucial to understand their differences and evaluate risk tolerance, investment objectives and time horizon.

Equities and bonds exhibit lower correlation since they react differently to market events. As a result, they can complement each other in a well-diversified portfolio. While equities are considered riskier assets with potentially more volatile returns, bonds generally offer smaller, more stable returns. However, this depends on an individual's time horizon, investment goals and risk profile.

There are two primary types of financial securities: bonds and equities.

Bonds

Bonds are debt instruments representing a contract between a borrower and a lender, where the borrower agrees to pay the principal and interest to the lender on specific dates. Bondholders act as creditors to the company and receive regular interest payments (coupons) and the fully invested amount when the bond reaches maturity (principal).

Investing in fixed-income securities places investors in a more secure position than equities in insolvency or liquidation, as they have priority when claiming the company's assets. Moreover, if the bond issuer defaults on its debt, recovery may be possible, unlike a share price that can plummet to zero.

Bond investors closely monitor the credit rating of a security as an indicator of potential risks associated with the investment. Generally, bonds shouldn't be expected to yield the same growth rate as equities but rather provide a relatively safer source of total return and capital preservation features.

Equities

Equities, also known as ordinary shares or common stock, signify a corporation's ownership share. Shareholders are considered the corporation's owners and usually possess voting rights. They are entitled to the residual profits of the company after satisfying all other claims and may receive dividends. However, companies typically have no obligation to pay dividends to ordinary shares.

Preferred stock, or preference shares, grant holders the right to claim the firm's earnings before dividends on ordinary shares can be distributed. Preferred stock also holds a senior claim on the firm's assets in case of company liquidation, making it a less risky investment than common stock.

Bonds: Some key features of bonds include:

Lower risk: Bonds are generally considered less risky than equities because they provide regular income and a predetermined return on investment.
Stability: Bonds can add stability to your portfolio as their values tend to be less volatile than equities.
Predictable income: Bonds provide a predictable income stream through coupon payments, making them attractive for income-seeking investors.

However, there are some downsides to bonds:

Lower returns: Bonds typically offer lower returns than equities due to their lower risk profile.
Interest rate sensitivity: Bond prices are sensitive to interest rate changes, and rising rates can lead to capital losses.
Inflation risk: Inflation can erode the purchasing power of bond income, making it less attractive over time.

Equities: Some key features of equities include:

Higher returns: Equities have historically provided higher long-term returns compared to bonds, making them more suitable for investors seeking capital appreciation.
Dividend income: Many companies pay dividends to shareholders, providing a source of income.
Inflation hedge: Equities can potentially outpace inflation over time, preserving the purchasing power of your investments.

On the other hand, equities come with their own set of risks:

Higher volatility: Equities can experience significant price fluctuations, leading to higher potential returns and losses.
Company-specific risks: The performance of individual companies can significantly impact your investment, making stock selection crucial.

Diversified portfolio containing both bonds and equities

For UK income-seekers, determining whether to invest in bonds or equities largely depends on your individual goals, risk tolerance and investment horizon. Bonds may be a better choice if you prioritise stability and predictable income. However, equities could be more suitable if you accept higher volatility for potentially higher long-term returns and an inflation hedge.

A diversified portfolio containing bonds and equities might be the best approach, as it can help strike a balance between risk and return while providing multiple sources of income. ■

NEED HELP TO ACHIEVE THE FINANCIAL FUTURE YOU WANT FOR YOURSELF AND YOUR FAMILY?

With access to an extensive range of investment structures, we will draw on the most effective and efficient wrappers for your investments, circumstances and objectives. We can help you determine the most appropriate asset allocation for your needs and circumstances. Whatever your long-term wealth priorities are, tell us about your investment goals and how we can help you. Please get in touch with us.

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THIS GUIDE DOES NOT CONSTITUTE TAX OR LEGAL ADVICE AND SHOULD NOT BE RELIED UPON AS SUCH.

THE VALUE OF YOUR INVESTMENTS CAN GO DOWN AS WELL AS UP, AND YOU MAY GET BACK LESS THAN YOU INVESTED.

THE TAX TREATMENT IS DEPENDENT ON INDIVIDUAL CIRCUMSTANCES AND MAY BE SUBJECT TO CHANGE IN FUTURE. FOR GUIDANCE, SEEK PROFESSIONAL ADVICE.

ARE YOUR FINANCES AND INVESTMENTS STRUCTURED EFFICIENTLY TO MEET YOUR FINANCIAL GOALS NOW AND IN LATER LIFE?

It is more important to manage your portfolio to meet your risk objectives than to chase short-term returns, so we will design your bespoke portfolio to meet your unique needs and attitude to risk.

To find out more about how we can help, please get in touch with us.

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