Growing gains

David Thorpe asks the experts what strategies parents should use when investing for their children

It's an easy decision to open a JISA or children's savings account for your child, but it is harder to work out precisely where to invest the money.

The option favoured by most is simply to leave the money in cash. Of the 295,000 JISAs opened in the 2012/13 tax year, over two-thirds of them were cash JISAs. Child savings accounts are also available, which unlike JISAs allow withdrawals before the child turns 18. However, you'll struggle to find cash accounts or JISAs with interest rates higher than inflation (see page 38).

An option with a little more of a frisson is to buy National Savings & Investments Premium Bonds on behalf of the child. These, of course, offer the chance of winning a range of monthly cash prizes from £25 to £1 million (tax-free). However, the odds of each £1 bond winning a prize were recently lengthened to 26,000 to 1 and the interest rate used to determine the size of the prize fund was cut from 1.6 to 1.3 per cent. So the chances are that after 18 years your Premium Bonds will have returned less than inflation.

Financial advisers are unlikely to be much help when it comes to investing for children. Martin Bamford, who runs advisory firm Informed Choice, explains, 'We don't really offer advice on investing for children as a stand-alone service.' Patrick Connolly, head of communications at financial adviser Chase de Vere, chimes in, 'We charge £200 per hour, so unless the amount of money being invested in the child's ISA is inordinately high, it probably won't be financially viable to hire an adviser just for stand-alone children's investment advice.'

The advantage you have when investing for children, especially from birth, is that time is most definitely on your side. Investing over almost two decades means that you can afford to take a few risks, although Nick Train, manager of the high-performing Finsbury Growth & Income Trust, warns that these risks should be tempered as the child approaches his or her 18th birthday.

'The advantage you have when investing for children is that time is most definitely on your side'

'There's a lot of merit in just putting your money in equities for 18 years,' says Train. 'But the danger is that after 18 potential years of growth, the market falls by 10 per cent in the week you go and take your money out.'

To remedy this, Train suggests, 'At the start of the final year, start liquidating the investments at a rate of, say, 10 per cent a month, transferring them to cash. This minimises the downside risk in the final year, but by withdrawing the capital slowly you can still capture some of the upside if the market is rising as you count down towards the 18th birthday.'

Bamford agrees with the principle, but is even more cautious. 'In my view, an investor should pursue a strategy based exclusively on equities for the first decade, then for the next five or six years diversify into a portfolio that includes bonds, equities and property where feasible, before in the final year or two moving into cash to a much greater extent.'

Connolly points out that the best time to convert funds to cash will depend on what the money will be used for. 'If there is no rush to liquidate all of the portfolio the instant the child turns 18, then realistically it should be a 100 per cent equity strategy.

'If the intention is to withdraw cash all in one go, say to pay for university fees, then the investor should start moving away from equities earlier.'

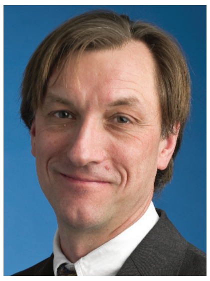
To provide more specific ideas about where to invest for a child, we asked the experts to outline a suitable portfolio. Their suggestions are based on investing the maximum £3,720 annual allowance and not touching capital or income for 18 years.

42-43 Kids Feat 2 Dec 13_WI 15/11/2013 15:31 Page 43

'At the start of the final year, start transferring your equity investments to cash at a rate of, say, 10 per cent a month'

Nick Train

Manager, Finsbury Growth & Income Trust



I would caution against using active funds for a child's ISA. For the amount of capital likely to be employed, the fees charged are not appropriate. If you want active management, pick a collection of three or four investment trusts with lower fees. For the typical private investor, though, the most sensible thing may be to buy something like a FTSE All-Share tracker, whichever one has the lowest charges, and leave it alone for 18 years.

Adopting a stockpicking approach isn't recommended, as the amounts of money involved are too small and it's more risky than necessary. However, if you do go down this route, stick to large companies that have been around a long time, such as Diageo and Unilever. I bought Unilever 20 years ago for £6 and it's now close to £25. Short of unprecedented market shocks and prolonged global poverty, it will still be generating returns in 20 years. I think it will be £100 a share in 2033.

Patrick Connolly

Head of Communications, Chase De Vere

With an 18-year timeline, there's no doubt that equities should dominate a child's ISA portfolio. One option is to invest in passive funds to take advantage of the lower charges. However, diversification is also important. I would

buy something like the Aberdeen World Equity fund, which should provide a broad-based exposure to global equity markets. If one market goes down, the risk is reduced by exposure to the other markets.

The key to maximising returns, though, is to diversify into other assets at the right times. After investing in the global equity fund for five years, you should start increasing the exposure to fixed income assets, such as bond funds. To what extent you do this, and what sort of fixed income assets you buy, depends on the risk profile and how stock markets are performing. Depending on the circumstances of the investor, I would try to gain exposure to property at this point as well. After 15 of the 18 years have elapsed I would then start to move into cash.

Jonathan Davis

Founder, Jonathan Davis Wealth Management

On an 18-year timeline I would try to have exposure to emerging market equities. However, I would also keep quite a large allocation to cash to hedge against the risk of another 2008-style crash hitting the global economy. At the moment, the economies of the UK and other countries are still heavily laden with debt, which is a big worry for those who put all their faith in equity markets.

Given the timeline involved I would look at investing in an exchange-traded fund that tracks natural gas prices, such as ETF Securities Natural Gas. The price of gas is at a four- or five-year low thanks to the advent of fracking. But insatiable demand for energy from emerging markets will mean that over 18 years gas prices will go up, and an ETF that tracks those prices should generate a positive return.

Martin Bamford

Managing Director, Informed Choice

The reality is that the average private investor making small regular monthly contributions should have all of the money invested in equities, and accept that there will be periods of volatility. My suggestion would be to go for a large-cap fund. Don't bother with small- and mid-caps – for the time period involved, large-caps have enough capacity to deliver growth without the volatility associated with smaller companies.

After ten years I would start to diversify into bonds, and after 15 years into cash. For government bonds, we prefer Allianz Gilt Yield, although the low yields on gilts make them relatively risky at the moment, so investors should tread carefully. In the corporate bond space, we would suggest M&G Corporate Bond, which has been managed successfully by Richard Woolnough for almost a decade. ◆