The Trustee toolkit downloadable

An introduction to investment

Scenario two

In this scenario you attend the trustee meeting where Brian provides some training on asset types.

As you work through this scenario you will be tested on your knowledge at decision points. Here you will have the option to work through a related technical tutorial before returning to the scenario or you can skip the tutorial. You can always work through the tutorial separately later if you would prefer.

This scenario includes two tutorials:

- Types of asset: Common assets
- Types of asset: Alternative assets

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at **www.trusteetoolkit.com**

The Pensions Regulator

The meeting

The first couple of items are dealt with quickly, and then Charlotte welcomes the new trustee, Adrian. She says: "I'd like to welcome Adrian on to the board. As you all know, he's stepping into Paul's shoes, both as Operations Manager and trustee. And we're very pleased to have you Adrian! I'd also like to introduce you all to Brian, an investment expert, who is going to be giving us all some training on asset types today."

Brian says: "Thank you Charlotte. I know that some of you are new to the role so we'll start with the most common asset types first and work our way towards the alternative asset types like derivatives a bit later if that works for you?"

Edmund says: "What would you say are the most common asset types?"

Brian says: "Those would be the main building blocks of a portfolio and are most commonly held such as equities, bonds, gilts and cash. You may hold these types of assets yourself, maybe in an Individual Savings Account (ISA). I thought I'd start with a quiz to see what you all know already."

Decision point: Common asset types

Brian puts four definitions of the common asset types on the board and asks the trustees to identify which definition belongs to which asset type. Take a look at the definitions below and choose the correct asset type.

Definitions: gilts, bonds, equities, cash

1. Buying shares in companies on a stock exchange
2. Depositing money in the bank
3. Lending money to companies
4. Lending money to the government

Answers at the back

Need help with this question? Read the **Tutorial 'Types of asset: Common assets'**

Alternative assets

As the trustees all seem to understand the common asset types, Brian moves on to alternative assets. He says: "So moving on to alternative assets, these would include property, infrastructure, commodities, hedge funds, private equity funds, derivatives, with-profit funds and annuities (DB only)."

Alicia says: "That is quite a list, should we be investing in all of these?"

Brian says: "Not all schemes will invest in alternative assets Alicia, and there are some restrictions, particularly for derivatives. But some assets may mitigate inflation risk, or provide a balance to a portfolio that you may not be able to achieve from the most common asset types."

Decision point: Alternative assets

Brian continues to discuss alternative assets with the trustees. The following statements are made, which two do you think are correct?

1. By holding a 'long' position in assets within a hedge fund, the investment manager aims to benefit from a fall in the value of the asset
2. In the derivatives market, contracts known as 'options' obligate the buyer to buy or sell an asset at a date in the future at a price agreed now
3. Investing in property is not usually as flexible (liquid) as equities
4. Investing in roads or water systems is known as 'commodities'
5. Private equity funds usually include high levels of leverage which can increase risk in a portfolio

Answers at the back

Need help with this question? Read the **Tutorial 'Types of asset: Alternative assets'**

Rounding up

Charlotte suggests a break before moving on to the next part of the training.

Now that you have completed this scenario we would recommend that you begin to work through the 'Check your scheme' worksheet for this module.

Answers

Decision point: Common asset types

Bonds offer a way of lending money to companies. When you buy a bond, the borrower (the company) pays you (the investor) an agreed rate of interest and repays the loan on an agreed date.

Cash is money deposited in the bank. It normally earns interest. The bank lends it out, usually for very short periods, to other organisations that need to borrow short term and may have to pay high rates of interest. In this way, the interest that the investor (ie the pension fund) receives may be advantageous.

Equities are shares in a company. Most shareholdings in large UK companies (or multinationals with UK connections) are traded on the London Stock Exchange.

Gilts are almost the same as bonds except that instead of lending money to a company you are lending it to the government.

Decision point: Alternative assets

The third and fifth answers are correct. When holding a 'long' position in assets within a hedge fund the investment manager aims to benefit from the asset increasing in value. Benefiting from a fall in the value of the asset is known as a 'short' position'.

In the derivatives market, 'options' only give the buyer the right to buy or sell an asset but they are not obligated to do so.

Investing in property can be less liquid than equities as properties can take a long time to buy or sell.

Investing in roads and water systems is known as 'infrastructure'. Commodities are physical goods such as foodstuffs, metals or energy sources.

Private equity funds usually include high levels of leverage which can increase risk in a portfolio. Leverage is the ratio of the value of derivative contracts held to the amount of cash available.