Santander Asset Management

50 years creating value

ABOUT INVESTING

A quick guide to index investing

Spreading your money across different investments, keeping your costs down and getting support from an expert are three ways to help make the most of your money.

Index investing is one approach that can potentially be used to help combine all three of these elements in an investment portfolio.

What's an index?

An index isn't an investment itself. It's a measure that represents the combined value of a basket of investments. Indices are put together by commercial providers and each has its own set of rules for what's included. For example, in the case of the FTSE 100, the basket contains the top 100 companies by market value listed on the London Stock Exchange.

Tracking an index: What's an index fund?

Tracking the ups and downs of an index is a way of sharing in the overall fortunes of its basket of investments. The easiest way to do it is through an index fund.

In an index fund, the fund manager either invests in all the individual investments in the index basket, in the right proportions, or, because some indices cover thousands of different investments, a representative sample of them.

How are index funds managed?

Index funds are described as **passively managed** because, apart from checking they are running as they should, their manager doesn't make ongoing investment decisions. The value of your investment simply goes up and down in line with the index.

They contrast with **actively managed** funds where the fund manager makes ongoing investment decisions with the aim of delivering the fund objectives.

Active vs Passive: Which is the lowest cost?

It's important to understand the charges for any fund you invest in, as they can affect the amount of money you get back. You can check the Ongoing Charge Figure and other information through a fund's Key Investor Information Document (KIID) or Key Information Document (KID).

Because of the way they work, passively managed index funds are generally less expensive to run than actively managed ones, so you'll usually pay lower annual costs to invest in them.

The benefit of diversification

Diversification, which involves spreading your money across different investments to help manage your risk, is a well known investment principle. Some investors diversify through a range of single asset class funds. Others might consider multi-asset funds, which aim to maximise the benefits of diversification under a single roof.

Index funds usually offer diversification across a single asset class, with the detail of that diversification depending on the index they follow.

A world of choice

It's possible to gain exposure to most asset classes, sectors and global regions through index funds. From familiar share indices like the FTSE 100 (UK), Dow Jones (US), S&P 500 (US) and Nikkei (Japan) to those tracking bonds, property, commodities and currencies.

Globally, there are literally millions of investment indices – an estimated 3.1 million as at October 2020 according to the most recent research by the Index Industry Association. Not all of these are tracked by funds, of course, but it gives you an idea of the level of choice potentially available to those interested in index investing.

Bringing it together

If you're interested in index investing you could choose to build your own portfolio of index funds covering different asset classes, sectors and global regions. But you could also consider investing in one or more multi-index funds.

A multi-index fund is a type of multi-asset fund, where the fund manager builds a diversified portfolio of index funds under a single roof to meet its objectives.

A suitable choice for you?

Whatever you feel about the idea of index investing, it's important to do your research before making any investment decisions. What's suitable for you will always depend on your own personal circumstances and the amount of risk you're willing and able to take. If you aren't sure what to do, it may be a good idea to take professional advice.

Let's be clear!

Investment terms explained

Alternatives: Any investment other than equities and fixed income, such as property and absolute return funds.

Asset class: A group of investments with similar traits. Shares, bonds, property, cash and alternatives are all examples of asset classes.

Bonds: A bond is a loan issued by a government or a company. When you buy a bond, the issuer promises to pay a certain amount of income until the bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the bond. This is known as creditworthiness.

Commodities: A raw material or product that has a market value and can be traded on an exchange. Examples include, precious metals such as gold, industrial metals such as aluminium or agricultural goods such as wheat.

Diversification: Spreading your money across different investments to help manage risk.

Fixed Income: Also known as fixed interest. A group of asset classes that involve debt, this is usually in the form of bonds where an issuer will lend money for a predefined period and these can be issued by governments or companies. These will involve a regular coupon (interest) payment and the return of capital (original amount lent) at the maturity of the bond.

Index: A way of tracking the overall performance of a basket of individual investments of a similar type. For example, the FTSE 100 index tracks the performance of shares in the 100 largest companies by market value on the London Stock Exchange.

Inflation: Measures the increase in price of selected goods and services in an economy over a period of time.

Property: Property may be difficult to sell and can demonstrate significant declines in value due to changes in economic conditions and interest rates.

Shares (often referred to as equities or stocks): In investing, this is a share of ownership in a company. Investing in a fund gives exposure to underlying share prices without investors actually owning the shares themselves.

Important Information

This material is for information only and does not constitute an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services.

Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested.

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