

Getting an income in a low interest world

With UK interest rates at their lowest levels for more than 50 years, anyone relying on their savings for income may need to look beyond deposits. So what are the options?

Looking beyond deposits

As at early 2009, UK interest rates are at their lowest levels for half a century. Individuals who rely on their savings may need to look beyond simple deposits to maintain income.

There are a wide range of investments that offer a regular income – some are shown below. All present a trade-off between capital security and the potential returns they can generate.

To build an appropriate income portfolio, investors need to consider the following issues:

1. Capital protection: Only deposits can assure that your capital will not fluctuate in value. Most government bonds promise to repay original capital if held to maturity but can fluctuate in value in the meantime. Corporate bonds may also promise return of capital but can carry a greater risk of default.

2. Capital growth: Stock-market linked options such as equity income funds and investment trusts can fluctuate in value but that also means there is potential for your invested capital to grow in value over time – something that low-risk deposits cannot offer

3. Inflation-proofing: You may want your income to keep pace with the cost of living. Only index-linked bonds guarantee to match inflation. Equity income funds, investment trusts and higher-risk corporate bonds have the potential to increase their income over time – although this is never guaranteed.

4. Link to bank base rate: The income offered on many investments is to some degree, influenced by the base rate which is set by the Bank of England. As a broad rule, the more risky an investment is, the higher the level of income it must offer above base rates to attract investors.

	1. Level of capital protection	2. Potential for capital growth	3. Potential for income to match/beat inflation	4. Influence of bank base rates	Your preferred portfolio allocation
Cash deposits	High ¹	None	Low	High	_____ %
Liquidity funds	High	None	Low	High	_____ %
UK Government Gilts	Medium ²	Low	Low	High	_____ %
Index-linked Gilts	Medium ²	Low	High	Medium	_____ %
Corporate bonds – investment grade	Low ²	Low	Low	Medium	_____ %
Corporate bonds – high yield	Low/None	Medium	Medium	Low	_____ %
Equity income funds	None	High	High	Low	_____ %
Investment trusts	None	High	High	Low	_____ %
					Total _____ %

¹ Deposits held with an institution with a UK banking licence are protected up to £50,000 per accountholder (£100,000 for joint accounts). ² Full return of capital is normally only offered if a bond is held from issue to maturity; the issuer can default on this promise if the business collapses.

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