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MONEY BOX SPECIAL: SAVINGS AND INVESTMENTS

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TRANSMISSION: 24th JULY 2010 12.00-12.30 RADIO 4

MUNCHETTY: Hello. In today's special programme on savings and investments, why it's become harder for our savings to beat inflation. An exclusive interview with a star fund manager. We look at how companies are encouraging workers to save for the long-term. And how a young virtual fund manager successfully took the bull by the horns after a tumble on the stock market.

PRAHALAD: What am I going to do? I might as well just go for it. So I invested all my money in one company and they went up, so I made money then.

MUNCHETTY: But first, some big changes made by a savings provider that's considered a bit of a national institution.

CLIP: THE QUEEN SPEAKING AT 40th BIRTHDAY CELEBRATIONS OF NATIONAL SAVINGS

MUNCHETTY: National Savings and Investments issued its first savings certificates during the First World War to fund the war effort. Well it now has almost 27 million customers. With interest rates at a record low, it's no surprise that savers poured a whopping £5.4 billion into the government's savings arm in April, May and June this year. For the first time since they were introduced in 1975, NS&I has withdrawn its products linked to inflation because they're too popular, dealing a blow to savers trying to keep pace with rising prices. Well we can speak with John Prout, Sales

Director from NS&I, who joins me now. Welcome John. Let's start with the 3 and 5 year index linked certificates. Why have you withdrawn them and so suddenly?

PROUT: Hello Naga. I mean this was a very difficult decision and we did agonise over this. But, as you said, we had unprecedented volumes of business coming into us in the first quarter and I think this was very much down to sort of a high inflation combination with low base rates. And, like any organisation, we have some clear targets. The way we run the business, we obviously have a very strong focus on our customers. But we are a bit unique; we are a stakeholder in terms of the Treasury. We do have a responsibility to the financial services market and we had to make this very difficult decision to trade off the three sort of criteria that we use to balance the business.

MUNCHETTY: You've mentioned that you're a bit unique. In that sense, in that vein, we know that the banks can't compete with these inflation linked products. Have you had any pressure from them to withdraw from the market?

PROUT: Certainly I've had no direct pressure, but we do know that the banks and building societies do take a lot of interest in terms of how we run the business and that is important because it is very much about the stability within the market. So we have these three features that we have to look at: the interests of customers of course, but also of the taxpayer, the Treasury, our stakeholder; and also of course the financial services market.

MUNCHETTY: I'm sure customers don't feel they've won out at the moment. But what happens then to those customers who already have index linked certificates which aren't going to mature for a while? What should they do?

PROUT: Well I really should stress that the product has been taken off sale for new customers. So existing customers who have certificates, whether it's in the index linked certificates or in the fixed interest certificates - that at maturity, which would be at the 2, 3 or the 5 year point, they would be invited to stay in that product if they wish in exactly the same issue or into any of the other issues of savings certificates that have just been pulled off sale for new customers.

MUNCHETTY: There's some speculation that these will be reintroduced. How soon can we expect them back on the market?

PROUT: Yes, I should stress that we see this very much as a temporary move. It is a response to the very strong sales performance in the first quarter. We do intend to bring these products back onto the market and we intend, we have no plans to change the nature of the product.

MUNCHETTY: No plans to change the nature of the product. What about the link to inflation? Currently you use RPI, the Retail Prices Index. Would you consider switching to CPI, the Consumer Prices Index, which of course is currently lower?

PROUT: As I said, we have no plans to change the nature of the product, which is linked to RPI. I should say whilst we're talking that you know we did say we would obviously bring these products back on. I don't really see that we would bring these back on in the very near future, so I think they will remain off sale probably for the rest of this year certainly.

MUNCHETTY: Okay. John Prout, thank you very, very much for joining us from NS&I.

PROUT: Thank you.

MUNCHETTY: With me throughout today's programme is Christine Ross, Financial Adviser at SG Hambros. Welcome, Christine. And in our Truro studio is Graham Hooper, a financial adviser at Best Invest. Graham, let me start with you. You are of course a regular guest on Money Box and you've often recommended these index linked savings certificates. What are you going to tell clients now?

HOOPER: I think they were unique and that's the shame of it really, and I think you have to look really, really hard and sort of try and find out the best alternatives. And one obvious alternative is index linked gilts; but they're not the same and if the rate of RPI starts falling, you may get back less than you invested in RPI index linked gilts than you would from your National Savings certificates. So don't be fooled into thinking well I can sort of … you know the money I used to put in National Savings certificates, I can put into index linked gilts because they are different sort of animals really. So that's the first thing to say. Secondly, I think there are dangers. The best rate you can get is about 4.75% on a 5 year fixed rate bond, but with the pressures on interest rates to rise, that might look like a cracking rate for a year or two, but you know for the latter 3 years of that bond, that may not look so good. So I think we're looking at short-term variable rate, like Saga (if you're over 50) have got a 2.75 account. Sainsbury's Finance have got an interesting account at 2.7%. And if you're looking at ISAs, bonds, they have an online fixed rate ISA fixed for about 18 months at 3.1%.

MUNCHETTY: Graham, thanks for that. Christine, just briefly, any other alternatives you'd be offering to your clients?

ROSS: I agree with Graham because I've been looking at 2 year. And, for example, Santander have a 2 year fixed at 3.75. Coventry and ICICI Bank each have 2 year bonds at 3.7. All those are on the Moneyfacts website. But I'd be looking in the shorter term because I think as rates start to rise, if we fix out for 5 years now people could be out of luck.

MUNCHETTY: Christine and Graham, we'll get more from you throughout the programme. Let's move onto investments now. Many of us wonder if fund managers are the best people to make the most of our money when stock markets are volatile. Well in an exclusive interview, Money Box reporter Ruth Alexander speaks to one of Britain's most successful fund managers, Neil Woodford from Invesco Perpetual. He gives a rare insight into how he's managed his funds - worth more than £10 billion - through two recessions, and explains why he thinks that buying shares should be a long-term, not a short-term endeavour.

WOODFORD: We focus on fundamentals of the economy and companies, in particular. We focus very much on the long-term and try and add value in the long-term. So we're not slaves to an index, we're not slaves to consensus thinking at all. It helps us to sort of think independently about what's really going on in the world. And once we have made our minds up about what's happening and what the fundamentals are, we are prepared to back our judgement. But you have to establish a track record to be able to enjoy that confidence. If you are backing your long-term judgement and you're wrong in the short-term - as I was for example in the early days of the tech bubble - it's a very testing time for the clients because you're underperforming, you're not doing what everybody else is doing and people ask some very searching questions. But if you've established a good reputation of getting things more right than wrong, then people will have the patience and stay with you. And I think over the years, I think we have enjoyed that confidence. When we do go through periods you know when we're out of sync with the market, as we were for example between say March 09 and March this year when the market was very bullish about recovery and we weren't, you have to take your clients with you because we under perform and we have to explain why we're underperforming. But I think in general terms, people back our long-term judgement.

ALEXANDER: And how did you explain that underperformance in 2009? Do you think you were too cautious?

WOODFORD: I wouldn't say we were too cautious. I think we were right. I think we've been proved right about the economy. The stock market can sometimes be quite divorced from reality. We have a strategy of focusing on fundamentals, and that is the way we always manage money. We don't try and anticipate investor behaviour. If we think investors in general terms are getting it wrong, we're not prepared to jump on that bandwagon and try and trade that sentiment.

ALEXANDER: Equities were for a long time seen as a great long-term investment and yet now here we are and the stock market levels really are pretty much what they were 12 years ago. Pension companies are moving out of equities and into bonds. Do you think the days of seeing equities as a surefire long-term investment are over?

WOODFORD: I think equities are an attractive asset class relative to other things. With the right selection strategy, with the right subset if you like of what's available to investing, you can produce very good returns in the medium and long-term. Many of the companies for example that I invest in have dividend yields that are way above the yields on their corporate bonds.

ALEXANDER: So you like pharmaceuticals. Which other sectors and stocks are you picking then?

WOODFORD: We also have big holdings in the tobacco sector, with BAT and Imperial Tobacco and a couple of American stock. We've owned tobacco stocks for a long time. Tobacco companies are challenged businesses, not least because the product that they manufacture is addictive and it kills people, but nevertheless it is a legitimate product and many consumers around the world choose to smoke it knowing of the health risks. It is an unusual industry because, unlike many where returns are very high, you don't get new entrants typically. Many other industries, if they enjoyed the sort of cash returns that a tobacco company enjoyed, you would find competitors starting new tobacco businesses or new other businesses and those returns would be driven down in a sort of classic economic theory sense. But in tobacco, that isn't the case.

ALEXANDER: What sectors and stocks within sectors have you got your eye on as possible future picks?

WOODFORD: The stocks that I have most confidence in and most faith in at the moment are the ones that I own in a portfolio. As I said earlier, I'm a long-term investor. My average holding period now is over 6 years.

ALEXANDER: This year you've done better than the peer average, but you've still been losing money. Is that good enough?

WOODFORD: No it's not, no. We're very conscious that we need to do better than that. When we communicate with our investors, what we're saying is don't measure us on the basis of 6 months or a year. Look at us over a 3 to 5 year period. And if we can’t deliver those absolute positive returns, then vote with your feet.

ALEXANDER: For the individual small time investor, what is your advice?

WOODFORD: Consumers are very motivated by value for money in terms of their everyday shopping behaviour. They should be motivated by value for money when they think about investment, and they should be very motivated by the valuation of the companies that they’re investing in and not try and buy the latest, hottest idea.

MUNCHETTY: You can hear a longer version of that interview on the website: bbc.co.uk/moneybox. Let’s get a view from Christine Ross now. Christine, you were listening to that interview there. You heard that Neil Woodford has suffered in the past 2 years. He’s underperformed how he’d like to have been. Is this typical of star fund managers that you follow?

ROSS: I’m not sure how much people follow star fund managers, but without doubt management groups attract money because of the stars. But equally yes sometimes if they move on, depending on the other fundamentals, sometimes investors stay with the group. Other times, yes they do follow them, and the movement of a really successful manager is going to be one of the criteria to consider when deciding whether one should move. I’ve got to say that Invesco Perpetual Income continues to be one of our core picks for our private client portfolios and has been for a long time, and he’s just had phenomenal success. But I entirely agree with what he says about the investment horizon. You know it is a 3 to 5 year play whenever anybody goes into the stock market. You can get lucky early on, but equally you can have a bad year in your first year and it can put you off entirely.

MUNCHETTY: Graham, you were also listening. Neil Woodford refers to the bonus system for fund managers. Christine referred to how long you could follow fund managers. The bonuses that fund managers are awarded often are for short-term dramatic gains, and Neil Woodford suggests that perhaps they should be rewarded for longer term. Do you agree?

HOOPER: Oh absolutely. I think most people invest in these type of funds for the long-term. Certainly as advisers we recommend, as Christine said, we look at over sort of a 3 to 5 year period minimum really. And I think to be rewarded for year on year performance, as a lot of fund management groups do, leads to higher risk decisions, more volatility within funds, sometimes losses, and that puts people off investing for the long-term. And it's not really fair on the people investing on the funds, so I think to be invested longer term - and Neil's been at this fund for donkey's years - you know it shows through in terms of the consistency. The average fund manager only stays in a fund for just over 3 years and then you do get volatility performance, the fund manager moves, and it's not really fair on the people investing, I don't think.

MUNCHETTY: Christine, Woodford also said go for the bargains, use common sense like you would when you look for a deal in a supermarket. Easier said than done, surely?

ROSS: It is, but there are so many websites these days where you can get in and there are bargains around.

MUNCHETTY: Okay, Christine thanks very much, and Graham too. We'll hear from you more later. Now the government is urging us to save more for the long-term, so could a new investment product, the company ISA, be part of the solution? Well from August 1st, three firms, including Barratt Homes, will give employees the option to invest in a stocks and shares ISA directly from their payroll. Gains of course will be tax free and employees will be able to invest up to £10,200 in this current tax year. Well Tony Filbin from Legal and General, which is managing these first company ISAs, is with me. Welcome Tony. Why do you think we need a work ISA now? Surely company pension schemes or save as you earn schemes are enough?

FILBIN: Well we think this is a very important addition to the range of saving opportunities for employees in the workplace, but one which complements other forms of savings such as pensions and shares. Let me just give you one very quick example how moving between these tax wrappers can give a better outcome at retirement. For example, if your SAYE matures and you transfer the assets into an ISA within 90 days and you shelter that from capital gains tax, if you subsequently invest that money into a pension you'll get another lot of tax relief on that. So you can get a better outcome at retirement by moving between these wrappers. And many employers are now recognising that long-term savings for their employees should be a holistic approach rather than a specific approach.

MUNCHETTY: Now this is a stocks and shares ISA, so still a level of risk. Of course stocks can go up as well as down. How do you convince workers that it's a risk worth taking?

FILBIN: Well we help investors along the way in terms of deciding a) whether it's the right product for them; but also what level of risk they should take. So within the enrolment process, we have an attitude to risk tool which helps those employees decide what their risk appetite is, and there's a direct read across to different funds which are in the same risk category that they've decided is the most appropriate one for them. But, as we've already heard earlier in the show, investing in the stock market is a long-term investment and we are encouraging people to consider this in that aspect and in particular saving for retirement and complementing pensions.

MUNCHETTY: How does it work? How do they contribute via payroll?

FILBIN: Well it's a very simple and easy way to join, which was one of the requirements we were given as a provider on entry into this marketplace. So enrolment can either be online or offline. A simple instruction to the employer who collects the money and passes it over to ourselves in a payroll file. So it's a very simple and convenient way to start saving.

MUNCHETTY: Briefly, just tell me about the management charges because it's definitely one of the turnoffs when you look at investing in these types of products.

FILBIN: It is and again that was another requirement that was given to us by employers, was to give great value for money and perhaps a discount to the charges that they could get as a retail investor. And we've been able to do this by actually getting institutional class of shares, so the annual management charges on those are lower than you would get as a retail customer starting at less than a quarter of one percent. There's a small administration charge, which is levied on top of that once a year, but overall it represents better value for money than you would get as a retail investor.

MUNCHETTY: Christine, you've heard Tony lay out his stall. Do you approve?

ROSS: Oh totally. Actually thinking about it, why hasn't this happened before? It is so obvious. One tiny word of caution: if someone has already saved in a maxi ISA this tax year, so since 6th April, they'll have to wait until next April to start into another one. You can only save with one provider in a year. But I think it's an absolutely brilliant idea.

MUNCHETTY: Graham, do you think people would be better off putting money in this type of scheme if their workplace offered it or pensions?

HOOPER: Depending what you want from your money. I think the beauty of this is it's an absolutely brilliant idea. It's shorter term in terms of you can have access to the money, so I think it helps people in that sort of context really. So I think you need your short-term money, which might be this type of work save ISA, and obviously pensions for the longer term. But I think it's attacking a whole new range of people, people who wouldn't come to the market and invest in ISAs perhaps ordinarily. It gives them an opportunity to save more money over a period of time on a tax free basis. And it's an absolutely brilliant idea for any employer to do a similar sort of thing because it's just going to be such good news for so many people throughout the UK.

MUNCHETTY: Graham, Christine, Tony, thanks very much. Time to ponder this: are successful investors born or bred? Three pupils from St. Martin's School in Northwood, Hertfordshire - Prahalad Prasad, Jonah Surkes and Maneet Patel - are already successful (albeit virtual) traders after spending 4 weeks mastering a fantasy stock exchange game run by the children's business newspaper OINK! The website, piggybank.co.uk, allows children to invest as a cartoon fund manager character. They can be anything from a wizard pig to a weightlifting cow. Prahalad starts by logging onto the site and giving me some tips.

PRAHALAD: So first you just type in your user name and password.

MUNCHETTY: I must say, I'm amazed. I'm just looking at Prahalad's piggy bank savings, and I'm sure you don't mind me disclosing your wealth at this moment in time: £1,027.72. How did you do it?

PRAHALAD: Well I like investing in quite cheap and low priced shares, so if they go up by a small amount, I make a lot of money. If you just keep repeating that process, you just gradually get more and more money over a long period of time.

MUNCHETTY: If only it were as simple as that, we'd all be millionaires I think by now. How do you know what's cheap and what's going to rise?

PRAHALAD: Well I just do some research on the BBC business and money section of the website, so I can look at the graphs and the year high and the year low. That means I can determine whether it's going to go up or maybe go down.

MUNCHETTY: Well we're also joined by your friends Jonah and Maneet as well. Jonah, let me start with you. You're looking on here. I saw a gasp when you saw the bank account of Prahalad. What's your account looking like?

JONAH: My actual savings amount is quite a lot lower than that. I think one of the reasons that all of us (apart from Prahalad) seem to lose money is that when we went on a school sort of trip/holiday and during that week the markets crashed and we all went down by a really large amount. And Prahalad for some reason didn't.

MUNCHETTY: Prahalad, was this a case of being in the right place at the right time?

PRAHALAD: Well after the trip that we went on when the FTSE crashed, I happened to be quite low. And I thought now that I'm so low, what am I going to do? I might as well just go for it. So I invested all my money in one company and they went up, so I made money then.

MUNCHETTY: My goodness, that's a real risk to take. Would you take that risk if it were your own money and not fantasy money?

PRAHALAD: I probably wouldn't take that risk.

MUNCHETTY: Maneet, tell me about how you view this. What does it do for you? Does it make you interested in stocks and shares?

MANEET: Before we went onto this website, I honestly didn't even have a clue how the stocks work. I've seen my granddad screaming down the phone, looking at Bloomberg, just not understanding what he's doing. Once I went on this website, I actually understood. It's really easily laid out. You can see how the shares sort of change in price when you buy and sell.

MUNCHETTY: Do you give your granddad tips now?

MANEET: Yeah, actually. I've seen him buying in some things and I've thought to myself, I've noticed that this is just going up and up and he's buying now. Then it went down and he actually lost a lot of money. I gave him some advice. He made a lot of money and he actually gave some money to me.

MUNCHETTY: Ah, so you can make real money as well as fantasy money. Let's talk about the kind of sectors you're investing in. Jonah, you mentioned you were invested in more expensive stocks, especially compared to Prahalad. What kinds of stocks are you investing in?

JONAH: Well the specific company I invested in was Shell and they were priced I think at 1643 when I bought them, and I sold them at 1830. And so I've made a bit of money from that because I had 28 shares and that's all I could afford because they're so expensive. But the thing with those expensive shares are that when they do go up, I feel they go up by a larger amount - well they would do - than the cheaper ones. So they'll go up by say 50p, which is the equivalent of one of Prahalad's companies going up by 1p.

MUNCHETTY: So it's thinking about percentage gains as well. What about the types of companies? Do you apply any ethics to the companies you invest in? Like, for example, would you invest in tobacco stocks?

JONAH: Generally not. I think the way we work out whether the company is going to be right to invest in are based on firstly what's going on around the world. So, for example, if there's something happening with BP - say they stop the oil spill - we can imagine that their shares might go up a little bit.

MUNCHETTY: Now you're all 13. Let's fast forward 5 years when you'll legally be allowed to buy and sell shares. Say you were given £500 of real money. Would you be taking the risks you take now? Maneet?

MANEET: I don't think so. In real life, I think you'll think much more and you won't just go all out, you won't spend the full £500. You might spend like £10 or something and then go into £100, but I think you'll just be that much more savvy and you'll actually think about what you're doing.

MUNCHETTY: Jonah, what about you?

JONAH: I do certainly think I'd try and enter some sort of risk taking market because I think if you don't take risks, you're not really going to get anything out of it.

MUNCHETTY: Prahalad, you've been successful so far. Do you think this success would continue if it’s real cash in your hands?

PRAHALAD: Well I wouldn’t take so many risks in real life, but I think if I monitored it as well as I’ve done so far, then I think I could make substantial amounts of money based on what I’ve done on this website.

MUNCHETTY: Prahalad Prasad, Jonah Surkes, and Maneet Patel. Successful fantasy fund managers from St. Martin’s School in Northwood. Graham, are you impressed?

HOOPER: I’m hugely impressed. I think their perspective on risk - I’m going to go home and get my son William on the computer and get him to do it this afternoon.

MUNCHETTY: *(laughs)* Christine, investors - are they born or bred?

ROSS: I think they’re bred because I think the most important thing with an investment manager is that they have the discipline; that they learn the skills but they have to have that level of discipline, especially if they’re going to work on other people’s money as well.

MUNCHETTY: Christine, thank you very much. I’d like to thank all my guests for today. And that’s it. You can find out more from the BBC Action Line - 0800 044 044 - and of course our website, bbc.co.uk/moneybox, where you can watch videos, download a podcast, and of course listen again to items on the programme. Money Box returns from its summer break at the end of August. So for the next 4 weeks, Alvin Hall will be presenting his Generations of Money, which looks at the personal finance issues that different generations are facing. Today the producer was Lesley McAlpine, the reporter Ruth Alexander, and I’m Naga Munchetty.