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SHOULD YOU JOIN THE RUSH INTO AIM SHARES?

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Investors are piling into AIM. Are they heading for a fall or is there a safe way to join the party?

The stock market's smallest and riskiest companies are suddenly attracting unprecedented attention from investors.

The question is: are these share buyers cleverly spotting businesses that are about to grow astronomically or are they wasting their money on companies destined never to make a profit?

The rush of interest in shares listed on the London Stock Exchange's (LSE) Alternative Investment Market (AIM) is due to a change in the rules last month that made these shares eligible for inclusion in tax-free Individual Savings Accounts (ISAs) for the first time.

The effect has been dramatic. In the two months before the rule change, 15.6% of all share purchases made through Hargreaves Lansdown, the stockbroker, involved AIM-listed companies. But in August, this figure increased to 23.6%, a rise of 51%.

In August, 14% of all money put into shares was invested in AIM-listed companies, compared to 9.7% in the previous two months. This is a rise of 44%. Some of the purchases were the result of investors selling an existing holding of AIM shares and repurchasing them within an ISA to shield them from future tax liabilities, said Danny Cox of Hargreaves Lansdown.

Other stockbrokers report similar rises in AIM-related trading. Sippdeal said volumes were up by a quarter, while figures from the LSE, which also includes trading by institutions, painted the same picture. One investment website, Interactive Investor, said trading volumes had doubled.

The increased activity seems to have pushed up the share prices of AIM-listed companies. Since the ISA rule change, the FTSE AIM All-Share Index has risen by 4.9%, whereas the FTSE 100 Index has fallen by 2.7%.

The change, which took effect on August 5th is especially significant because AIM shares were already exempt from inheritance tax, as long as they were held for at least two years. Holding AIM shares in an ISA now allows you to avoid income, capital gains and inheritance taxes.

Expert view: Oliver Bedford, Co-Manager of the Hargreave Hale AIM Venture Capital Trust, debunks the myths associated with AIM shares.

The commonly held view is that AIM is synonymous with volatility, risk and poor performance. Many retail and professional investors have shunned it since the collapse of the equity markets in 2008 and early 2009. Fund managers have been known to attribute their underperformance to AIM. We seek to differ.

While it is certainly true that an investor in an AIM-listed company can lose a significant part, or even all, of their investment, and low levels of liquidity can increase share price volatility, it's our view that a company's fundamentals, business model and management ultimately determine the success or failure of an investment, not the exchange on which the company's shares are listed.

With three times as many companies as the FTSE 350, the scale of the market opportunity on AIM presents investors with a challenge that sits alongside the opportunity. The inefficient flow of information and reduced amount of analyst coverage, which cannot be adequately overcome with traditional desktop tools such as Bloomberg, is another barrier to be overcome. As a result, the market is large, under-researched, less efficient and therefore more likely to contain pricing anomalies. It is a place for stock pickers and those prepared to make the necessary investment of time and effort. Those who do so will find that AIM is home to a wide variety of businesses.

Many AIM-listed companies are young and dynamic, often operating in new and emerging sectors. U.S-based MyCelx is one such example. It is a water technology company that provides clean water solutions to the oil, gas and petrochemical industries. Its patented polymer is capable of permanently removing free, emulsified and dissolved hydrocarbons from water. Revenues are forecast to grow to $24 million in 2013, up from $4 million in 2010.

WANdisco is another example of a young and rapidly growing company with an emerging technology. The company operates from Sheffield, England and San Ramon, California and provides computing technology that enables software developers in separate locations to work simultaneously. Customers include a host of Fortune 1000 companies, such as Hewlett-Packard, Intel, John Deere, Barclays Capital and Nokia. Its revenues are forecast to grow from $4 million in 2011 to $15 million in 2014.

Yet AIM offers much more than "frontier investing". It is also home to numerous established and more traditional businesses. ASOS, the online retailer, Brooks Macdonald in financial services, Majestic Wine, Nichols (which owns the Vimto and Sunkist brands), the restaurant operator Prezzo and Vertu Motors, the automotive retailer, are good examples.