Bulletin

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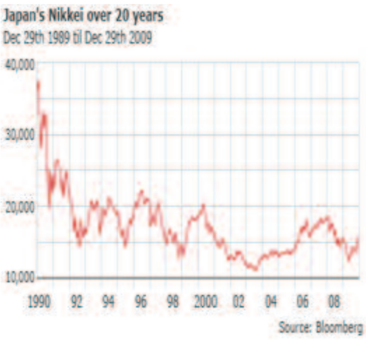
What does a real crash look like?



We have passed the 20th Anniversary of the Japanese stock market crash. 20 years of a stock market in the doldrums. This is for those readers who do not believe a slump can last 20+ years… It hasn't been just the stock market that slumped all this time. Their housing market fell 75%.

That is the primary reason why they have had a 20+ year slump in the economy and markets. NB. Some regions of the UK already see house prices down 30+%. And there's a lot more to come.

This was the 2nd largest economy on Earth. This is the country that makes all those cars and exports them globally. So, how did they let this happen?

A. In the beginning they allowed too much debt causing the biggest property bubble in history.

B. Then they bailed out the banks saying that was the way to ensure the economy got moving again.

C. Then they slashed their interest rates saying that households and businesses needed low rates to borrow and 'get things moving again'.

D. Then their consecutive governments borrowed and spent like there was no tomorrow saying that they needed to 'protect the recovery'.

Does this remind you of a country near you? It is exactly what 'New' Labour did to us. (Don't get me wrong. Thatcher started the borrowing explosion. However, Brown and 'New' Labour could easily have done something about it to bring it back to manageable levels. Instead they encouraged it and pretended they'd ended Boom and Bust. The hubris of 'New' Labour was and remains breathtaking and ugly.)

After this orgy of debt and spend, what they did was leave us with the biggest economic hangover in history. I said six or so months ago that, after the 2010 Budget, the man and woman on the street would finally realise what it means to be in a country in Depression – higher taxes, lower govt spending, falling asset prices, higher unemployment, more home repossessions, more personal and corporate bankruptcies. Debt levels remain gargantuan.

The differences between the UK now and Japan in the 90s are:

1. Japanese households had savings at the beginning of the crash. We started with none.
2. Two years in and The Tories and Lib Dems are saying 'we're going to cut spending' Until we heard these pronouncements/Budget etc our economy had no chance of picking itself up. Now we have a chance.

Will we move to Double Dip? Almost certainly. [Please note Double Dip is merely a euphemism for Depression. In 1931, they did not know then that they were in The Great Depression.] However, we will have the desperately needed rebalancing away from the Public Sector to the Private Sector, where people actually create wealth and who pay taxes that keep the Public Sector going.

It appears that we are taking a breather from making exactly the same mistakes as Japan in the 90s, namely, printing money like there is no tomorrow and propping up failed industries. How long will it continue? Will it even happen or will the Government be brought down by self-interested parasites? Who knows? But at least we have a chance.

Unlike the stock market. Have you seen it recently? How are your investments and pensions doing?

What should you do to secure your finances or help secure those of your friends or family or your private and trustee clients? Call me personally to discuss how we can help.

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The Emergency Budget

The first Budget after an election is usually the most taxing. George Osborne did not stray from tradition.

There was some immediate tax pain, but much of it was deferred:

VAT The standard rate VAT will rise to 20% from 4 January 2011, the first working day of the new year.

Capital gains tax (CGT) The CGT changes, which took effect from 23 June 2010, were less draconian than feared. Capital gains (after the usual annual exemption) are now taxed as income, but at special rates. The main rate of tax is 18%, but for gains which fall into the higher and additional rate bands, a 28% rate applies. The lifetime limit for entrepreneurs' relief was raised to £5 million.

Business tax The main corporation tax rate will fall by 1% a year for four years from April 2011, leaving a 24% rate from 1 April 2014. The small profits rate (formerly small companies' rate) will be cut by 1% to 20% from April 2011. However, the annual investment allowance will fall from £100,000 to £25,000 in April 2012.

Personal allowance and tax bands The personal allowance will rise by £1,000 in 2011/12 to £7,475, but if you are a higher rate taxpayer you will not benefit because the starting point for 40% tax will be reduced to claw back the potential tax saving. The higher rate tax starting point will then remain frozen for 2012/13.

National insurance contributions (NICs) The previous government's planned 1% rise to all the main NIC rates will go ahead for 2011/12. However, adjustments to the NIC bands will temper the impact of the higher rates.

Pension contribution tax relief Mr Osborne has abandoned the much-criticised 'high income excess relief charge', which had been due to replace the 'special annual allowance charge' from 2011/12. However, he plans to impose new restrictions on pension contribution tax relief, probably by reducing the annual allowance from £255,000 to between £30,000 and £45,000. As a result of this proposal, 2010/11 may be the last tax year in which you could benefit from full tax relief on a substantial pension contribution, whether made by you or your employer. There were also moves to end the effective requirement to buy an annuity by age 75 (see 'No more annuities!' on page 4).

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Are you ready for 31 October? If you prefer to complete your 2010 tax return on paper rather than online, then HMRC must receive the return by Sunday, 31 October 2010. Miss that date and you face an automatic penalty of £100 unless you subsequently file online, which gives you another three months' leeway. Whether you choose paper or online, any tax balance due for the 2009/10 year and your first payment on account for 2010/11 will be due on 31 January 2011. If your income has fallen, you can ask for your payment on account to be reduced using form SA303.

Anyone for some income?

The base rate has remained at 0.5% for well over a year now. There are few signs that it will rise much in the near term.

The Bank of England cut the base rate to 0.5% in March 2009. The Bank's calculations, revealed in its May 2010 Inflation Report, show that the base rate is now not expected to reach 3% until the beginning of 2013. If you rely on bank or building society deposits for income, the expected slow progress of interest rates back towards normality is unwelcome news. It means that even fixed term rates are relatively low, with a 4% gross rate unavailable for terms below three years.

One way to increase your income is to move away from deposit-based investments. You will lose the security of capital which deposits provide, but if your ultimate goal is income, you may consider that to be a price worth paying. With the right type of investments, your future income would be free from the ups and downs of short-term interest rates. However, alternative investments are not directly comparable with deposit accounts and the type of investment you choose should depend on your personal circumstances and attitude to risk, which is why it is so important to seek financial advice before investing.

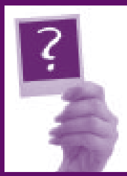
The potential list of investments includes:

- **Fixed interest funds** which invest in interest-paying securities issued by companies, governments and a variety of other bodies.
- **UK equity income funds** which generally invest in higher yielding UK company shares. These types of funds have long been popular because of their potential to provide rising income in the long term.
- **Overseas equity income funds** which are the global equivalent of UK equity income funds, mostly covering geographic areas, eg Asia.

All of these funds can be held within individual savings accounts (ISAs). The fixed interest funds make especially attractive ISA income investments because there is no tax on the interest. If you have an existing cash ISA – perhaps one that started life as a TESSA – you can transfer it to a stocks and shares ISA and invest in income funds. This is a one-way transfer – there is no going back to the security of cash – and your ISA provider may levy transfer charges.

Past performance is not a reliable indicator of future performance. The value of investments and income from them can go down as well as up and you may not get back the original amount invested.

Did you know that Government contributions to the child trust fund (CTF) scheme will end in December? From 1 August 2010 the Government cut initial payments to CTFs from £250 to £50 and reduced the additional payment by the same amount. Payments at the age of seven, which had been £250, stopped. From the start of 2011, no new CTFs will be created, but existing ones will remain in being, with their tax treatment unchanged and personal top ups of up to £1,200 a year still possible. Other ways of saving for children – of which there are many – are unaffected.



Good things in small packages?

Is smaller better? In the wake of the BP disaster, SME (small and medium enterprises) funds can look alluring.

Companies with the largest market capitalisation have a lot to offer. They are frequently well diversified: internationally; by business type; or by customer base. They also typically have a reputation for paying regular and reliable dividends, which allow fund managers a degree of confidence in performance.

So it came as a particular shock when BP announced in June that it was suspending dividend payments to shareholders, in order to ensure its Gulf of Mexico compensation fund was sufficient. The company's share price has been equally shocking. The bigger they are, so the saying goes, the harder they fall.

However, savers in the UK can choose from a wide variety of stock funds, including those that focus solely on small and mid-sized companies. They too have much to offer savers. While these companies do not have the advantage of enormous size, a lower profile makes them less vulnerable to swings in public sentiment.

A smaller size can make them more adaptable to changes in technology or the business cycle, such as a pickup in consumer spending. They are also often keen to please shareholders, using dividends or returning shares. Savvy fund managers can pick up stocks with good potential at low prices.

The Government has cut corporation tax from 21% to 20% for smaller firms (ie companies with less than £300,000 of profits) from 2011/12, and for larger firms from 28% to 24% by 2014/15. The threshold on employer national insurance has also been raised.

But a good fund manager is essential. With a much wider range to choose from, selection becomes more important than ever – there are not just 100 or even 250 firms to choose from, but thousands.

Diversifying your investments is always important. But smaller firms, though well-placed to benefit once economic recovery takes root, may struggle as long as the economy remains subdued, leaving these firms highly vulnerable to a double-dip recession.

The values of shares in smaller companies are often more volatile than those of larger corporates.

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Socially responsible investment

Socially responsible investment (SRI) is growing in popularity, from investing in clean power to shunning child labour. It is meant to be good for everyone – but is it bad for your rate of return?

Early funds selected stocks to buy using 'negative filters' to exclude unethical operators or producers of morally controversial products and services. This filter catches companies that may, for example, pollute or destroy the environment, exploit workers, abuse human rights, be involved in the weapons trade or produce tobacco products.

However, more popular today are 'positive filters'. These favour companies that are, for example, active in environmental technology, clean energy, healthcare, or have been successful in promoting human rights, equal opportunities or welfare standards throughout the supply chain.

The huge variety of decision-making approaches demonstrates one thing very clearly – there is no universal definition of what is 'ethical'. Fortunately, the growth of the market means there is now plenty of choice. Those seeking green and ethical funds for their portfolio can choose from around 100 different funds, compared with just a handful a decade ago.

Do such 'virtuous' funds generate inferior returns? When it comes to performance, the answer is, as always, it depends. If sectors that these funds cannot invest in are doing well, they are likely to underperform, and vice versa.

But this may change as more companies adopt sustainable business practices and activities that enable them to be branded ethical. The investment universe for these funds will grow, removing obstacles to performance. There is also great potential for green companies to benefit from government and legislative support, while surging commodity prices mean that sustainable energy generation and recycling make sound economic sense for a business. Those who get in early are likely to benefit most.

There is a multiplying range of ethical funds out there, but there is some evidence that their performance lags behind that of their unfiltered peers. While this discrepancy may decrease in the future, it is something savers need to consider when making investment decisions.

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A bad year for trustees

2010 is proving a taxing year for trustees.

On 6 April 2010, the main income tax rate for trusts which are not required to pay income directly to beneficiaries rose from 40% to 50% (32.5% to 42.5% for dividends). Before the change came into force, it was suggested that trustees should focus their investment strategy on achieving capital gains, which were only subject to 18% tax, rather than income. Then, on 23 June 2010, the capital gains tax (CGT) rate for all taxable trusts increased to 28%, following the Emergency Budget. Trusts now face the same income and CGT rates as individuals with income of over £150,000.

If you are a trustee, you should review your trust's investment approach in the light of these changes. Investment for capital gain in preference to income still has some tax logic to it, especially if the trust has the maximum £5,050 annual capital gains exemption available to it. However, there are several other investment opportunities which could be worth considering.

Remember, as a trustee, the law now requires you to take suitable external advice on the selection and management of the trust's investments, unless you have sufficient personal knowledge.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Battle of the indices: CPI vs RPI

One surprise in the Emergency Budget on 22 June was that the Government announced it would use the consumer prices index (CPI) rather than the retail prices index (RPI) for benefit, tax credit and public sector pension increases from 2011.

A few weeks later the Pensions Minister, Steve Webb, sprang another surprise by stating that CPI rather than RPI would also form the basis for statutory increases to private sector defined benefit pensions from 2011. The move from RPI to CPI may not sound significant, but it could make a big difference to your retirement income.

The CPI measure of inflation is generally lower than the more familiar RPI. For example, between January 1990 and January 2010, the RPI rose on average by 3% a year against 2.5% for the CPI. Over 20 years that 0.5% difference translates into a total inflation of 82.3% on an RPI basis and 63.8% for the CPI – over 22% less.

If you are a member of a defined benefit pension scheme, you may not automatically be worse off; for example your scheme may offer more generous pension increases than the statutory minimum. As is often the case in pensions, the devil is in the detail and, crucially, this is distinctly lacking from all sides at present.

No more annuities!

The Emergency Budget signalled an end to the effective requirement to buy an annuity income with your pension fund.

If you have not yet reached the age of 75, then you may never have to buy an annuity or otherwise take an income from your pension fund. The Chancellor announced as an interim measure that the requirement to take an income could be put off until age 77, while new rules are finalised. In a subsequent consultation on these, the Treasury has proposed:

- Capped and flexible income withdrawal options, for those not wishing to buy an annuity. Anyone using the flexible option will have to satisfy a secured minimum income requirement;
- Payment of benefits, including tax-free lump sums, may be postponed beyond age 75, although they will still be tested against the lifetime allowance by 75; and
- An end to alternatively secured pension (ASP) rules including removing explicit inheritance tax charges on pension funds post 75. Existing ASPs would become subject to the revised income withdrawal rules.

If you are close to drawing benefits from your pension fund or nearing age 75, the proposals may complicate your decision, not least because many providers are not yet able to cope with the interim changes. Before taking any action, make sure you seek our advice.