Bulletin

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Jonathan Davis BA MBA FCII AIFP FPFS
Chartered Financial Planner
Managing Director

JONATHAN DAVIS WM

Leaders in Wealth Management

"During the preceding boom, credit expansion had caused an unsustainably high rise in living standards and the propaganda about a "new era" created the idea that this standard was some sort of divine right"

This quote came not from an analysis of the 2005-2007 housing and debt bubble nor from an analysis of the 1998-2000 Dot Con (!) bubble but …from an analysis of the 1920s and the Great Depression.

Plus ça change (plus c'est la même chose).

The more things change, the more they stay the same.

Think about a bubble of which you may have some knowledge. How about house prices? Starting from a low base in the early 90s, they grew gradually until around the end of the decade then boomed to the mid 2000s then whoosh there was an absolute mania in 2005-2007.

This progression has been seen over and over again in bubbles throughout hundreds of years of recorded economic history. Most recently it was experienced also in shares in the 90s and again – only a decade or so later – during the mid part of the decade to 2007. It will happen again. And again. And again.

Main stages in a Bubble

The difference is that as it happens to houses it affects, directly, far more families than anything to do with shares. However, as our house prices continue to fall – as we forecast they will by perhaps 30% from this point – then people hope their investments and pensions will look after them in later life or to keep them secure, if already retired.

Gilts V Shares

Historically, the rate of interest our government pays for debt has a very high correlation to the stock market. Also, the debts market traditionally leads the equities market. In this chart (the 4 years of 2007-2010) we see that the rate on 10 year debts (Gilts) moved almost in tandem to that of the FTSE until earlier this year, with equities (shares) slightly moving away from last year and moving in the opposite direction this year.

The debt market sees deflation on the horizon. Equities see inflation. Which will be right? Who knows?

However, why even try to choose? Why not wait to understand more what the global economy will be like once we settle down with US Federal Reserve asset purchases (the second round of Quantitative Easing) and see if they have helped or hindered recovery. (NB. We believe hindered but what we believe is irrelevant.)

Mostly, investment portfolios in the UK are equity heavy and that has helped them for the last year. The problem is they were equity heavy in 2007 too. It definitely did not help over the 2 subsequent years. As well as 1999. And 1929.

Making money in the long term from investing is not about quick gains. With these come quick losses. It is about compounding returns and making as few losses as you can. The loss of 2008 to most portfolios in the UK will affect long term returns far more than most appreciate – or that most professional investors or advisers will admit.

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.

In this issue:

Navigating the corporate year-end • Could your family take the knocks? • No Pre-Budget Report, but….
• UK economy – still in recovery • How low can you go? • All wrapped up • The Pay As You Earn mess

Jonathan Davis Wealth Management
City Office:
Token House
12 Tokenhouse Yard
London EC2R 7AS

Tel: 0845 862 2919
www.JonathanDavisWM.com

Head Office and Correspondence:
6 Riverside Avenue
Broxbourne
Herts EN10 6QZ

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Reg Office: The Granary, 39 Bell Street, Sawbridgeworth, Herts CM21 9AR

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Navigating the corporate year end

If your company's year end is 31 December, now is the time to focus on tax planning.

Each year the question of what to do with company profits is complicated by changes to corporate and personal taxation. 2010 is no different:

- **Tax relief on pension contributions** New rules are due from next April, although some of the precise details remain unclear.
- **National insurance contributions** The main rates for employers and employees will all rise by 1% from 6 April 2011.
- **Corporation tax** The small profits (formerly small companies') corporation tax rate is due to fall to 20% from April 2011.
- **Capital allowances** The annual investment allowance (a 100% allowance for plant and machinery expenditure) was doubled to £100,000 in April 2010, but will fall to £25,000 from April 2012. The main writing down allowance for plant and machinery will be cut from 20% to 18% in 2012.

The interaction of these changes is complex and will depend upon your and your company's specific circumstances.

At its simplest, the mathematics of the bonus/salary/pension director's decision for this year is shown on the 'Bonus v Dividend v Pension' table, based on a marginal £50,000 of profits.

There is no substitute for a face-to-face meeting to go through the figures relevant to you and your company and explain the options. However, the number-crunching for such a meeting can take time, so the sooner you can fix an appointment, the better.

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

Bonus v Dividend v Pension

	Bonus £	Dividend £	Pension £
Marginal gross profit	50,000	50,000	50,000
Pension contribution	N/A	N/A	50,000
Corporation tax	N/A	(10,500)	N/A
Dividend	N/A	39,500	N/A
Employer's NICs £44,326 @ 12.8%	(5,674)	N/A	N/A
Gross bonus	44,326	N/A	N/A
Director's NICs £44,326 @ 1%	(443)	N/A	N/A
Income tax	(17,730)	(9,875)	N/A
Benefit to director / amount in pension	**26,153**	**29,625**	**50,000**

Assumptions:

1. Company's marginal corporation tax rate is 21% for calendar year 2010.

2. Director's marginal income tax rate for 2010/11 is 40% (32.5% for dividends less 10% tax credit).

3. The special annual allowance charge does not apply to the director.

Could your family take the knocks?

With the rising cost of living affecting virtually every family's budget, this is a sensible time to review your personal protection insurance.

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The chances are that over 2010, inflation will lift prices by around 3%, based on the consumer prices index. Inflation in 2011 will then be boosted by the 2.5% January increase in VAT to 20%.

The rise in prices is one reason why it makes sense to review your life and health protection cover now. If you have not done this in the past few years, you could find that inflation has reduced the real value of your family's financial protection. For example, based on the retail prices index, the £1,000 you had in January 2006 is now worth less than £860.

It is particularly important to review the cover you have to protect your family in the event of ill-health:

- If illness or accident meant you had to stop working and/or caring for the home, your income protection plan might not pay out enough to take care of day-to-day expenses.
- If you had a serious illness, such as cancer, your critical illness cover might not provide you with a large enough lump sum to give you time off work to recuperate or to reduce outstanding loans. It is important that you review which medical conditions are actually covered by your policy.

If you are hoping to rely on state benefits to cover such situations, you are likely to be disappointed. In October 2008, the last Government replaced Incapacity Benefit with the Employment Support Allowance (ESA). As the name suggests, ESA is more focused on what work a claimant is capable of doing rather than on what they cannot do – as used to be the case.

In ESA's first 13 months of existence, just under four out of ten would-be claimants were classed as 'fit for work', according to figures from the Department for Work and Pensions (DWP). And over a third left ESA before completing the 13-week first-stage Work Capability Assessment. The new Government is considering a further restructuring of working age benefits, with the objective of cutting DWP expenditure.

Unless you want to find out how weak the social security safety net is becoming, you owe it to yourself and your family to make sure you have adequate private provision against the consequences of ill-health. We can help you to ensure that your cover meets the needs of you and your family and we would be happy to go over your options with you.

No Pre-Budget Report, but...

After two Budgets in the first half of 2010, we have been spared the usual autumn Pre-Budget Report. But we do know that next year's spring Budget will be on 23 March 2011.

As well as the standard rate of VAT increasing to 20% on 4 January 2011, the scheduled changes include:

6 April 2011

- The main personal allowance (£6,475 in 2010/11) will rise to £7,475.
- The basic rate band (£37,400 in 2010/11) is expected to shrink by £2,500. This cut will counterbalance the increase in the personal allowance, so you will be no better off if you are a higher or additional rate taxpayer.
- All the main national insurance contribution rates are to be increased by 1%, although the bands will be changed to limit the increases for low earners and employers.
- There will be new restrictions on tax relief for large pension contributions.
- The rules on tax credits will be tightened. The income ceiling (above which the family element of child tax credit (CTC) is withdrawn) will be reduced from £50,000 (2010/11) to £40,000.

6 April 2012

- The level of total income (personal allowance + basic rate band) at which higher rate tax is payable will be frozen.
- A further tightening of tax credit rules will take place, including another substantial lowering in the income level at which the family element of CTC is withdrawn.

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The advantage of all these early tax announcements is that today's tax planning can take account of the future changes. At its simplest that might mean completing costly purchases before the 2.5% VAT increase. Where matters are more complex, such as on the pension front, please ask us for advice.

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

UK economy – still in recovery

The economy is struggling to find its feet in the wake of the credit crunch-fuelled recession. If growth is likely to remain subdued, this will have important implications for investors.

There was a sense of relief when the Government's Office for National Statistics (ONS) released the second quarter's (Q2) figures. Gross domestic product (GDP) was actually better than the spring quarter's expectations. But the signals since then point to an economy that is struggling to gain traction in the face of weak exports, high unemployment, the Government's spending cuts, a lacklustre housing market and a floundering retail sector. ONS figures released at the end of October show that the economy grew by 0.8% in Q3 – compared with a growth rate of 1.2% in the previous quarter. What might this slow pace of recovery mean for the UK's savers?

- **Interest rates could stay lower for longer** The Bank of England (BoE) is unlikely to raise interest rates until policy makers are convinced the economy is strong enough. After many months at 0.5%, it is even considering the opposite – further 'quantitative easing' to stimulate growth. That means low returns from cash investments and government bonds are likely to persist for some time to come.
- **Inflation will remain a concern** The BoE will not raise rates to contain inflation at the risk of tipping Britain into a double-dip recession. High inflation might be regarded as a price worth paying to keep the recovery on track, and it is a clear risk with commodity prices on the rise. The BoE has admitted inflation is likely to remain above its 2% target until the end of 2011.
- **The outlook for UK equities is uncertain** A sustained rally in equities typically accompanies the growth cycle of the economy, so with growth prospects under a cloud, the outlook for stocks is similarly uncertain. In many ways, the FTSE 100 has been disappointing investors since toppling from its end 1999 peak of 6930.

With inflation above 3%, and inflation-adjusted returns from deposit accounts and government bonds close to zero, the quest for attractive income returns is relentless. Very often higher yields can only be achieved in return for higher risk.

There may be opportunities in corporate bond funds that invest in securities offering higher yields. Commercial property is a possibility for income seekers, especially as there is a wide differential between gilts and commercial property yields. Overseas equities funds can take advantage of more buoyant growth in emerging markets and regions like Asia and parts of Europe such as Germany, although fluctuations in currency exchange rates could affect the value and return from your investment.

Investors may have to get used to a period of disappointing UK economic growth and the difficult environment that goes with it, but thankfully warnings of a double-dip recession from economic indicators are still few and far between. It may prove necessary to diversify into a range of different assets in order to achieve either income or growth from investments.

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. Past performance is not a guide to future performance.

How low can you go?

Annuities rates are close to historic lows.

Traditionally, the two main drivers determining annuity rates for a particular age have been long-term interest rates and life expectancy. If you are about to buy an annuity, the bad news is that for some time both factors have been moving in the direction that pulls down annuity rates.

However, insurers are now using a number of other factors to 'fine tune' annuity rates to the individual, a process that could turn out to be to your advantage. For example, some of the largest insurers now take account of your home postcode when setting annuity rates. You could also qualify for a higher annuity rate if you are a smoker, have had a serious illness (such as cancer), or have current health problems.

This 'fine tuning' of rates means that the annuity league tables which appear on the financial pages of the national press from time to time can be too generalised to be of any real use. If you want to know the annuity rates that apply *to you*, then you need to seek our independent advice.

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All wrapped up

Wrap platforms, internet-friendly schemes through which portfolios can be managed and monitored, give investors a great deal of control over their investments.

Wraps often greatly expand the opportunities available, as well as the speed with which investments and changes in strategy can be implemented.

Proliferation has been remarkable, with literally dozens springing up to compete for a share of the market. Consolidation of the industry is highly likely in the years ahead.

And they are not all the same – wrap platforms vary in what they offer, but one way of thinking about a wrap is as a technologically advanced filing system for your long-term investments. This allows you to look at your investments as a whole and assess their progress and value online, and on a single screen. Wraps generally allow you to invest in several types of investment, and can be a terrific tool, but they are not for everyone.

They may not suit your circumstances and some types of wrap suit certain people more than others because of the different facilities and charging structures that they offer.

Great care needs to be exercised when selecting the right one for your needs, and our job is to make sure we provide the appropriate advice and investment structure to suit your circumstances.

To discuss whether you would benefit from the use of a wrap platform, please contact us.

The Pay As You Earn mess

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HM Revenue & Custom's (HMRC's) problems with Pay As You Earn (PAYE) contain an important message.

The news that HMRC would be writing to 5.7 million people telling them they had paid the wrong amount of tax under PAYE was widely portrayed in parts of the press as evidence of HMRC's incompetence. The comments made by Dave Hartnett, the permanent secretary at HMRC, served only to add to the impression of an organisation out of control. However, behind the media storm, there is a different story.

The reason HMRC found the errors was, ironically, the introduction of a new PAYE computer system. This enabled HMRC to begin a more accurate analysis and reconciliation of the data it holds, with the inevitable result. It is a reminder that technology is bringing together disparate information about the tax affairs of HMRC's 'customers'.

The good news is that if you have to complete a self-assessment tax return, the PAYE problems should be largely irrelevant. In theory at least, each year your tax liability is assessed using information on all your income and reliefs. Which reminds us: if you missed the 31 October deadline for paper returns, you need to file your 2010 tax return online by 31 January.