Bulletin

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Leaders in Wealth Management

It's not so far from Christmas and credit card statements, to remind you that it is a time when kids tell Santa what they want and adults pay for it. Government deficits, however, are when adults (the voters) tell the government what they want – and their kids pay for it.

In other words, 2009 has been a year when most lived in La-La Land and they confused Government borrowings for prosperity.

In 2003 Vince Cable MP dared to question the mantra of "the end of boom and bust". He asked Gordon Brown: "Is it not true that...the growth of the British economy is sustained by consumer spending pinned against record levels of personal debt, which is secured, if at all, against house prices…?" Gordon Brown scoffed in response: "…[He]… has been writing articles in the newspapers… that spread alarm, without substance, about the state of the economy..."

In 2005, when house price inflation fell to 0% – pointing to an obviously needed easing of house prices (obvious to a few) – the Bank of England, with the encouragement of politicians from all sides, *reduced* interest rates and allowed banks to *ramp up lending*, beyond the then already extremes. Thus, absolutely inevitably, we set up the biggest bubble in history and, inevitably, the biggest subsequent bust in history, which is as yet uncompleted.

After the election (in less than 3 months) and in the medium term after, the man and woman on the street, will *finally* realise what the biggest bust in history means – higher sustained unemployment, higher taxes (for years), lower public spending for years (which means fewer public sector employees, worse council and (even worse) government services etc), and then also higher mortgage rates for years, lower pensions and investments (we aim for this not to apply to our clients), falling house prices and *significant falls in standards of living for the bulk of the population.*

The Prime Minister's struggle to win re-election and protect himself from dissent within Labour is "becoming more important to Gordon Brown than controlling the budget deficit … or controlling inflation," said an economist at a financial institution in January. I would suggest that his struggle isn't 'becoming' but *became* several years ago.

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Hoon and Hewitt's 'botched' bid to oust Brown, I would contend, was a touch of genius (or perhaps Mandelson…). The result is that Darling and Mandelson had more power and, within days, they were out telling the public – and more importantly, perhaps, the global lenders – that *Labour's cuts would be deeper than the Conservatives*.

At a stroke, relative sanity starts to set in – as our government *finally* admits the scale of the enormous problem – and Sterling starts to rise against other currencies, especially the weakening Euro. All of a sudden, others, such as Greece, Spain and Portugal, are viewed as even worse basket cases than us.

To which you may say 'That's good then'. It means that a huge sector of the economy – public spending, accounting for some 30% of GDP – will be slashed. A 10% cut, say, takes 3% off the economy. 20% takes 6% off etc. Some regions will be hit extremely hard. The whole country will be hit very hard.

20 years after Japan started to take actions *like the UK and the US* are taking, Japan remains in deep depression. TWENTY YEARS!

The UK may be growing, extremely feebly (0.1% at Christmas!!!), however we expect to re-enter negative GDP and, therefore, recession later this year or 2011. Double dip? As Churchill the TV Dog says "Oh yes".

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

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The PBR: what the tax changes mean for you

Mr Darling's third Pre-Budget Report (PBR) was directed at two main audiences. The first was the electorate, which will be considering the Government's fate within the next few months. The second was the global investment markets, which have become increasingly concerned about countries with large budget deficits.

The PBR was thus a balancing act, which introduced additional taxes and spending cuts (to please the markets), but – bankers aside – the impact of the revenue-raising measures was largely deferred until after 2010 (in order to appease voters). The Chancellor's most important announcements were:

- **National insurance contributions (NICs)** In 2008 Mr Darling announced a 0.5% increase in all the main rates of NICs from 2011/12 and a rise in the NIC starting point to match the personal allowance threshold (£6,475 in 2010/11). He added *another* 0.5% in the December PBR, so that from April 2011, all NIC rates will rise by 1%. However, to help low earners the Chancellor also raised the NIC starting threshold in 2011/12 to £570 a year above the personal allowance.
- **Restriction of higher rate relief on pension contributions** The rules introduced in April 2009 to limit higher rate tax relief on pension contributions have been tightened. If your 'relevant income' for the current or either of the two preceding tax years is at least £130,000 and your total pension contributions from all sources exceed £20,000, you are now potentially within the ambit of the special annual allowance charge. The previous limit was £150,000: the reduction brings the limit in line with the ceiling of the new rules due from 6 April 2011.
- **Income tax** There were no new changes to the main allowances or tax bands for the coming tax year. However, as previously announced, 2010/11 will see the arrival of a 50% 'additional rate' (at £150,000 of gross income) and the phasing out of the personal allowance above £100,000. The 2012/13 higher rate tax starting point will be frozen at the 2011/12 level, although personal allowances will increase in line with inflation.
- **Basic state pension** The basic state pension will rise by 2.5% in April 2010 to £97.65 a week for a single person and £156.15 a week for married couples and civil partners.
- **Inheritance tax** The nil rate band for 2010/11 will be frozen at £325,000.

The Financial Services Authority does not regulate tax advice.

Did you know that company car benefit scales are changing from April, with the main CO_2 threshold falling by 5g/km to 130g/km for 2010/11? For 2011/12 there will be another 5g/km cut and the £80,000 list price cap will be abolished. Unless you have a low emission car (120g/km or below), the effect of these changes will usually be to increase the taxable value of your car by 1% of its original list price every year. For example, if your company car had a list price of £25,000, the amount on which you will pay income tax will typically rise by £250 in each of the next two tax years.

Tax planning before 5 April

The new tax year sees the arrival of a 50% additional rate income tax band and the phasing out of personal allowances if your total income is over £100,000. These changes make the latest round of year-end tax planning even more important:

Use your ISA allowance Your ISA contribution limit in 2009/10 is £10,200 if you were born before 6 April 1960 or £7,200 otherwise. While these are hardly generous ceilings, maximising your ISA is generally a wise move because of the ISA's income and capital gains tax (CGT) benefits. Although there are no capital gains or income taxes on the underlying fund, dividends are received with a 10% tax credit and this cannot be reclaimed by the ISA manager.

Don't waste your CGT annual exemption Stock markets around the world have rallied strongly since the end of March 2009. As a result, you may have capital gains which you can realise. Up to £10,100 of gains (*not* proceeds) is exempt from CGT each year. However, the exemption cannot be carried forward, so you either use it or you lose it.

Pension contributions The value of higher rate relief on pension contributions became clear when last year's Budget introduced 'anti-forestalling' measures. These could affect you if your income in this tax year or either of the two previous tax years is £130,000 or more. Whether or not you are caught by the restrictions, you should review topping up your pension arrangements before this year's Budget.

Inheritance tax (IHT) Your annual IHT exemptions offer a simple way to reduce the impact of this tax. The £3,000 annual exemption can be carried forward, but only to the next tax year (2010/11) and then can only be used once the 2010/11 exemption has been exhausted. If you and your partner have not made any gifts since 6 April 2008, you could now jointly give away £12,000 free of IHT in 2009/10.

Bring forward income If you are likely to be a 50% taxpayer or find your personal allowance reduced, it could make sense to bring forward income into the current tax year. For example, you could close and re-open deposit accounts to crystallise interest that would otherwise be payable after 5 April. You would pay the tax sooner, but at a lower rate.

The value of tax reliefs depends on your individual circumstances and tax laws can change. We are happy to help you with any queries you may have. The Financial Services Authority does not regulate tax advice.

Inflation: how you can protect investments

The inflation rate has swung up and down massively in recent times, threatening the value of savings. How should inflation protection be incorporated into your savings?

The UK's key measure of price increases, the Consumer Price Index (CPI), had struck an annual 5.2%, the fastest pace of price increases for more than 15 years. It was back to just 1.5% in October 2009 – but by January 2010 the rate was 2.9%. What's going on? Has inflation slipped out of the Bank of England's (BoE) control?

The most recent bulletin on the state of UK price stability, the BoE November Inflation Report (11 November 2009), said that while there are some downward pressures on prices, these will ebb as the economy picks up, leaving 2% as its anticipated medium-term rate. Assuming a rate of 2% is a good place for savers to start, though the BoE admits that the extent to which inflation will deviate from 2% is 'highly uncertain'.

Inflation measures by how much prices are rising, but it's more important to consider what that means for your savings. Unless you are making annual returns that are higher than inflation, you are effectively losing money. Simply put, if your investments are making 5% a year, but inflation is 2%, you are actually making 'real' returns of only 3% a year. That makes a huge difference to your buying power.

There are plenty of inflation-linked savings products available, like the government's index-linked bonds. Traditional assets, such as stocks, do on average yield substantially more than inflation when their long-term returns are considered.

Recent volatility has meant returns in the past decade have been below average, but typically stock returns are at their best in the years following a substantial pullback. That data indicates that it could be a good time to get into stocks to beat inflation in the years ahead. When you make forecasts of how much money your investments can make, it's important to incorporate an inflation adjustment. Don't panic though – on a long-term horizon, traditional investments such as stocks have shown that they can offer returns that compensate for higher prices.

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, while large bonuses for bankers have been grabbing the headlines, another distinctly less exciting annual bonus ritual has been taking place? Life companies have been declaring their with profits bonus rates. Many of the companies involved are either no longer open to new business or write little new with profits business. In both cases the incentive to compete is absent, something which can show through in the bonus rates declared. If you have with profits policies which are producing disappointing returns, why not ask us to review them? You can then decide whether it is worth waiting for next year's bonus declaration.

Big changes to state pensions kick in

Important changes to state pensions begin on 6 April 2010. They include:

State pension age (SPA) The SPA for women will start to rise from 60 to 65, bringing it into line with the current male SPA. The transition to 65 is spread over ten years to April 2020. Its net effect is that if you are a woman born after 5 April 1960, you will start to receive your state pension later than age 60.

This equalisation exercise is only the first stage of the SPA increases. Between April 2024 and April 2026 another year will be added to the SPA and the process will be repeated in 2034/36 and 2044/46, by which time the SPA will be 68. Although the main impact of the SPA change between 2010 and 2020 is on women, it will also affect men because some benefits, for example winter fuel payments, are in fact payable from women's SPA.

Basic state pension From 6 April 2010, you will need only 30 'qualifying years' of national insurance contributions (or appropriate credits) to be entitled to a full basic state pension. At present the requirement is 44 years if you are a man or 39 years if you are a woman. April 2010 will also see the end of the rule which denies you *any* basic state pension if you do not have a contribution record covering at least 25% of the period for a full pension entitlement.

State second pension (S2P) The structure of the S2P started to change last year, when the upper level of earnings on which the pension accrues was frozen at £770 a week (£40,040 a year). This freeze is due to continue until the S2P eventually becomes a flat rate pension scheme in 2031/32.

From April 2010 the amount of S2P you accrue each tax year will be reduced if you earn more than £31,800 (in 2009/10 terms). There will be a corresponding reduction in the amount of personal pension contracting out rebates.

These reforms do not mean that you can dispense with private pension provision, unless your goal for retirement is living close to the breadline. The Government has recognised the pension shortfall and is introducing a quasi-compulsory employee pension plan, the National Employment Savings Trust, or NEST (previously known as Personal Accounts), the first stage of which is due to start in October 2012.

Income protection: for when the going gets tough

The most recent Government statistics show total unemployment in the UK increased by 21,000 to 2.49 million, the highest level since early 1995. The UK's unemployment rate has now reached a 13-year high of 7% (Office for National Statistics, 16 December 2009).

Unemployment is a grave concern for most people, but the adverse publicity about payment protection insurance (PPI) could lead some consumers to think that the cover is poor value and not worth having. Income protection insurance may be an alternative, although in the current economic climate adding unemployment cover might be a good idea. Depending on the policy, this can pay up to retirement age.

Surprisingly, there is low take up (based on December 2008 research, Scottish Provident calculates that just 9% of people have income protection insurance). However, income protection is possibly a good alternative to PPI for individuals and, for employers, group income protection helps to ensure that staff not only receive claims payments, but increases the chances that employees will return when able to with 'back to work support'.

Providers have been more innovative in recent years, launching products which offer greater flexibility and at lower rates for restricted terms. There is always a risk of sustaining an injury or contracting an illness that means having to stop work – and job security can never be guaranteed. It's time to take cover.

Child Trust Fund to end?

Child Trust Funds (CTFs), which finally came into being in April 2004, may not be around for much longer.

The Government provides a £250 CTF voucher for each child at birth and a further payment at age seven, with the amounts doubled for low income families. A CTF can be topped up by parents, relations or friends, up to a maximum of £1,200 a year (based on the child's date of birth, not the tax year).

A CTF enjoys similar tax benefits to an ISA: no UK income tax on income and no capital gains tax on profits. Despite these attractions – and the 'free money' aspect – CTFs have not been a great success.

The latest statistics, released on 4 November 2009 in the CTF Statistical Report, show that just over a quarter (26%) of parents who received CTF vouchers on their child's birth left HMRC to open their child's CTF by default. The average addition is under £300 a year.

Tight Government finances and public apathy have prompted a suggestion from the Institute for Fiscal Studies in September last year that the CTF should be axed, saving £500 million a year. It could therefore make sense to top up your child's – or grandchild's – CTF now, while you still can.

Update on trends in the housing market

This year is set to bring substantial changes to the housing market, which could include the removal of the zero rate stamp duty band and higher interest rates.

UK real estate has been floundering, despite Government intervention. Prices remain depressed, and key surveys disagree on whether they are rising again. Rightmove reported a 2.2% drop in prices in December 2009, a sharp contrast to the 1.3% gain reported by Halifax in November and the 0.5% rise announced by Nationwide.

Mortgage approvals, though, give a clearer indication that the tide has turned: according to official Bank of England figures, the number of approved mortgages increased, on a seasonally adjusted basis, for the 12th successive month in November 2009.

The Government's attempts to revitalize the market included lowering interest rates to a record 0.5% and slicing stamp duty off homes costing below £175,000. This latter measure, introduced in September 2008, expired at the end of 2009.

Low prices, cheap borrowing costs and stamp duty benefits made 2009 a good time to buy as long as you were in a position to purchase the property you wanted. However, some of those buyer's advantages are unlikely to last, so if you are looking to invest now it might be a good idea to lock in your interest rate for as long as possible.

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