Bulletin

Winter 2009

Armstrong Davis

Leading the Management of Wealth

For this Bulletin, we are indebted to Greg Pytel of the blog "FINANCIAL CRISIS? IT'S A PYRAMID, STUPID." for allowing us to use his 25 October 2009 diatribe:

"Will the UK go bust after the elections?

Sir Howard Davies made some very refreshing comments at recent HSBC clients' gathering in London. It is clear that the public do not understand the scale of the crisis which was caused by a collapse of the giant pyramid scheme. The demands of those who are still at work, from postal workers to university professors, make it clear that the current crisis appears as something unreal. And, ironically, it is.

The government have no idea of the size of liquidity hole they are trying to plug. It may still be some hundreds of billions, if not trillions, of pounds. On top of that they keep on spending money to sustain artificially the lifestyle the UK cannot afford any longer (if it ever afforded at all). This puts the country in even more debt. As the government does not want to lose the next elections (or to lose them by the least possible margin), they keep the public in delusion of affluence like someone who got unemployed and is draining his credit cards to their limits.

The Conservatives, seeing the public mood and appetite for continued high lifestyle, are too afraid of telling the harsh truth: that the UK is already in a very deep debt hole and tightening of the belt has to start now. They do not want to be accused of scaremongering by the Labour, which may well result in scuppering their elections chances of near-certain (at the moment) victory.

It is this rather unholy alliance of interests of both sides of the political spectrum: the Labour's and the Conservatives' contributes not only to irresponsible but economically irrational behaviour. We try to live financially as nothing has happened. After the publication of the recent economic figures, the time till the next elections increasingly looks like the last dance on the Titanic. The reality check will come after the elections. Doesn't matter who wins: there is a pretty good risk that the UK will be bust by then."

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I believe Mr Pytel has nailed it. His blogs are incisive and very well researched and informed, a little dramatic however no-one said Shakespeare was the worse for being dramatic (well perhaps Ben Jonson 1572-1637).

We would not be surprised at all if the next two ONS announcements of GDP are positive – just in time for the election. Inevitably, given the macro reality, the ending of the recession can only be temporary. After the election, taxes will rise and government spending will be cut. (Either greater or smaller, depending on who wins. The result on the economy and assets will be the same).

So, the stock market has had the incredible run over the spring and summer – the biggest summer rally in 60 years. Our clients, on a bespoke advised basis, reduced – a little – exposure to stocks and commodities in the weeks ending 9 and 16 October 2009, thus locking in some more extraordinary gains created by Govt.con. We still steer clear of illiquid property. Incidentally, on 28 October I wore my tin hat again when I returned (having done so in 2008 also) to speak at *"Survive and Thrive 2009"* – the national conference of… Estate Agents. It's a funny old world…☺

There are some very interesting developments taking place in the world of the markets. Deflation or inflation? That is the question. Now what is the answer?

What do you need to do to secure your position and your future?

Contact me to discuss how we can help you or your clients.

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Start planning early if you want to retire early

Many people yearn to retire early – well before their 60s if possible. The trouble is that this is hard to achieve without careful preparation; relatively few people achieve a comfortable early retirement, and it may even be getting harder.

Part of the problem is that early retirement has become increasingly expensive:

- Many employers with final salary pension schemes are facing substantial deficits and can no longer afford to offer generous early retirement terms as a way to soften redundancy.
- Life expectancy has continued to rise, increasing the period over which pensions are paid and hence their cost.
- Annuity rates have fallen since the turn of the century, because of rising life expectancy and generally lower long-term interest rates.[1]

Two future changes, already legislated for, will further constrain your early retirement options:

- From 6 April 2010, the normal minimum age at which you can draw pension benefits will rise from 50 to 55. In practice retirement before age 55 is usually too costly to contemplate.

  If you are caught by the change and are considering drawing your pension benefits (including tax-free cash) now rather than at age 55 or later, please contact us as soon as possible.
- From 6 April 2010, the State Pension Age (SPA) for women begins a phased increase that will see men and women have an equal SPA of 65 by 6 April 2020. Four years later a further phased increase of one year will be introduced, raising the SPA to 66 by 6 April 2026. Another year will be added in 2034–2036 and 2044–2046, so that by 6 April 2046, the SPA will be 68.

If you want to retire before the state thinks you should, your starting point should be to arrange an initial discussion with us. We can then assess what would be required to meet your retirement objective, taking into account your existing pension provision and investments. Even if the result is that you need to rethink your retirement age – not an uncommon outcome – you will be better informed about when you can realistically stop work.

Levels and bases of, and reliefs from, taxation are subject to change and their value depends on individual circumstances.

1. *National Statistics, October 2009 and www.employeebenefits.co.uk, November 2009.*

Instead of the latest gadget, why not give your grandchild an investment in a unit trust or other fund for Christmas? Within a month the latest gizmo may be out of favour, but an investment could help fund university fees in later life. For a young child, tax would usually not be an issue.

Your retirement income choices could have a lifelong impact

The choice you make when turning your pension fund into a retirement income is one that needs great care. Get it wrong and you, and possibly your dependants, could spend many years regretting an irreversible error.

In summary, your two main options at present are:

Annuities An annuity is the most popular way of producing a regular income from a pension fund. Its key attraction is that once payments start, they continue throughout your life – however long that is. Payments are guaranteed, unless you choose an investment-linked annuity. The main drawback of lifetime annuities is that they are inflexible; once they have been started they normally cannot be changed.

A number of major insurance companies actively compete in the annuity market, but some only quote rates for their own pension policyholders. This makes it vital that you check with us what is available in the market place before accepting your pension plan provider's offer.

Income drawdown Income drawdown (a type of 'unsecured pension') is a higher risk, more complex approach, generally only suitable if you have a variety of other income sources in retirement and can afford to dispense with the security offered by an annuity. Under income drawdown, withdrawals from your pension fund provide your retirement income. The maximum initial withdrawal level is set by HM Revenue & Customs (HMRC) – there is no minimum – and withdrawals must stop by age 75.

Income drawdown has a number of important advantages over annuities, which need to be weighed against the reduced security and additional running costs:

- The value of your remaining fund can be paid out as a lump sum if you die before reaching age 75. A flat 35% tax charge would apply, but normally inheritance tax would not.
- You can vary your income at any time, so long as you stay within the HMRC maximum. However, the higher the income you choose, the greater the chance that it may not be sustainable.
- Your pension fund investments remain under your control.

We can provide you with detailed advice on all your options and help you in making that all-important retirement choice.

Past performance is not a guide to future returns. 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.

Asset allocation is the key to successful investment planning

Asset allocation took a beating in 2007 and 2008, largely because investors found they seemed to be losing money no matter what securities they favoured. That has led to doubt about its worth, so it is useful to take another look at this approach to investment portfolio design in the light of the past two years' performance.

Asset allocation is based on the theory that the choice of assets you invest in will have the biggest impact on the level of returns you make – rather than the individual funds selected. Research by Paul Merriman supports the view that a very high proportion of investment returns come from the choice of underlying assets.

The first step in the investment planning process is to assess your risk profile, followed by recommending how your investments should be deployed across the main asset classes. Then individual funds are selected to fine tune the portfolio – the reverse of the traditional approach.

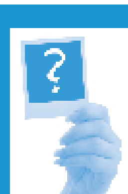
The idea is that different asset classes normally move in broadly different ways. In theory, you can increase performance and smooth out the ups and downs of an investment portfolio by combining different asset classes – described as 'diversification'.

The numbers show that the model largely held up in the market mayhem of 2007, 2008 and so far in 2009, although there have been times when all main asset classes fell together. In 2004, 2005 and 2006, property was the best performing asset by far, followed by shares, and fixed-interest securities were the laggard – although all three made positive returns for investors. 2007 and 2008 saw that order reversed, with property posting losses while fixed-interest securities and shares made very small gains. So far in 2009, the trend of 2004–2006 has been restored.[1] This demonstrates that no one asset class is always a winner and that over time, diversifying really can smooth out returns.

Your risk profile assesses how much risk you can afford. With this established, asset allocation can be optimised. Those with higher risk profiles can look to riskier strategies, such as commodities or hedge funds. Remember, with all asset classes, the value of your investments and the income from them can go down as well as up; you may not get back the amounts you have invested and past performance is not a guide to future performance. It is important that you take advice before investing.

1. *www.castlestonemanagement.com, 12 November 2009.*

Did you know that the final date for online filing of tax returns for the 2008/09 tax year is 31 January 2010? On the same day, any balance payments owed are due, as are the first 2009/10 payments on account. If these balance payments are not settled with HM Revenue & Customs by 31 January 2010, an automatic 5% surcharge will be added to the outstanding amount – in addition to any interest payments that may be owed. The FSA does not regulate tax advice.



As life changes ... check your cover

Why did you take out life insurance? The spur is often to provide financial protection for a partner or children, by arranging a big enough lump sum to pay off a mortgage and to cover living costs.

Few people want to spend much time thinking about their life or health insurance protection. There are always far more pressing things to think about, and the result is that policy documents are often stashed away in drawers and forgotten about.

Unlike car insurance, there is generally no need to assess your life cover every year but it is certainly worth checking regularly that your current life insurance is fit for purpose. There are no rules as to when you need a review, but there are several factors that could affect your cover:

Family matters

Since your last review, you may have added to your family or perhaps you or your partner have changed jobs (or are no longer working at all). School fees or other future expenses may have become an issue, and you could now need insurance for a larger amount.

Property ladder

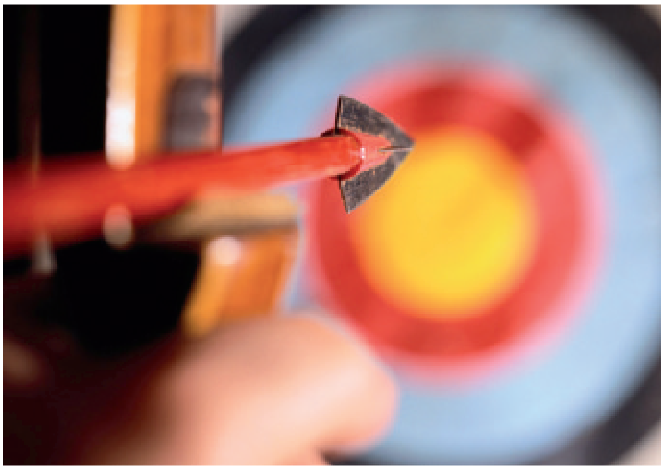
There are some signs of improvement in the property market after the recent slump in prices. Is your life cover enough to deal with your mortgage or other loans? Some people have switched to an interest-only mortgage where the capital value remains static, and so cover may now be insufficient. If you have bought a second property with a mortgage since you last reviewed your insurance, it could be wise to consider extending your life cover.

Added value?

The cost of life insurance is very competitive, so there is no need to pay over the odds. Even if you have a medical condition we may be able to find specialist insurers to provide cover. If you have given up smoking since you arranged a policy, it might well be possible to reduce the premiums you pay.

Remember, life assurance is not the only financial protection you should be considering. If you were too ill or disabled to work, you would probably have grave difficulty paying all your bills. The state benefits for long-term illness are much lower than most people think. The answer could be an income protection policy that would pay out an income in these circumstances.

Absolute return funds are increasingly attracting investors



The concept of an absolute return fund is disarmingly attractive. Branded as able to make money in good times and bad, these funds generally provide a lower but steadier average return than many of their more conventionally managed competitors. The idea behind such funds is that they should outstrip conventional equity or bond funds when markets drop, but the flipside is they are likely to lag behind their rivals when the markets rally.

They come in a variety of types. Some allocate their investments across a very diverse range of assets with the aim of smoothing out returns. Many are indistinguishable from hedge funds, and typically use unconventional investment techniques or complex financial products to try to generate positive returns in both rising and falling markets. The key word here is 'try': absolute return funds can no more guarantee you a positive return than any other open-ended investment fund. More to the point, many failed to achieve exactly this during the meltdown unleashed on markets by the credit crunch.

Some absolute return funds coped with 2007's and 2008's volatile trading conditions, but others failed completely, losing up to 25% of savers' cash in a single year.[1] The strategies they had carefully constructed to accrue modest returns in all market conditions simply did not work in extreme conditions. It is a warning to investors: if your investment scheme aims to achieve something, but does not guarantee it, you may not get back what you expect.

The good news is that the challenges of 2007 and 2008 highlighted those absolute return funds whose strategies coped well in extraordinarily trying times. They have demonstrated that there are some funds that have been able to produce positive returns in both good times and bad. If you are still keen to add an absolute return fund to your portfolio, the credit crunch has pointed to a selection of candidates to choose from.

But do not forget: the value of your investment can go down as well as up and that past performance is not a reliable guide to future performance.

1. *Standard & Poor's, 13/07/09 and Bloomberg, 31/08/09.*

Were you born before 6 April 1960?

If the answer is Yes, you can now take advantage of the new individual savings account (ISA) investment limits announced in the 2009 Budget:

- Your maximum ISA investment is now £10,200 per tax year – a £3,000 increase over the previous limit.
- Up to £5,100 of your new limit may be invested in a cash ISA.

The new limits took effect from 6 October 2009 and will apply to all eligible ISA investors from 6 April 2010.

Some ISA providers will not be operating the new limits until 6 April 2010 and are refusing top-ups beyond the old £7,200/£3,600 ceilings. To complicate matters further, you are only allowed to invest in one cash ISA and one stocks & shares ISA per tax year, so you may not be able start another ISA just for the top up. However, there are ways around this restriction which we can explain to you.

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. Levels and bases of, and reliefs from, taxation are subject to change and their value depends on individual circumstances.

A parent's job is never done

Just as you thought your adult children were off your hands and earning their own living at last, you wake up to the fact that they still need your continuing financial support.

Your help may just amount to advice and a sympathetic ear. But it could easily extend to financial help with their buying a home or starting a business – so much depends on your circumstances and their needs and aspirations.

So just imagine what would happen if your adult child were to fall seriously ill and could no longer afford to pay their bills. Remember, state benefits will probably cover just a small proportion of their financial needs. In the end, who do you think will pick up those bills, or else be concerned that there is simply not enough money to go round? Yes, probably you.

Fortunately, there is an insurance policy that everyone in work should consider, and it is called 'income protection'. The policy pays out if the insured person is unable to work and continues paying out until they are well enough to return to work. It is in your interests that your adult children should look into it as a matter of urgency.

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