FINANCIAL FOCUS

KEEPING YOU UP TO DATE WITH DEVELOPMENTS IN FINANCIAL PLANNING WINTER 2008

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This autumn has seen the most volatile period of stock market activity since the 1930s and has been a stark reminder for investors that share values fall as well as rise. Our previous newsletters have talked about market volatility, but it clearly becomes challenging to comprehend ongoing daily price movements of more than 20% in our biggest listed companies in the FTSE 100.

The events of 2008 will have affected all of us with investments. For those retaining a large amount of their wealth in the company that they own or work for (where stock often cannot be sold or will have certain restrictions), this period will have been very painful. Perhaps more so for those working in the city, with share losses of up to 90%, or worse if you worked for Lehman Brothers.

It goes without saying that there will be great opportunities for brave investors over the coming years. As of today (November 21st) the FTSE is trading at the cheapest level for 15 years relative to its earnings. For those with capital to invest for the medium to long term (say 3-5 years plus) and can afford to look through the next few months, there will almost certainly be good rewards.

Please do talk to us if you are concerned about your portfolio, want to reappraise your current strategy, or indeed have questions on any of the articles in this newsletter.

I hope all our readers have a good Christmas break and that 2009 is a prosperous year for investors!

Savings come back into fashion

Rollercoaster, see-saw, helter-skelter...

The fairground ride analogies have been out in force over the last few months as the global financial crisis has brought unprecedented volatility to investment markets. There are long-term lessons to be learnt.

One is that we should save more. A major contributory factor to the crisis in the United States and, to a lesser extent, the UK has been low rates of saving. In the second quarter of 2008, for each £100 of net income, the average UK household saved just 40p according to National Statistics.

With regular savings in deposit accounts, you can create a cash reserve that may help you through when problems arise. Beyond such 'rainy day', short-term regular saving, long-term regular *investment* can be made in unit trusts and similar share-based funds.

If you make a regular monthly investment, you are not committing all of your money at a single point. So 'market timing' – choosing when to invest – is not an issue. Instead, your monthly

investment could buy more units/shares when market prices are depressed than when prices are high. This process, known as 'pound-cost averaging', means that over a period of years the average price at which you invest can be lower than the average price for that period.

Past performance is not a reliable indicator of future performance. Investments can go down as well as up and you may not get back the original amount invested.

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Boxed in by the credit crunch?

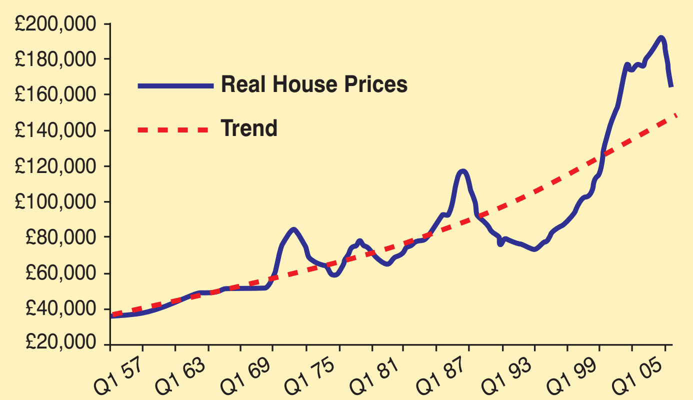
The credit crunch started in US but first hit the UK over a year ago with the Northern Rock crisis and has grown in seriousness ever since. The sea change in the world's financial structure is affecting more and more people's lives.

> "If your solution to a cash shortage in the past has been to remortgage, you may now need to rethink your options."

Bank deposits

The collapse of three Icelandic banks has served as this generation's reminder that even in the world of bank deposits, the rules of risk and reward still apply. The Icelandic banks were regular 'chart toppers' in the interest league tables, but it now appears that the marginal extra rate was there for a good reason, just as it was for BCCI 17 years ago.

On this occasion, individual depositors were lucky in that the government was willing to fill the gaps left by the Financial Services Compensation Scheme (FSCS), notably for deposits above £50,000. If there had not been such an atmosphere of crisis, the government might have decided the FSCS was enough (see page 5 for more on the FSCS).



Mortgages

US sub-prime mortgages – property loans to risky borrowers – have been blamed by many commentators as one of the main causes of the crisis. Once those mortgages started to default, the effect was felt throughout the world because of the way in which the loans had been repackaged and sold to a wide range of institutions.

The backwash in the UK has seen banks and building societies adopt much more cautious lending policies. In some areas of the mortgage market – notably buy-to-let – there has been an over 70% contraction in the number of mortgage offerings.[1]

If your solution to a cash shortage in the past has been to remortgage, you may now need to rethink your options.

House prices

By October 2008, house prices were falling at an annual rate of 15% according to the Halifax. That drop exceeds the entire fall of the early 1990s and looks likely to continue. The Halifax notes that the current ratio of house price to earnings is 4.92, which is still almost a quarter above the long-term average of 4.0. This view is echoed in data from the Nationwide (see graph below).

The decline in house prices is a reminder that relying on residential property – be it your home or buy-to-let – as your only retirement/savings fund can be a dangerous strategy.

Pensions

The drop in share prices has inevitably reduced the size of many pension funds. For private sector final salary schemes, deficits will generally have widened as a consequence. That could mean higher employer (and employee) contributions in the future, unless there is a major market recovery. It will also increase the likelihood that these schemes will close to existing members – many have already shut their doors to new employees.

For other types of private pensions, including personal pensions, smaller funds will normally mean lower pensions, although annuity rates have been rising (see page 3). Once again, higher contributions may be required to restore benefits to the original target levels.

If you need help in managing any of the issues raised, let us know.

1. Source: Yourmortgage.co.uk, 30 September 2008

“The growth of competition has prompted one of the UK’s biggest insurance companies to launch postcode annuities”

Annuity rates reach a peak

One consequence of the credit crunch has been a rise in the yields on the fixed interest securities that underpin annuities. By September 2008, annuity rates had reached a six-year high.[1] This is good news if you are looking to convert your pension fund to a lifetime income, although the bad news could be that the credit crunch has also affected the value of your pension plan.

If you have no immediate plans to convert your pension fund into an income but are close to retirement, it could still be worth asking us to give you an illustration of what is available. As a rough rule of thumb, if you are in your mid-60s, you gain nothing in terms of the annuity rate by waiting a year before purchase if, over that period, the underlying interest rate drops by 0.25%.

So buying now could give you an extra year’s income at no cost if interest rates fall by only a small amount. Of course, this ignores what happens to the value of your pension fund over the 12 months. Movements in your fund value could swamp annuity rate changes – in either direction.

Postcode annuities

Higher rates have not been the only development in the annuity market this year. The growth of competition has prompted one of the UK’s biggest insurance companies to launch postcode annuities, ie annuities based on the exact postcode of the purchaser. The theory behind these is that the more affluent the area in which you live, the longer you are likely to draw your pension. So if you are a Kensington pensioner, you will receive a lower annuity rate than if you live in one of the tougher parts of Glasgow.

Postcode annuities are the latest example of a trend to tailor the annuity rate you are offered more closely to your personal circumstances. For example, there are now several annuity providers offering ‘enhanced’ rates based on a lifestyle or other factors, eg smoking or diabetes. A handful of companies go further and will quote ‘impaired life’ rates if you have a serious health condition, possess a sufficiently large pension fund and are willing to undergo any necessary medical examinations.

Annuity selection

If you are considering buying an annuity, your first step should be to seek independent advice. When it comes to discussing the alternatives to annuity purchase, such as unsecured pensions, your pension plan provider is unlikely to give you anything more than the most basic of information. The alternatives are generally worth considering if:

- You have a large fund – typically at least £100,000;
- Death benefits and/or inheritance tax planning are important to you;
- You are willing to accept investment risk, which means the value of your fund and the income/payments you receive from it could fall as well as rise;
- You want to leave any unused pension fund to charity.

Please remember that past performance is not a reliable indicator of future values on your pension fund.

1. Source: *The Independent*, 12 September 2008

Focus on a New Year review

If you have made, or are about to make, your New Year's resolutions, one of the first, and a vital one, should be to make a full review of your financial situation.

2008 has been an incredibly difficult year as far as finances are concerned. Governments worldwide have struggled to ease the financial position in previously untested ways. While the credit crunch has raised some specific issues (see page 2), taking a general overview of your financial planning could highlight some important questions.

Investments

If you have deposit investments, are they properly protected? The Financial Services Compensation Scheme now protects up to £50,000 of an investment in a specific bank (see opposite). Do you have more than that at risk in an institution? Should you spread these investments?

What about the stockmarket? It has been extremely volatile during 2008. How have your equity-based investments been doing? It may be time to look at these to see if your portfolio is balanced properly. For example, are you overweight in any particular sector where there could be some excessive downside risk?

Mortgages

If you have a mortgage you may well be coming to the end of a fixed interest rate period, possibly leading to increased mortgage repayments. With the mortgage market in a state of uncertainty following the recent interest rate cuts, it is important to take professional advice. Experienced mortgage advisers often know where the best deals are to be had and could save you considerable amounts of money. Your home may be repossessed if you do not keep up repayments on your mortgage.

Protection

The financial situation over the last few months has adversely affected the wealth of many families and you may wish to look at the different ways of protecting your family for the future. Do you have enough life cover to protect your spouse/partner as well as your children or grandchildren? Again, professional advice is important to ensure that such life cover is set up in the correct way.

Pensions

One major area to suffer from the decline in stockmarket values is pension funds. Most of these have some equity exposure. If you are already retired and drawing on your funds or you are rapidly approaching retirement, you really owe it to yourself to conduct a full review of how your pension fund is performing. You do not want to suffer a drastic reduction in pension just when you find that you need to maintain your income.

You may wish to think about switching your pension funds to more 'safe' investments as retirement approaches. Pensions are complex. They combine government rules on limits regarding tax-efficient investments and the tax reliefs available with actual investment decisions. Again, you will need to take professional advice to see if any strategic decisions need to be taken.

An overall financial review at this time could serve to put you into a much better financial position in 2009.

Where there's a will

Many people believe that on death their assets will automatically pass to their surviving spouse or civil partner, even if they don't make a will. Where there are significant assets this is not the case: the state dictates where your assets will go.

For most people, relying on the intestacy rules is not a desirable outcome. Assets could go to people that you do not wish to benefit, awkward 'statutory' trusts could be set up over some of your assets and there may also be unnecessary inheritance tax liabilities that could have been deferred or, with successful planning, avoided altogether.

Intestacy rules vary in different parts of the UK. Proposed changes from the Ministry of Justice from 1 February 2009 will increase the statutory legacy limits in England and Wales from £125,000 and £200,000 to £250,000 and £450,000 respectively. In Scotland the rules are different: a surviving partner has prior right to a home worth up to £300,000 and specified assets. In Northern Ireland the limits have been £250,000 and £450,000 since 1 January 2008.

From 1 February, if you die intestate in England and Wales leaving a surviving spouse or registered civil partner, your assets will pass as follows:

- If you leave a spouse or civil partner *and* children (including adopted children and illegitimate children as long as there is proof of parentage) that spouse or partner will receive assets to the value of £250,000 (up from £125,000) plus your personal chattels. They also receive a life interest (in effect, a right to the income only – not the capital) of one-half of the remainder of your estate.

  The other half of the remainder of your estate goes to your children directly – so they will receive the capital – provided they are not minors. Statutory trusts are created for any minors until they come of age, when they will receive the capital.

- If you leave a spouse or civil partner but *no* children, then they will receive assets to the value of £450,000 (up from £200,000), your personal chattels and one-half of the remainder of your estate absolutely. Your parents receive one-half of the residue. If you leave no parents, your brothers and sisters – or their children – inherit.

Wherever you live, there is no acceptable substitute for proper estate planning and making a valid will that reflects your wishes as far as your assets are concerned.

The Financial Services Authority does not regulate will writing and some forms of inheritance tax planning.

Financial services compensation – what's covered?

When things go wrong with financial products, it is good to know that there is a safety net in place to protect investors in some circumstances. In the UK, this is provided by the Financial Services Compensation Scheme (FSCS).

The FSCS is the body currently being used by the Government to bail out investors in some of the firms that are experiencing problems arising from the banking crisis.

The FSCS is an independent (though government created) institution formed under the Financial Services and Markets Act 2000. It is a compensation fund of last resort for the customers of financial firms that are regulated by the Financial Services Authority. The FSCS is funded by levies from the providers of financial services type products.

The FSCS considers claims from investors against firms that have ceased to trade and where the firms, or their owners, are unable, or likely to be unable, to meet those claims. There are strict limits to the compensation amounts as shown in the table opposite. If you are in doubt, it would be prudent to contact the provider for limits on specific products or deposits held.

TYPE OF CONTRACT	MAXIMUM AMOUNT OF COMPENSATION
Deposit accounts	£50,000 per person per deposit firm Joint account limit £100,000 (Limit increased from £35,000 from 7 October 2008)
Investments	£48,000 per person per investment firm 100% of first £30,000 and 90% of next £20,000
Mortgage advice and arranging	£48,000 per person calculated as 100% of first £30,000 and 90% of next £20,000
Long term insurance (including investment bonds)	100% of first £2,000 plus 90% of balance of claim No actual monetary limit

Customers should be aware that the maximum limit will only be covered per authorised banking licence, not per brand of bank or building society under a parent company.

There are, however, areas that are *not* covered. The FSCS does not consider any claims against firms that are still trading, which must be made in writing to the firm and could end up with the Financial Ombudsman.

If you think the FSCS would be relevant to you, please get in touch.

SIPPs open up

When personal pensions were launched in 1988, one of their most important features was that they could be used to opt out (technically 'contract out') of the state earnings-related pension scheme (SERPS).

Contracted-out personal pensions then received national insurance rebates that were allocated to 'protected rights' funds. When SERPS was replaced by the state second pension (S2P) in 2002, the opt-out option continued. Since 1988, personal pensions have also been able to receive transfer payments from contracted-out final salary (defined benefit) pension schemes and contracted-out money purchase (defined contribution) schemes.

However, until 1 October 2008, only insured personal pensions could hold protected rights funds. Thus, nearly all self-invested personal pensions (SIPPs) were excluded from receiving national insurance rebates or a full transfer from a contracted-out pension scheme. Regulations have now removed this restriction.

The new rules mean that you now have the opportunity to transfer existing insured protected rights funds into a SIPP, potentially gaining greater investment control and benefit flexibility. Your protected rights funds might currently be held in old plans to which rebates have not been paid for some years – contracting out has steadily become a much less attractive option since 1988 and is now rarely recommended. The insurers may themselves have closed to new business, taking their administrative and fund performance out of the spotlight reserved for new investments.

While it is definitely worth examining what protected rights benefits you have, a transfer to a SIPP may not be the right option. The final decision depends on a wide variety of factors. For example:

- Do you have an existing SIPP to which the transfer could be made?
- How long do you have before you would draw benefits from the protected rights fund?

- How do the existing pension plan charges compare with SIPP charges?
- How important to you is the wider range of investment opportunities a SIPP can offer?
- How do you plan to take your protected rights benefits?
- Will you lose any benefits or suffer penalties by making the transfer?

We can help you find the answers to these questions.

Environmental investment comes of age

Protecting the environment and the impact of climate change are no longer matters of fringe interest to a small handful of activists. 'Carbon footprint' is a term that is now widely understood, and governments around the world are introducing targets for CO_2 reductions.

"Many of the big name investment management companies have at least one ethical fund"

For example, the EU has set two main climate change goals for 2020:

- A cut in greenhouse gas emissions to at least 20% below 1990 levels, and
- 20% of energy consumption across the EU to come from renewable sources.

These are challenging targets, a point underlined by a report this July from EIRIS (Ethical Investment Research Services). Over a third of the world's 300 largest companies assessed by EIRIS were categorised as having a high or very high climate change impact.

Among the very high impact companies, EIRIS found 84% had a corporate-wide climate change commitment, but only 25% had published a long-term target for emissions reduction.

If you want to invest in companies that are taking positive environmental action rather than just issuing grand-sounding statements, there is now a wide range of funds available:

Open-Ended Investment Companies (OEICs) and Unit Trusts

The Investment Management Association lists over 50 ethical funds, some of which are focused solely on environmental issues, while others adopt a broader socially responsible investment approach. Many of the big name investment management companies have at least one ethical fund and several groups offer a range of funds.

Pension Funds

Life company personal pension plans normally offer environmental or ethical funds, usually invested in the unit trusts or OEICs mentioned above. If you have a self-invested personal pension (SIPP) or are a member of a small self-administered scheme (SSAS), either arrangement will usually have the power to invest directly in ethical unit trusts or

OEICs as well as the small number of environmental investment trusts available.

Life Assurance Funds

The major life companies generally offer links to environmental funds for their investment bonds and other contracts. There is no universal definition of 'ethical' or 'environmental', so do make sure you discuss your objectives with us before investing.

If you are interested in environmental or other areas of socially responsible investment, let us know. Past performance is not a reliable indicator of future performance. Investments can go down as well as up and you may not get back the original amount invested.

How much will you get?

Have you ever wondered what your total state pension benefits will amount to when you reach state pension age? There could be up to four components – basic state pension, graduated pension, state earnings-related pension (SERPS) and state second pension (S2P).

The Department for Work and Pensions (DWP) has just relaunched their state pension forecast service to give you an answer that takes account of the various changes introduced by the Pensions Act 2007.

Log on to www.thepensionservice.gov.uk/state-pension/forecast/home.asp or ask your local DWP office for form BR19.
For help interpreting your forecast, please feel free to call us.

Investment ins and outs

Share markets around the world have seen substantial declines in 2008, with the pace of falls accelerating sharply during September and October.

The spectre of recession meant that even sectors that had been performing relatively well, such as commodity producers, were pulled down. It was all very gloomy.

However, to paraphrase a common warning, investment values can go up as well as down. There have been sharp rallies in the aftermath of past stockmarket crises, such as the October 1987 crash and the post-2000 technology bust. An investor who sold out in the darkest hours had to be very quick to reinvest to avoid finding themselves in a worse position than if they had simply shut their eyes and held on.

The idea that you can time when to buy and when to sell (or vice versa) looks very attractive in theory. It also appears extremely easy when you study a graph of share price movements: buy in at the troughs and sell out at the peaks.

However, practice is somewhat different. Share prices can move very fast – in either direction – as has once again been proven by the last 12 months of dizzying swings.

One major investment group, Fidelity, looked at the impact that missing just a few days of sharp rallies can have on overall returns. It found that over the 15 years to the end of September 2008, if you had missed just the best ten days of performance, your annual return would have been reduced by 3.25% (based on the FTSE All-Share with net income reinvested). Similar effects were observed for other major markets, such as the US and Germany.

The major investment institutions, such as pension funds, generally do not attempt 'market timing'. The professionals realise that market timing is just too difficult in the real world, even though they are watching the markets constantly and can deal instantly.

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

"The major investment institutions, such as pension funds, generally do not attempt 'market timing'"

Varying inheritance tax liability

Strange as it may seem, for inheritance tax (IHT) purposes, death is not, in fact, final.

Your will or intestacy provisions can be altered by your beneficiaries to change the destination of your assets. For IHT purposes, these changes are deemed to be made by you.

These post-mortem IHT benefits can be achieved by creating a deed of variation, sometimes called deeds of family arrangements. The changes have to be made within two years of your death and the process is best illustrated using an example.

Geoffrey Jones died on 1 May 2008. In his will he left inheritance taxable assets to the value of £512,000 to his children. The residue of his estate, £1million, was left to his widow. The nil-rate band of IHT when Geoffrey died was £312,000. Therefore IHT of £80,000 is payable on his taxable assets (£200,000 @ 40%).

As long as his children agree to make a deed of variation over part of their inheritances in favour of their mother, Mrs. Jones, they could reduce their inheritances to £312,000 and the IHT liability on Geoffrey's estate would be nil. The deed would have to be made sometime between 1 August 2008 and 30 April 2010 and it would need to include a suitable declaration that it is intended to be applied for the purposes of IHT (and, if appropriate, capital gains tax as well).

Mrs. Jones could then, for example, make lifetime gifts of £200,000 to her children to replace their part inheritances. Provided she survives seven years after making these gifts, there would be no IHT to pay, and the family would have received the assets as Geoffrey wished.

There could be a problem with making a deed of variation if, for example, one of the children is a minor. Strictly, the minor could not enter into such a deed, but it is possible to make an application to a court to obtain agreement on behalf of a minor.

If someone in your family has died within the last two years leaving an IHT bill to be paid, it is well worth investigating whether a deed of variation can reduce the liability.

The Financial Services Authority does not regulate some forms of inheritance tax planning.

A higher state pension

The 5% annual increase in the retail price index for September is an important number, because it is the basis for next April's increases in most personal tax allowances and bands. It also determines the annual rise in the basic state pension. Next year's basic state pension should be £95.25 a week for a single person and £152.35 for a married couple.

The link between increases in the basic state pension and earnings inflation will be re-established, probably sometime after 2010/11. However, this will do little to reduce the importance of private provision if you want a comfortable retirement.

Time to file online

If you received a paper tax return for 2007/08 in April and have not yet sent it back to HM Revenue & Customs, it is now too late to do so. The final date for submitting a paper return issued in April 2008 was 31 October 2008.

Your only option now is to file online. The cut-off date for this is 31 January 2009. However, given the problems experienced in January 2008 with last minute filing, you would be well advised not to wait until the deadline is only hours away to log on.

Mortgage interest help

There is now extra help from the government for mortgage interest payments made by people who lose their jobs and are buying their homes with a mortgage.

The benefits system, known as Income Support for Mortgage Interest (ISMI), is administered by the Department for Work and Pensions (DWP). ISMI is available to assist people who are eligible for income support or job seeker's allowance.

The rules change from April 2009 and the 'before and after' position is shown in the table below. The Government estimates the cost of the new package for ISMI to be £100 million and hopes that it will prevent a further 10,000 repossessions across the UK.

These new limits are more generous, but 13 weeks can still be a long time to pay full mortgage interest if you are out of work. With house prices having reached a very high level before the economic downturn during 2008, there are some extremely large mortgages out there, with equally high mortgage interest payments.

The fact that many cheap fixed rate mortgages have come to an end and have had to be rearranged, usually at a higher rate, has not helped.

At the beginning of November, the Bank of England cut the base rate of interest by 1.5% to 3%. Lenders have been under pressure to feed the cut back to borrowers, which could serve to ease some of the pain. However, the impact of the cut across the mortgage market remains unclear.

A word of warning. ISMI will not be of any assistance whatsoever to people who have not actually lost their job but are having to work shorter hours for less pay because of cutbacks.

Also, those who are losing income because of illness, together with those on incapacity benefit, are not eligible for ISMI either. Nor are people struggling to pay mortgage interest on a second mortgage.

In addition to the changes to ISMI, as part of a wider set of measures the government is also going to help people to buy their homes through a new shared equity scheme and a mortgage rescue scheme.

	BEFORE APRIL 2009	FROM APRIL 2009
First amount of mortgage on which ISMI benefit paid	£100,000	£175,000
Period of unemployment after which ISMI cuts in for new claimants	39 weeks	13 weeks