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Market Correction… Stay Calm

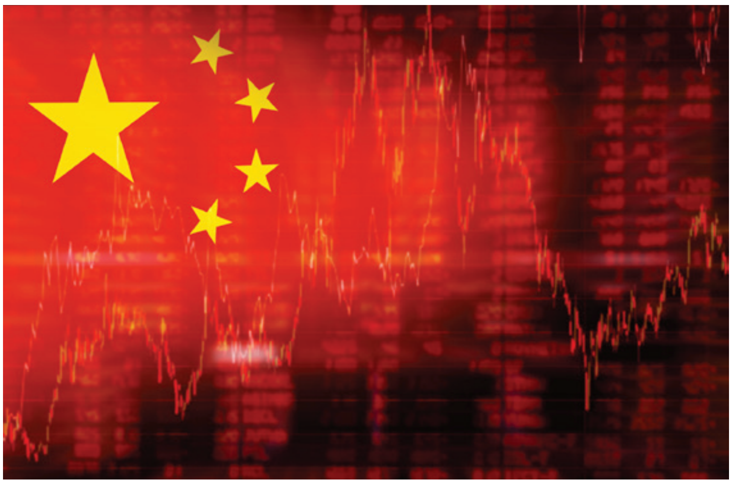
If a week is a long time in politics, then it is an eternity in financial markets.

In the two week period in August I was enjoying a summer break, the FTSE All Share Index fell almost 8% and has officially entered into correction territory, having declined by over 15% since the end of May. That drop is 5% greater than that of the S&P 500, albeit still a third less than the 22.5% fall in the German DAX 30 Index. Germany has double the export exposure to China than the rest of Europe, which partly explains its under-performance.

In my view, this latest equity market storm, which was initially sparked by the likely impact of monetary policy tightening later this year by the US Central Bank, is largely being driven by growth concerns and earnings downgrades in Asia-Pacific markets, and the fallout from the ongoing slowdown in the Chinese economy and the lack of a credible response from its government.

To compound matters, the unexpected devaluation of the Chinese renminbi has stoked fears that the country's economic slowdown – the latest data showed that China's manufacturing sector is shrinking at its fastest pace since 2009 – could be far worse than feared. The jittery market environment has not been helped either by the resignation of the Greek Prime Minister Alexis Tsipras, when he called a snap General Election to ask the Greek people to pass judgement on the country's €86 billion bail out deal.

Despite this gloomy backdrop, I think some perspective is required. Firstly, the chance of the US Federal Reserve increasing interest rates at this month's meeting of the FMOC has decreased markedly. Secondly, the deflationary impulse coming from China will now allow the European Central Bank to extend or expand its QE programme. Thirdly, having fallen by over 23% since peaking out, valuations in the Asia-Pacific region are close to levels associated with previous recession trough lows.



Chinese stock market volatility

Clearly, with global markets under pressure, it takes nerves of steel to contemplate buying equities right now, but my view is that a capitulation moment is coming. We are certainly getting close to it, as the Wall Street gauge of fear (the VIX Index) spiked by 118% in the last week of August. The last time this happened (August 2011) one month later the S&P 500 was up almost 6% and within three months was 12% ahead.

My feeling is that this period will ultimately prove to be a market correction, driven by a growth scare, and worth taking advantage of.

As always, please do contact the office if you wish to review individual portfolios.

Rob Sandwith | Chief Executive

Independent tax revisited

Changes to the tax system now and in 2016 mean it is time for couples to review their tax planning.

When independent tax for married couples was introduced 25 years ago, it prompted a flurry of tax planning as husbands and wives rearranged their financial affairs to take advantage of the new rules. However, over the years the benefits of independent taxation faded somewhat, partly as a result of other tax reforms. Now a new set of tax changes, announced in recent Budgets, have brought the focus back to independent tax, which also applies to civil partners:

The starting rate band

This tax band applies to savings income (mainly interest). At the start of 2015/16 the band was widened from £2,880 to £5,000 and the tax rate was cut from 10% to 0%. Unfortunately many taxpayers are unable to exploit this apparent generosity, as the band applies to the first slice of your income after deducting allowances, provided the £5,000 slice is not already filled with earnings and/or pension income.

The personal savings allowance

This will be introduced from 2016/17 and will give basic rate taxpayers an allowance of £1,000 to set against their savings income. Higher rate taxpayers will receive a £500 allowance, but additional rate taxpayers will get nothing. The maximum tax saving offered by the allowance is £200 (£1,000 @ 20% or £500 @ 40%). Its arrival means banks and building societies will pay deposit interest without deduction of tax from 6 April 2016.

The dividend allowance

The dividend allowance also comes into being next tax year. The first £5,000 of dividend income will be free of personal tax, regardless of what tax rate you pay on your other income.

Alongside these changes are a variety of individual income thresholds to watch, including:

- **£42,385** If you have just the basic personal allowance, this is the starting point for higher rate tax for 2015/16.
- **£50,000** The clawback of child benefit starts at £50,000, with 100% of the benefit lost when income is £60,000 or more.
- **£100,000** Above £100,000 of income, the personal allowance starts to be reduced, creating an effective marginal rate of tax of 60%. This hidden 60% tax band runs up to £121,200 in 2015/16 and up to £122,000 in 2016/17 (thanks to the Summer Budget increase in the personal allowance to £11,000 next tax year).
- **£150,000** This marks the start of additional (45%) rate tax and, like the £100,000 threshold, is fixed.

In theory, in 2016/17 you and your husband/wife/civil partner could each have total income of £22,000 before paying any tax. It would need to be a particular mix of income – if it were all earnings and/or pension you would have a tax bill of £2,200. However, establishing the right structure of income – who gets what from where – must be balanced against your long term investment goals: generating a large slice of interest income may help keep your tax bill down, but in the current economic environment it also places a low cap on your investment returns.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice. The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

The Summer Budget: ringing in the changes

The first Budget after an election is often the most radical and this year's post-poll offering was no exception.

The Summer Budget of 2015 was a very different affair from its March predecessor. The spring Budget was determinedly a pre-election presentation, with a small net reduction in tax over the five year period from 2015/16. Although you might not have guessed it from the contents of Mr Osborne's speech, in contrast the summer Budget increased taxes by more than £22 billion over the same five year period.

Dividend taxation

One of the largest money-spinners for the Exchequer is the reform of dividend taxation taking place from 2016/17. This is an area where previous Chancellors created a confusing set of unique tax rates and non-reclaimable tax credits to boost Treasury coffers. From 6 April 2016, a simpler system will emerge. You will be able to receive up to £5,000 of dividends with no tax liability, regardless of your tax rate. However, above this new £5,000 dividend allowance tax rates will be higher than at present, as the table below shows.

Effective dividend tax rates*

Tax rate	Basic	Higher	Additional
2015/16	0%	25%	30.56%
2016/17	7.5%	32.5%	38.10%

*Based on net dividend paid (ignoring 2015/16 tax credit)

The Chancellor said that 85% of those who receive dividends will see no change or will be better off. However, if you have a large investment portfolio or you are a company owner who draws dividends instead of salary, you could be considerably worse off from next April.

Another target for increased tax revenue was buy-to-let residential property. From April 2016, the 10% wear and tear allowance which applies to furnished lettings will be replaced with a new relief based on the actual costs incurred in replacing furniture. This means that investors will have to spend money to obtain any relief, whereas at present they can claim the allowance without any corresponding expenditure.

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The following tax year, the maximum rate of tax relief on finance costs (mainly interest) for individual investors will start to be reduced year by year. By 2020/21 the tax relief will be at basic rate only (20%). If, as a buy-to-let investor, you have used a mortgage to fund part of your property purchase costs, the end result could be a substantial increase in income tax.

There was an easing on the inheritance tax front, although even this was not as generous as had been expected. A new transferable main residence nil rate band, initially £100,000, will be introduced in 2017/18, rising to £175,000 in 2020/21. As a result, from April 2020 a couple with a joint estate worth up to £2 million will be entitled to nil rate bands totalling £1 million, provided they have (or, in most cases, have had) property worth at least £350,000 that is passed to direct descendants. For estates that are valued above £2 million, the new nil rate band will be subject to a 50% taper. The Chancellor also froze the normal inheritance tax nil rate band at £325,000 (its 2009 level) for another three years, until April 2021. A previous three year freeze was meant to fund a new £72,000 cap to care costs in England from 2016, but in mid-July this too was deferred – until 2020.

These tax changes, together with many other measures announced in July, mean that an early review of your financial planning could be a wise and rewarding move. For example, if you are a private company director, it may pay you to bring forward some of next tax year's dividend payments into 2015/16.

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New bereavement benefits to be introduced

From April 2017, a new set of bereavement benefits will be introduced. The existing combination of bereavement payment, widowed parent's allowance and age-related bereavement allowance will be replaced with a new bereavement support payment (BSP) consisting of lump sums and instalments paid over 12 months. While BSP will be tax free, it will not be as generous if your widow(er) has a young family, as widowed parent's allowance is currently payable as long as Child Benefit can be claimed for at least one child. The reform is once again a reminder that reliance upon the state for a safety net is not to be recommended. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

Investment in volatile times

Market volatility has been at near-record levels in recent months, as investors respond to the uncertainty in Europe. How should we deal with it? Just go on holiday and ignore the noise or take evasive action?

What is volatility?

Volatility is simply the up-and-down movement of the market measured by the deviation of such movements from the expected. Investors naturally find high volatility rather scary and most are not in a position to do anything about it.

Is volatility bad?

Whilst the daily market moves can be dramatic, there is a strong relationship between volatility and market performance. Volatility works well to help identify market bottoms based on high volatility. For long-term investors, it also helps to identify that the stock market is at or near a top when volatility is very low.

Should you take action?

The foundation to any successful investment portfolio is firstly to establish the risk that you are willing to take with the money that you will be investing. Every asset can be risky in isolation and the best way of controlling risk is to diversify. You should certainly make sure that your portfolio is regularly rebalanced so that it is put back to the original percentages invested in each asset class. This rebalancing procedure obeys one of the key requirements of a good investment process, that of buying low and selling high and this is instrumental in ensuring that you meet your long term financial objectives.

Ways to deal with volatility

There are two ways to profit from volatility: market timing and pricing. By timing we mean anticipating the action of the stock market. By pricing we mean to buy funds when markets are particularly cheap and sell them when markets look expensive. Few fund managers will make big bets on the future direction of any market because it is very difficult to always get it right. On the other hand it is easier to get a feel for when valuations look cheap or expensive.

We subscribe to the view expounded by a major investment house that time in the market, not timing the market, is the best way to proceed. So by all means go on holiday and leave your diversified, regularly rebalanced, portfolio to take care of itself.

Living wage = state pension – £100

The Summer Budget introduced the concept of a National Living Wage for those age 25 and over from next April at the rate of £7.20 per hour. For a 35 hour week, that equates to £252. Coincidentally, the new single-tier state pension also begins next April. The full rate for the new pension has not yet been set, but the Department for Work and Pensions (DWP) says it is £151.25 a week in 2015/16 terms. The £100 gap between the two underlines the fact that the new state pension still needs to be supported by private provision if you are to enjoy anything like a comfortable 'living' retirement.

Pension futures come into focus

The Summer Budget revealed more changes to pensions in 2016/17 and launched a consultation on the future of pension tax relief.

There were four important pension announcements in the Summer Budget:

- The lifetime allowance, which broadly sets the maximum tax-efficient value of all your pension benefits, is to be cut by 20% to £1 million from 6 April 2016. Alongside the reduction will come another set of transitional reliefs, to provide some protection if your benefits are near to or above the new allowance.
- The annual allowance, which broadly sets the maximum tax-efficient total pension contributions for a tax year, is to be cut back for high earners from 2016/17. If you have income of over £110,000 and your income plus pension contributions (from all sources) exceed £150,000, your annual allowance will be reduced by £1 for each £2 over that £150,000 total threshold. A minimum annual allowance of £10,000 will apply.
- There has been an overhaul of 'pension input periods', which determine the tax year to which a contribution relates for purposes of the annual allowance. All pension input periods will now coincide with tax years.
- The government launched a consultation paper on "Strengthening the incentive to save", examining the future of pensions tax relief. The paper notes that the gross cost of all pension relief meant "the government sacrificed nearly £50 billion in 2013/14". The paper makes no detailed proposals, but does mention the possibility of switching to an ISA-type of structure, with all benefits tax-free, but tax relief on contributions replaced by a "government top-up".

This quartet of actual and possible changes means that it is important to keep your pension arrangements under review. For example, the revised rules for pension input periods may now allow you (or your employer) to contribute up to another £40,000 in the current tax year while tax relief on contributions remains available. This could be particularly valuable if you will also be affected by next April's allowance cuts.

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Good news for holidaymakers, bad news for depositors…

The weakness of the euro is having a variety of effects.

In the 12 months from mid July 2014, the pound rose by over 10% against the euro. While good news for people going to the Mediterranean for a holiday, it is bad news if you hold large deposits in UK banks and building societies. The maximum depositor protection provided by the Financial Services Compensation Scheme (FSCS) is determined by an EU directive, which sets the limit at €100,000.

In December 2010, when the FSCS limit was last reset, the conversion into sterling meant cover was up to £85,000. Roll forward to 3 July 2015 and a mandatory five year review means FSCS cover has been cut to £75,000. In practice, this action taken by the Treasury means that your existing deposits will continue to benefit from £85,000 of cover until the end of the year, but from then onwards the £75,000 cap applies.

However, there is a useful new provision alongside the £10,000 cut. The government has launched a new cover for 'temporary high balances' of up to £1m for six months, covering specified payments, such as house sale proceeds and divorce settlements.

Found – 500,000 extra employers

The Chancellor may be reviewing the whole basis of pension taxation, but the process of automatic enrolment into workplace pensions rolls on, unaffected.

The Pensions Regulator's latest annual report on automatic enrolment contained an unwelcome surprise. Three years ago the report had estimated there would be 1.3 million employers who would need to comply with the requirements of automatic enrolment. However, in summer 2015 the regulator revealed that it had raised the estimate by 500,000 – over a third – because of "an increase in the number of new companies that have started up, and fewer going out of business than was forecast".

The extra 500,000 employers are all at the small (5-49 employees) or micro (1-4 employees) end of the scale. They have generally not yet reached their 'staging date', when automatic enrolment is legally required to be in place. Some, such as employers of a children's nanny or carer, are only just becoming aware of their responsibilities.

The large jump in employer numbers will mean that in the peak quarter (summer 2017), 350,000 of them will reach their staging date and need to comply. The previous estimate had set the peak at 220,000. Even in the first quarter of 2018 there will now be about 250,000 employers reaching their staging date. To put those numbers in perspective, in the year to 31 March 2015, 35,000 employers had completed the automatic enrolment process.

If your business is one of that vast number which have not reached their staging date, the jump in the regulator's estimate is not good news. It will create more demand for advice in a pension sector that is already under considerable pressure from the relentless flow of reforms introduced over the past couple of years. The regulator currently suggests that you should start planning approximately 12 months before your staging date. However, given the increased employer numbers, we would recommend that you start even earlier – some bottlenecks look inevitable. We can then guide you through the various stages of automatic enrolment and help select the appropriate pension arrangement for your workforce.

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