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SUMMER 2017

rosan helmsley quarterly

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UK Political turmoil continues

June 9th marked a surprising outcome in the UK General Election – and inevitably the onset of a further period of political, and doubtless market, uncertainty. The Conservative majority achieved in the last election has proved a false dawn for what many perceived might be a period of more stable leadership. Theresa May hung her hat on 'strong and stable' but now looks nothing but weak and wobbly.

What is interesting of course is the analysis of what has happened to generate this result and it is clear that two factors have played a significant hand in the outcome – elderly voters and, for the first time, young voters seem to have played a major role in the election result.

For the more mature voter considering the financial impact of poor health in old age, the Andrew Neil interview that characterised the idea of a 'dementia tax' marked a moment when the Conservative 6% lead rapidly reduced to 3% and never recovered. The inclusion of this policy in the manifesto was clearly completely flawed and lacked any kind of management or thought process at a time when the Prime Minister was seeking a significantly enhanced mandate. It appears as though the elderly voters short-term memory was fully intact when it came to lodging their ballot papers.

For the young, who voted generally to remain in the EU, Jeremy Corbyn's sound bite of free tuition fees in a time of soaring student indebtedness and a dysfunctional housing market, was music to their ears.

These voters have finally found their voice – they have of course no context of 1970's-style inflation and unfunded giveaways but Jeremy Corbyn realised that and combined it with a use of social media that has engaged the younger generation. It also demonstrates the power of this medium in communicating short term vote generating ideas – many without economic substance or financial base – but that has proved unimportant as part of the process. Trump also harnessed considerable support using this type of 'marketing'

How will markets react?

The slightly surprising short-term outcome for the UK stock market is likely to be an uptick in the FTSE. With sterling weakening against the dollar – at $1.27 as I write – and likely to move lower in the short term on a Theresa May resignation, (if indeed this transpires), the overseas earning dominated FTSE 100 will almost certainly rise. Longer term there are more likely to be problems, particularly if recent events lead us to another general election, which of course is now entirely possible over the coming year.

At a global level, the world remains a fractious place with many other political and geo-political challenges likely in the months ahead. The US situation remains worrying with Donald Trump struggling to move ahead with the policies that matter and the US market expects – namely tax reduction, infrastructure spend and healthcare reform. North Korean and Middle East tensions persist and Italy remains the problem country in a Europe that needs to embrace change if it is to survive in it's current state.

As always, it's money that makes the world go around and investors continue to chase returns in an era of low interest rates that despite recent trends, are likely to remain low in the UK and Europe for some time yet. Significant portfolio weightings in cash for anything beyond the short term will only guarantee negative real returns.

The stock market in the US is now trading at a premium to long-term trends and is unlikely to weather any bad market news well. Ironically, Europe remains a market where there is generally good corporate news flow and on a relative basis looks good value. Emerging Markets also look as attractive as they have in the last few years.

Theresa May looks uncomfortable today and so she should – she has demonstrated poor judgment in a period when we need our leaders to display strong conviction in well considered, debated and researched policy. It seems unlikely she will be fighting another election as leader. Let us hope a new leader can emerge, with the foresight, inspiration and talent to engage all parts of our diverse and dynamic country.

Rob Sandwith | Chief Executive

The ISA family grows again

6 April marked the launch of the Lifetime ISA, an important addition to the ISA family.

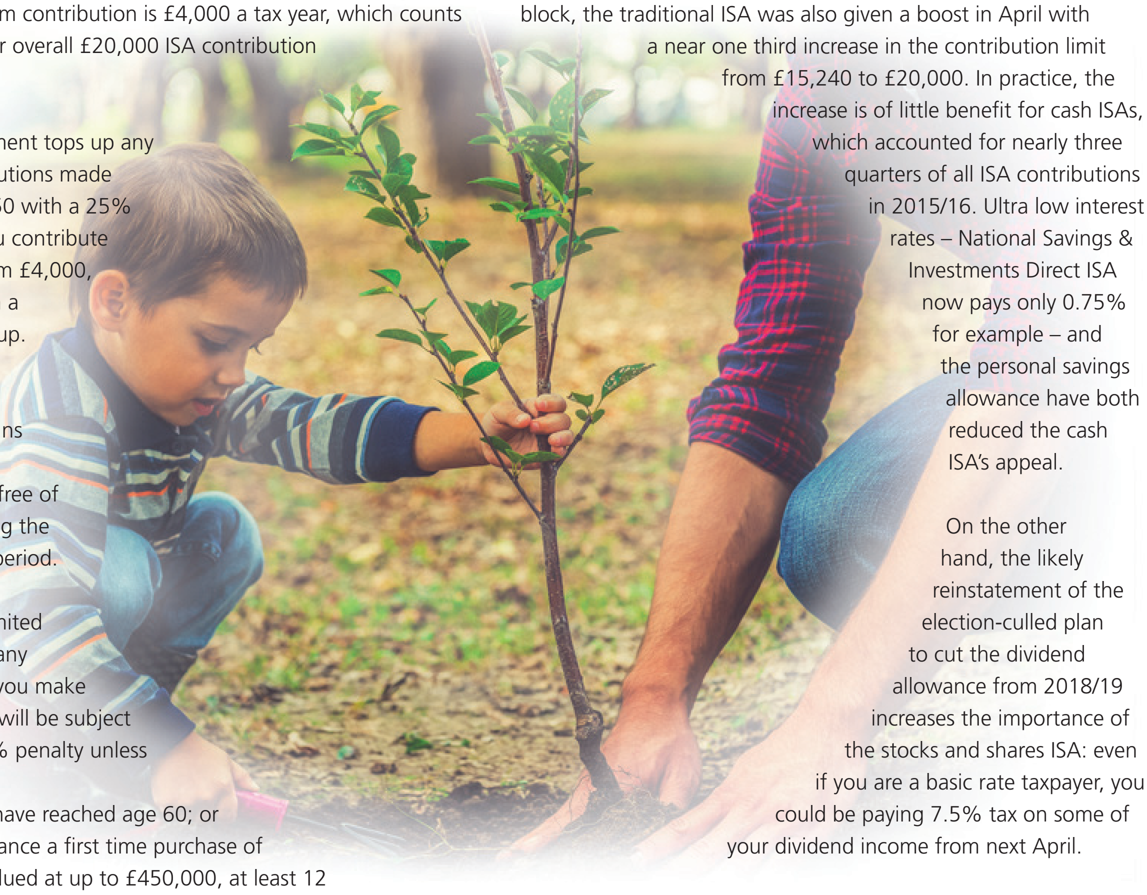
The latest innovation to the Individual Savings Accounts (ISA) is the Lifetime ISA, which inevitably has become known as the LISA. This new addition could be very attractive for certain investors.

ISAs used to come in two varieties: cash ISAs and stocks and shares ISAs. Now, depending on how you count, there are up to seven different types of ISA.

The LISA features

The LISA is significantly different from her siblings. A quick look at her main features reveals:

- You can only open a LISA if you are aged under 40 and at least 18.
- The maximum contribution is £4,000 a tax year, which counts towards your overall £20,000 ISA contribution limit.
- The government tops up any LISA contributions made before age 50 with a 25% bonus: if you contribute the maximum £4,000, you will gain a £1,000 top-up.
- As with all ISAs, any gains and income accumulate free of UK tax during the investment period.
- With very limited exceptions, any withdrawal you make from a LISA will be subject to a flat 25% penalty unless it is made:
  – once you have reached age 60; or
  – to help finance a first time purchase of a home valued at up to £450,000, at least 12 months after the LISA was opened.



Up until 5 April 2018, funds held in a Help to Buy ISA can be transferred to a LISA and gain the 25% bonus. However, any contributions to the Help to Buy ISA made after 5 April 2017 will count towards the LISA's contribution limit, and the overall ISA contribution limit.

The government left it late in the day to introduce the necessary LISA legislation, with the result that to date only a handful of LISAs have been launched. More are due to emerge in coming months – both cash and stocks and shares types.

Making the right choices

Whether a LISA is the right choice for you depends upon your personal circumstances. The 25% government bonus may look attractive, but a tax-relieved pension contribution will often be the better option if your focus is on retirement rather than your first home purchase. The LISA might not be the best choice if you forgo a pension alternative that includes employer contributions that you would lose.

While the LISA has grabbed headlines as the new kid on the block, the traditional ISA was also given a boost in April with a near one third increase in the contribution limit from £15,240 to £20,000. In practice, the increase is of little benefit for cash ISAs, which accounted for nearly three quarters of all ISA contributions in 2015/16. Ultra low interest rates – National Savings & Investments Direct ISA now pays only 0.75% for example – and the personal savings allowance have both reduced the cash ISA's appeal.

On the other hand, the likely reinstatement of the election-culled plan to cut the dividend allowance from 2018/19 increases the importance of the stocks and shares ISA: even if you are a basic rate taxpayer, you could be paying 7.5% tax on some of your dividend income from next April.

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> "The dividend allowance cut was aimed at shareholder directors but it has wider ramifications."

Budget tax changes – set for a comeback?

The Spring Budget contained a few surprises, but came before the big surprise – a snap election.

Mr Hammond's first and last March Budget was a relatively low-key affair. Once the general election was announced, its profile shrunk even lower, as most proposals were shelved.

In theory, from now on there will be Autumn Budgets each year, with the first of the new breed due later this year. However, despite the general election muddying the waters, there are still some measures to bear in mind.

Dividend allowance and business structures

The £5,000 dividend allowance, introduced by George Osborne, was represented as a tax reduction for many people, but was aimed at raising extra tax. The tax rates on dividends above the allowance were increased to claw back revenue from small business owners who sidestep national insurance contributions (NICs) by operating through companies.

In March Mr Hammond said that the dividend allowance would be cut to £2,000 from 2018/19. This would have been the biggest Budget tax raising measure, but in the frenetic end of parliament period the necessary legislation was dropped. The Chancellor had also looked for more money from sole traders and partnerships by proposing to raise class 4 NICs by 1% in 2018/19 and again in 2019/20.

However, backbench opposition to this measure meant it was withdrawn even before reaching the Finance Bill. Given the underlying aim to make the tax and NIC system more consistent, this is very unlikely to be the end of that story.

The dividend allowance cut, which is expected to be reinstated, was aimed at shareholder directors but it has wider ramifications. Far more ordinary investors would find themselves paying tax on their dividends with the allowance at only £2,000. For example, at current average UK FTSE 100 stock market dividend yields, about £57,500 of shares will produce £2,000 of dividends.

If you had thought stocks and shares ISAs were becoming a waste of time, the potentially lowered dividend allowance (and new £20,000 ISA contribution limit) should prompt a re-think.

Higher rate income tax threshold

Mr Hammond confirmed the goal of a £50,000 higher rate income tax threshold by 2020/21, but gave no indication of how this will be reached. He left untouched last year's legislation raising the threshold for 2017/18 to £45,000 (other than for certain income in Scotland). The benefit of this £2,000 increase may not be as significant as it at first appears, as the upper limit for class 1 employee and class 4 NICs has also risen by £2,000. So a saving of £400 in tax could be offset by a near £200 NICs increase.

As with the likely dividend allowance change, the higher rate threshold is a reason to revisit the opportunities presented by independent taxation if you are married or in a civil partnership. At present a couple can – in theory, at least – enjoy a £45,000 annual income with no tax liability if they have the right type of income in the right hands.

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Company cars: two turns of the screw

If you have a company car, the new tax year brought two pieces of bad news. Firstly, in most instances there was a 2% increase in the car benefit rate – the percentage applied to the car's list price to calculate its taxable benefit. Because the 2% was almost universal, the highest proportionate tax increases were for the lowest emission vehicles. Secondly, if your company car is part of a salary sacrifice arrangement, then be warned that when you change cars (or April 2020 if earlier), you will be taxed on the salary forgone unless the taxable value of your car is higher.

The residence nil rate band – not all it seems

The inheritance tax (IHT) residence nil rate band is now available, potentially cutting the IHT bill on your estate by £40,000. This new relief could be valuable for many families, especially as the general nil rate band (NRB) has been frozen until at least April 2021.

The residence nil rate band (RNRB) finally went live on 6 April 2017 and this is how it works:

- The RNRB only applies to gifts of residential property (that at some point have been the main residence of the deceased) made on death (not during lifetime) to your 'direct descendants'. This is defined as including your children or stepchildren as well as any adopted and foster children. The RNRB will not cut your estate's IHT bill if you do not have any surviving direct descendants or if you wish to leave your home to someone who does not fall into this category, e.g. nieces, nephews or siblings. In 2017/18, the RNRB is £100,000, meaning that when added to the NRB, the total excluded from IHT for a couple amounts to a maximum of £850,000 or £425,000 per spouse/civil partner.
- The RNRB will increase by £25,000 in each of the next three tax years, so that it reaches £175,000 in 2020/21.
- Like the NRB, any RNRB unused on first death can be 'inherited' by the estate of the surviving spouse/civil partner. It does not matter if that first death occurred long before 6 April 2017, but the second death must be on or after that date.
- Unlike the NRB, the RNRB is not universal. Instead, it is subject to a tapering reduction of £1 for each £2 by which your estate at death exceeds £2 million. Larger estates will therefore see no benefit.
- To ensure this allowance is not lost there are some highly complicated rules where someone has downsized their home or moved into residential care.

The RNRB will result in some IHT-saving for many estates, although predictions say it will not stop the growth in IHT revenues for the government in the next few years.

For example, Mr A dies in 2021 when the full £175,000 RNRB is available. He leaves his children a house worth £300,000 and other assets worth £190,000. The £300,000 house is worth more than the £175,000 RNRB, so his estate qualifies for £175,000 RNRB plus NRB of £325,000 = £500,000. So the total estate is covered by the aggregate nil rate bands. Any excess would be taxed at 40%.

The arrival of the RNRB means that you should review your estate planning as soon as possible to see whether any changes are necessary. For example, you may need to revise your will. Given the complexities of the RNRB, expert advice is essential if you are to maximise the potential IHT savings.

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Just one more year…

The next increase in State Pension Age has edged nearer.

Do you know when you will start to receive your single-tier State pension? You can use the government website (www.gov.uk/state-pension-age) to tell you, but the answer may not be the correct one for much longer.

The Department for Work and Pensions (DWP) is due to announce shortly when the next increase in State Pension Age (to 68) will take place. Existing legislation, dating back to 2007, says that this will happen between 2044 and 2046, 18 years after the increase to age 67. However, a recently published report prepared by John Cridland for the DWP has recommended that the schedule should be brought forward by seven years to 2037–39. That would mean if you are under 47, your State pension age will rise.

The DWP or, perhaps more accurately the Treasury, is unlikely to contest such a money-saving proposal. Looking longer term, Mr Cridland suggested that further increases should not be more than one year every ten years, unless there were exceptional circumstances. That might mean anyone born after 1988 will face a State pension age of 70. Perhaps it is time to start reviewing the adequacy of your private pension provision…

Diversifying your investments

"The only indisputable truth that the past teaches us is that the future will always surprise us – always!"

The quotation is from what the hugely successful investment guru Warren Buffet has described as "by far the best book on investing ever written". The author was a university lecturer called Benjamin Graham – someone who Buffet acknowledges was one of his early mentors.

We have seen how unexpected events can impact on investment markets – with Brexit, Donald Trump's election to the US Presidency, the run up to the French Presidential polls and Theresa May calling a surprise UK general election.

With the lesson of uncertainty in mind, how can we arrange our investments to cope with future uncertainty? Another very successful investor, Sir John Templeton, who was "arguably the greatest global stock picker of the century," according to Money Magazine, said that "to avoid having all your eggs in the wrong basket at the wrong time, every investor should diversify".

What is diversification?

The aim of diversification is to create a set of investments – a portfolio – that includes a range of types of assets that will behave in different ways whenever events occur.

So as an extreme example, if you were to invest all your money in the shares of a single company, the risk would be very high. You would do really well if it prospered, and really badly if it encountered difficulties. But by investing in several different companies – preferably in different industries and economies – you would reduce the risk. When some shares might disappoint, others could be doing well and the risk would be much lower.

Of course in worldwide booms and recessions, almost all companies in all markets will move together – at least to some extent. In the 2008/09 crash, most markets turned sharply downwards, while in the subsequent years, there has been a general if sometimes uneven recovery.

A sound strategy, therefore, is to diversify into a range of other assets as well as shares, in particular bonds and cash. Bonds are fixed interest investments like gilts (loans to the UK government) and corporate bonds (loans to companies). These types of assets are less volatile than shares: they lose less value than shares when times are tough and may even grow at such moments. But the scope for growth from bonds and cash is normally rather less than from shares – although this is by no means always the case.

Risk vs return

The more you are prepared to take on risk, the more you should expect to be rewarded for it – at least in the longer term – although this is not guaranteed. Likewise, where you are not likely to lose money, the returns are mostly relatively low. Cash, for example, is currently generating very low returns, especially after taking into account tax and inflation. And the position is much the same for short-dated bonds (i.e. where the capital is due to be redeemed in less than five years).

At the core of your portfolio is likely to be equity funds that hold shares in a range of different companies, as well as bond funds that hold government and corporate fixed interest investments. The mix will depend on your ability to cope financially – and also psychologically – with fluctuating markets. But there are other types of assets that can provide diversification. Property funds do not necessarily move in line with either shares or bonds. Nor generally do commodities and absolute return funds (where the managers aim to provide positive returns in all market conditions – at least in the medium term).

Working with you to decide on the right mix of investments to meet your aims and approach to risk is at the centre of what we do.

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Think before you phase retirement

If you are planning to retire gradually, the Chancellor is making things more difficult.

"Simplification" was once a word applied to the reform of pensions taxation. These days, with a nod to the past, pension experts talk about "complification" instead. What started out as relatively straightforward in 2006 has become fiendishly complex as successive Chancellors have attempted to reduce the expense of pension tax reliefs. For 2015/16 their cost was estimated at £38,200 million – a tempting target for the Treasury scissors.

Before the election put a stop to the legislation, the latest example of complification was to have been April's reduction in the money purchase annual allowance (MPAA) from £10,000 to £4,000. The cut was supposed to prevent double tax relief on recycled pension savings and is likely to reappear after the election.

In practice, you could be caught by an MPAA charge if you and/or your employer contribute to a pension while you are simultaneously drawing from a money purchase pension flexibly. Should that happen, the effect is that any tax relief on money purchase pension contributions above the MPAA is clawed back via your tax return. Unrelieved pension contributions do not normally make financial sense, so falling foul of the MPAA is best avoided. The £4,000 MPAA was meant to come into effect on 6 April 2017 and may still do so via new legislation.

Ongoing contributions

Paying into and simultaneously drawing from a pension most commonly happens if you are phasing your retirement, working part time and supplementing your reduced earnings with payments from your pension. Such a strategy can be a wise course to take as it avoids the retirement cliff edge and may have tax advantages. However, it might also be a necessity if pension provision is inadequate, or retirement from full time employment comes earlier than planned.

It is usually possible to avoid triggering the MPAA if pension benefits are structured properly. However, it is vital to take advice before drawing any benefits from any money purchase pension arrangement as once the MPAA is triggered, you are subject to it throughout life.

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National Savings & Investments – is that it?

In April, National Savings & Investments (NS&I) launched its new Investment Guaranteed Growth Bond, which was originally announced by the Chancellor in last year's Autumn Statement. The Bond has a three-year term and a (taxable) fixed interest rate of 2.2%. In the current low rate environment that counts as a market-leading rate, but the investment limit is just £3,000. Ironically, NS&I's launch date coincided with the Office for National Statistics publication day for the March inflation numbers. These showed the Consumer Prices Index running at 2.3% and the Retail Prices Index at 3.1%, both above the rate NS&I were offering…

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