

PENSION ALLOWANCE TRAPS

Increasing numbers hit by unexpected tax penalties

EASIER BEING GREEN

How you can make a difference as a small investor

IT WON'T HAPPEN TO ME

How income protection can provide your Plan B



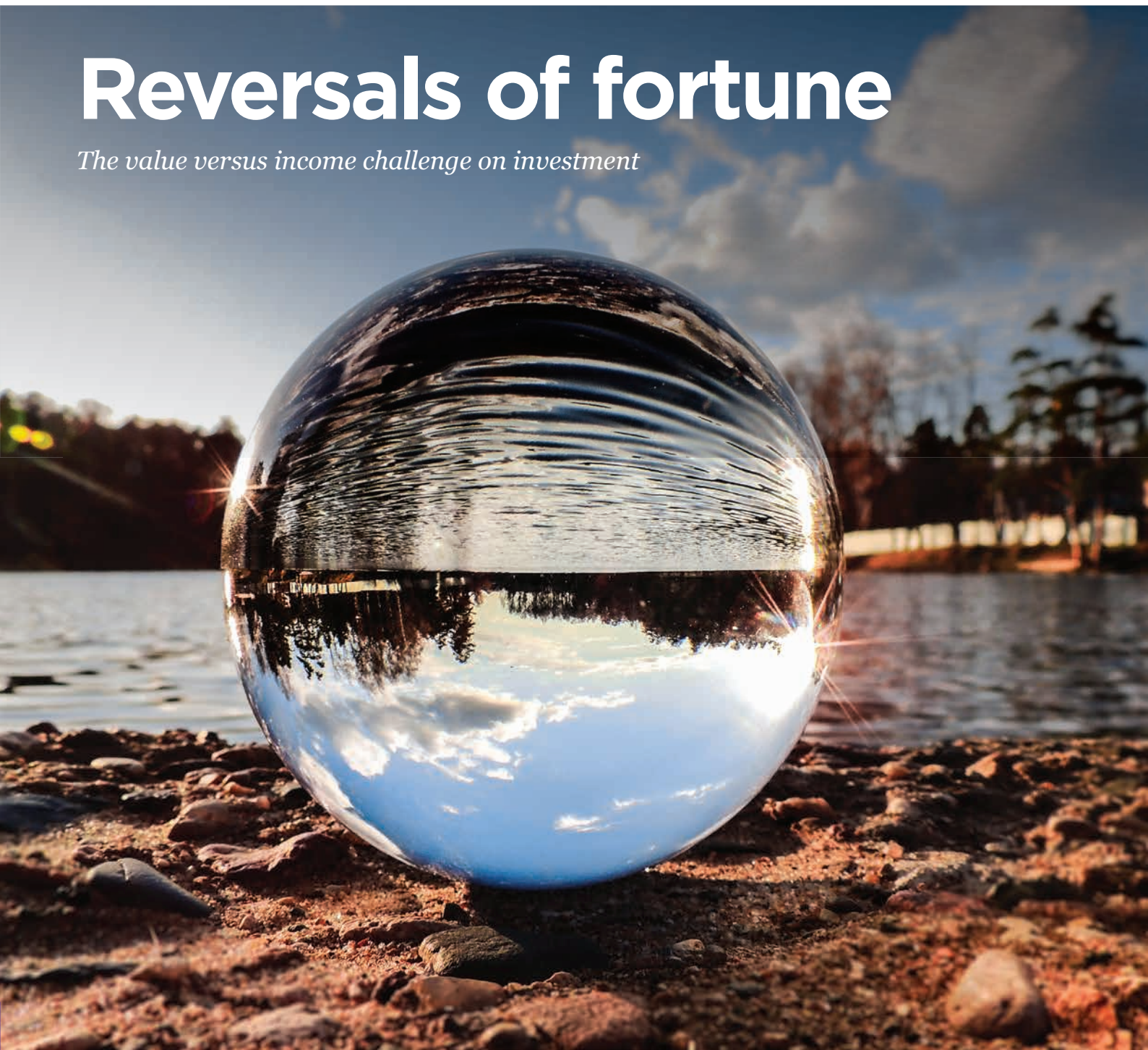
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WEALTH MANAGEMENT

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Quarterly Newsletter

Reversals of fortune

The value versus income challenge on investment



In this issue...

Our focus on investments this issue highlights the need to stay alert in the markets as all is not what it seems. Our feature looks at the peculiar case of the behaviour of UK shares versus government bonds. The last ten years have seen a reversal in previous trends. If this makes you feel like you're on unstable ground, take heart from where your influence can make a difference. With climate change at the top of the agenda in recent months, the movement for change in individual behaviour can extend to where you choose to invest. Ethical and environmental, social and governance factors mean you can extend your principles to your financial investments. We also explore the dangers of tipping into tax charges on your pension lifetime allowance and, in the run up to the holidays, highlight some simple strategies that can help you keep on top of your spending in this most tempting of seasons.

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Value or Growth?

You may have read, or heard comment recently in financial circles, on the merits of value investing. Value investing, in its simplest form, involves buying shares that appear cheap as they are trading at less than their intrinsic or inherent book value. Value investors - famous ones include Warren Buffet and Benjamin Graham - use discounted cash flow analysis to determine a company's financial future and then apply a discounting mechanism to relate this to a current share price, thereby determining a company's relative value.

Over the last decade, digital innovation has meant that many growth orientated businesses have massively outperformed. We have seen this with the share price performance of companies such as Amazon, Apple and Google. Classic value type stocks, such as banks and energy companies, have underperformed not helped by factors such as sluggish economic growth and historically low interest rates.

Value investing underperformed the MSCI AC World growth index by over 89% in the decade ending October 2019. Although value investing has underperformed again in the first part of 2019, there are signs that a change maybe a foot. Many professional investors have become less worried about recession recently and more optimistic about future corporate earnings.

Global politics could assist value style investing with seemingly better US China trade relations recently, which may also reduce the threat of global recession. In addition, it is very obvious here in the UK that whether we have a Labour or Conservative government, there will be significant fiscal stimulus, which in itself will likely feed into growth and inflation. Higher inflation, growth and likely higher interest rates can all assist value stocks.

There are a number of value-based funds in the market and we can advise on an appropriate allocation to funds in this space to compliment an existing portfolio. There are of course many actively managed funds that have already recognised a developing trend shift to value and are repositioning their own portfolios to take advantage.

INVESTING AT CHRISTMAS

I have personally seen the value over the last couple of decades (as a Godfather multiple times) of investing for children each year on birthdays and Christmas rather than buying transitory gifts. I can attest to the personal satisfaction of handing cheques over to godchildren on their 21st birthdays for several thousand pounds, funded by modest annual payments at Christmas and birthdays since birth into equity fund based investments.

These funds have been used to help children through university, fund gap years or perhaps a first car and as a provider of these investments, individual street cred can rise hugely, as well as the obvious satisfaction generated by introducing young adults to the value of wealth creation through investment!

We include an article in this newsletter on the value of investing for Children, grandchildren or just friends and the main strategies you might consider. We have many clients whose children and grandchildren have attained six figure ISA and pension investments at age 20, all achieved through following our advice on tax exempt investment from birth.



Investing for Children and Grandchildren is very rewarding

This newsletter contains a number of articles on current topical industry and financial planning issues. Please do contact us if you wish to review any of the articles, or individual investment portfolios.

Rob Sandwith | Chief Executive

PENSIONS

Pension allowance tax traps?

Increasing numbers of people are facing substantial tax penalties on their pensions, sometimes unexpectedly. Are you at risk of an unwelcome surprise?

The tax and national insurance contribution reliefs enjoyed by pensions cost the government £53.7bn in 2017/18, according to statistics issued by HMRC in September 2019. It is little wonder therefore that successive Chancellors have attempted to cut back on such levels of generosity.

The most recent attacks on pension reliefs have focused on two key allowances:

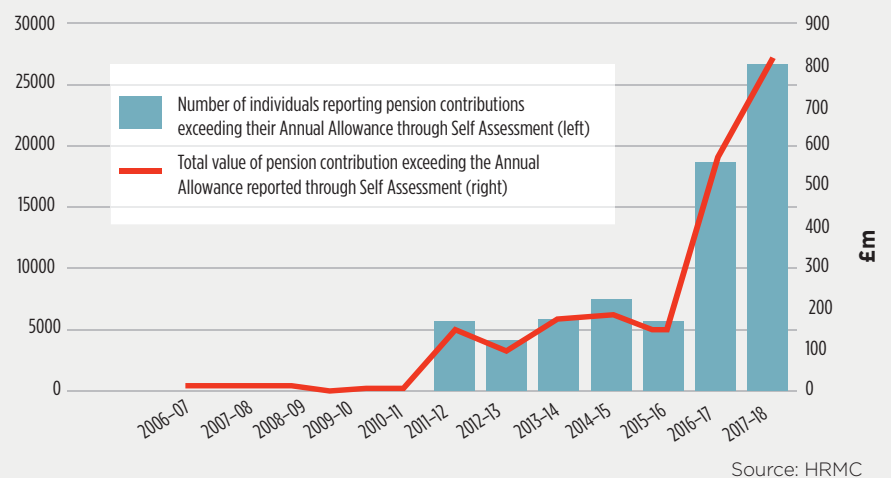
■ **The lifetime allowance** sets the maximum tax-efficient value on all your pension benefits. The standard lifetime allowance is currently £1.055 million, after three cuts between 2012 and 2016 reduced it from £1.8m back in 2010/11. The value of pension savings above the available allowance (after any transitional reliefs) is subject to tax at a flat rate of 55% (as a lump sum) or 25% (as income).

As of mid-November 2019, for a 65-year-old non-smoking single person, the current lifetime allowance would buy a level pre-tax pension of about £53,000 a year. Add inflation protection and the figure falls to about £29,000. That's probably not as much as you'd imagine a fund of £1.055 million would provide.

■ **The annual allowance** sets the maximum tax-relievable pension contributions that can be made for you from all sources during a tax year. This is now a standard £40,000 but it started the decade at £255,000. In 2016/17 the tapered annual allowance was introduced, targeting high earners, and reducing their annual allowance to as little as £10,000.

Personal tax relief is effectively clawed back on excess contributions over the available allowance (which can include unused allowance from the preceding three tax years). About one third of the tax payments due is collected as a deduction from the individual's pension fund, but most is reported and collected via self assessment. There is no special tax treatment for the

THE ANNUAL ALLOWANCE CHARGE MOUNTS UP



benefits arising from these contributions, so you could receive no contribution tax relief, but still pay income tax on your eventual pension.

COMPLEX CALCULATIONS

The penal tax charges for breaching the lifetime or annual allowances were probably designed to be more of a deterrent than a revenue raiser for the Treasury. In practice, the charges have proved to be money-spinners for the government. As the graph shows, in 2017/18 over 26,500 people reported contributions exceeding their available allowance, nearly five times the number two years previously. The lifetime allowance charge raised £185m in 2017/18, virtually double what it did two years before.

One reason why these hefty charges are being paid is the complexity of the calculations involved. For example, the amount of the tapered annual allowance cannot be accurately calculated until after the end of the tax year to which it relates.

If you may be affected by either, or both, of these pension tax charges, then it is vital to take advice as soon as possible. Ultimately, you may need to consider

some additional alternatives to pensions for your retirement planning.

✦ *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.



INVESTMENT

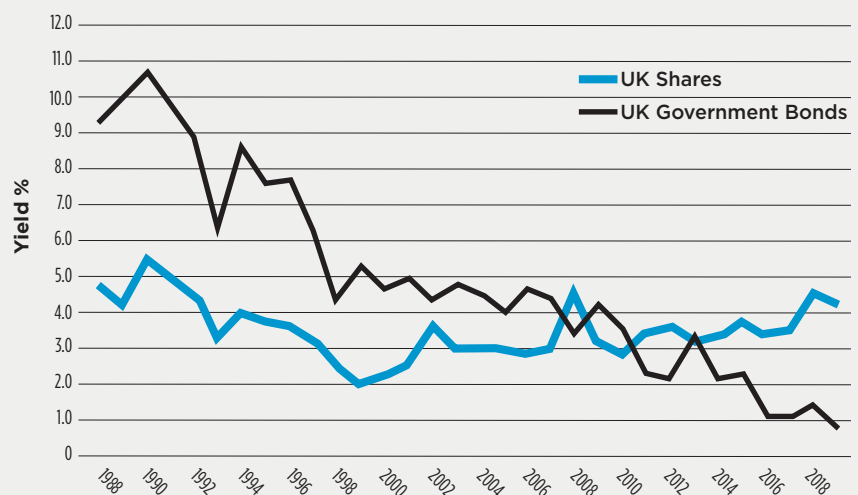
Reversals of fortune – the value vs income challenge

Where can you find value in today's investment markets?

These are strange times in the investment markets. The looking glass world of negative interest rates – where borrowers are rewarded for taking out loans and savers pay interest – has become a reality in parts of continental Europe and Japan. In the UK, the Bank of England base rate has been below 1% for more than a decade. In the US, the central bank started cutting rates from a peak of just 2.25%–2.50%, set last December. The idea that interest rates would be 'lower for longer' is edging towards 'lower forever'.

Fixed interest securities (bonds) have also come under the spell of negative interest rates. At the time of writing, there were about \$11.4tn of bonds, mostly government paper, offering a negative return to those investors who held them through to maturity. There was a time when an investor in bonds would look forward

UK YIELD CROSSOVER



Source: Barclays Equity Gilt Study

All change on company car tax

If you are changing your company car soon you need to get on top of the new tax rules.

CO₂ emissions have been the basis of company car taxation for over 15 years, with each new tax year usually seeing a nudge up in the scale charge for most emission levels. However, from 6 April 2020, the tax scales undergo a more radical set of changes:

- For **newly registered cars**, the 'real world' WLTP measure of CO₂ emissions will replace the existing and largely discredited NDEC basis (which will still stand for older vehicles). WLTP emission results are on average 20%-25% higher than NDEC figures.
- For all **hybrid cars** with CO₂ emissions of 1-50g/km, the scale charge will take account of the electric-only range.
- The scale charge for **zero-emissions cars** will itself be nil in 2020/21, rising by 1% a year in the next two tax years.

From January 2021, all newly registered diesel cars must meet the RDE2 emissions standard, which exempts them from the current 4% diesel surcharge.

The government has already published revised company car tax scales for the next three tax years (2020/21 - 2022/23), which take account of the reforms. In 2020/21, most of the scales will begin 2% lower than originally legislated for because of the sharper than anticipated increases in emissions under WLTP.

✚ *Tax laws can change. The Financial Conduct Authority does not regulate tax advice.*

This article is for general information purposes only and for specific tax advice please refer to a tax specialist

“*In the last three years, value shares and the funds that favour them underperformed growth shares on a global basis.*”

also capital value. The graph opposite shows the historic yield advantage of bonds in the UK up until the time of the financial crash.

THE YIELD GAP

Since then, the picture has changed with a marked widening in the last few years of an income yield gap favouring shares over bonds. Ten-year UK government bonds currently have a yield of under 0.8%, while the average dividend yield on UK shares is over 4.3%.

There have been similar reversals in many other world markets. Even in the US, where interest rates are relatively high, the average share yield was 1.85% in mid-November compared with 1.88% for a 10-year government bond.

But the average figure can itself hide a significant difference between individual shares, as is often the case.

- **Value shares** generally have a higher than average yield, but relatively limited growth prospects. A typical example would be a utility company.
- **Growth shares** are expected to see earnings grow faster than the norm and thus carry a relatively higher than average rating (and lower yield). The classic example would be a technology company.

In the last three years, value shares and the funds that favour them underperformed growth shares on a global basis, despite the higher dividends on offer. However, as the global economy shows increasing signs of slowing down, there could be an argument for taking a second look at the value sector. Many funds target value investing, although it is important to select the right ones.

✚ *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.

to a return on their capital (i.e. interest); now some cannot even expect a return of their capital.

The decline in interest rates and bond yields since the 2007/08 financial crisis has overturned some traditional relationships in investment markets. For instance, it was once the case that the longer the term of a bond, the higher the interest rate. In many countries, such as the UK, US and much of the Eurozone, the return on a 10-year government bond is now lower than the central bank's short-term interest rate.

Another example of a norm that has been overturned is the difference in immediate income available from bonds and shares. It used to be that government bonds provided a higher income than shares because the latter offered the possibility of growth, not only of income but



INVESTMENTS

Easier being green: investing on principle

Whether it's the Extinction Rebellion protests or Greta Thunberg's speech to the UN, there has been a renewed focus on climate change in recent months and what individuals can do about it.

This has led to high profile calls for governments and institutions to divest funds away from 'harmful' industries and sectors such as oil and gas, mining and airlines, which are some of the biggest producers of carbon and other damaging greenhouse gases.

But this doesn't just apply to large organisations with millions of pounds at their disposal. Ordinary investors also have opportunities to 'green' their ISAs and pensions by reducing their exposure to carbon-heavy industries. You can choose instead to invest in companies that support and promote more sustainable strategies

Many people are changing their everyday habits as they become more environmentally aware, through reducing plastic, recycling or cutting down unnecessary car trips. If you want your investments to follow suit then there are several options — from ethical funds to ESG (environmental, social and governance)-based investments.

ETHICAL FUNDS

As the name suggests, these funds take a more principled stance on investment choice. Many screen out companies, or whole sectors, that do not meet their guidelines, which will vary from fund to fund. For example, some of the oldest ethical funds stem from the Quaker movement, so may not invest in companies that sell or manufacture alcohol, weapons, tobacco or pornography.

Today many 'ethical' funds have a more environmental remit. However, while some will automatically exclude whole sectors such as oil and gas, others take a 'best of breed' approach, investing in those companies with better track records on issues like pollution, water waste and recycling. Those who take this approach argue it encourages

companies to improve environmental standards and engage with wider issues such as climate change.

ESG INVESTMENTS

Funds that adopt this approach take into account environmental, social and governance factors, alongside standard financial data, when deciding whether to buy or sell a stock. This extra information can help identify future risks.

For example, companies with poor environmental track records may face fines and tighter regulation in

“ *It's worth remembering that £28.2bn was contributed to personal pensions in 2017/18... It is your money, and you can choose where it is invested.*

future, affecting their appeal as a long-term investment choice. This ESG analysis also tries to identify companies that are ahead of this curve and may profit in a world which is more environmentally aware, for example, electric car manufacturers.

Like any investment decisions, these judgments may not prove to be correct with hindsight.

Many funds combine these two approaches, excluding some sectors or companies, but using ESG screening as part of their investment process.

It is easy to think the relatively small amounts we save as individuals into ISAs and pensions won't make much of a global difference. But it's worth remembering that £28.2bn was contributed to personal pensions in 2017/18 and the UK pensions industry is worth over £2tn alone. While your retirement savings are managed on your behalf, it is your money, and you can choose where it is invested. Please get in touch if you want to discuss your options.

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PROTECTION

It won't happen to me... protecting your income

The cornerstone of good financial planning is ensuring you have sufficient income to meet essential bills. For most of us, this will be covered by our earnings. But what happens when this source is cut off?

There is no guarantee that your income will keep rolling in each month and one of the most obvious threats is redundancy. This issue has certainly made headlines recently, with household names like Tesco and HSBC laying off staff, and Mothercare and Thomas Cook going into administration.

Such high-profile cases can create concerns around your own job security. But there are other issues to bear in mind. Your earnings may be seriously reduced if you suffer ill-health, forcing you to take time out of work, or reduce hours on a more permanent basis.

It's easy to assume that this won't happen to you, particularly if you are currently fit and healthy. But government statistics show that over 100,000 people leave the workforce each year, following a period of absence due to sickness.

WHAT PROTECTION IS IN PLACE?

If the worst happens, and you are made redundant or forced to give up work through ill-health, then there is likely to be only limited financial help from your employer and the government.

For those with at least two years continuous service, statutory redundancy pay is limited to one week's pay for each year you've worked (when aged between 22 and 41), with older employees getting 1.5 weeks' pay within capped provisions. Those who are too ill to work will receive just £94.25 statutory sick pay a week for a maximum of 28 weeks. Only those in employment are eligible for these payments, although there are benefits the self-employed can claim for relatively limited protection.

However, it is worth bearing in mind these are statutory minimums: your employer cannot pay less than this, but they may provide more. Check your employment contract for details about your rights around redundancy and the company's policy on sick pay. Some employers



will pay a higher amount (for example a fixed proportion of your income) and for longer.

BOOSTING PROTECTION LEVELS

Regular saving is one way to create a financial cushion. But it's also possible to buy insurance to help protect your income should you be unable to work through illness or injury.

An income protection policy can cover both physical and mental health. These policies will pay out a proportion of your salary, typically 50 to 70%, until you either return to work, or the end of the term or your death. Most will include a deferral period of a set time you have to be off work before you can claim. As a rule

of thumb, a longer deferral period will lower premiums.

The cost will also vary depending on the type of work you do: most insurers group jobs into different 'classes' of risk, so those who do a lot of driving or heavy manual work, for example, may pay more than an office-based workers. These policies differ from critical illness policies, which pay a one-off lump sum on the diagnosis on one of a specified set of serious illnesses.

For increased peace of mind in troubled times, we can help you work out what type of protection arrangements are right for you.



INVESTMENT

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Still holding a cash ISA?

Does a cash ISA still make sense?

The most recent ISA statistics from HMRC show that in April 2018 over £270m was invested in cash ISAs which represents around 44% of the total adult ISA funds.

Whether that is a sensible use of the tax advantages offered by ISAs is a moot point. The introduction of the personal savings allowance in 2016/17 of £1,000 for basic rate taxpayers or £500 for higher rate, means that most savings interest no longer attracts tax. Add to that the lowly cash ISA interest rates – NS&I pays only 0.9% – and if you still have a cash ISA, you may want to consider transferring it to the stocks and shares version.

+ *A stocks and shares ISA is a medium to long term investment, which aims to increase the value of the money you invest for growth or income or both. The value of your investments and any income from them can fall as well as rise. You may not get back the amount you invested. Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.*

PLANNING

Five ways to develop better spending habits

At a time of year even more focused on spending than usual, there are a few habits you can develop to help you keep a rein on your resources.

Retailers understand the psychological cues that encourage us to spend and deploy them online, in their store layout, advertising and marketing campaigns. Multi-buy offers, or short-term sales such as Black Friday can create a sense of urgency and encourage impulse buying. It can be hard to resist, even in straitened times.

Shrewd shoppers can deploy some simple strategies to help them spend wisely and save more.

Prioritise saving: Move money into your savings account or ISA before you have time to spend it. A simple direct debit going out on pay day is a great first step towards adjusting your spending habits. Set a budget on spending and stick to it.

Pay in cash: Leave your debit and credit cards at home and take cash instead. Studies have shown paying in plastic reduces the 'pain' of paying, because it feels less like 'real' money. Contactless payments can make spending even more 'painless'. Brain scans have shown the 'pleasure' regions of the brain are associated with purchases made on plastic, but both 'pleasure' and 'pain' light up for those paying in cash.

Don't shop until you drop: Avoid hitting the shops when you're tired, which reduces your ability to focus and make logical decisions. Long shopping trips, or hours browsing online, just add to this fatigue, and undermine your willpower when trying to make sensible purchasing decisions.

Take your time: Do you really want or need that item? When shopping online, simple steps, like disabling 'one-click' purchasing and deleting saved cards details on your computer can create useful delay. Better still, keep your wallet in another room when browsing. Even small hurdles like this can nudge us away from an online purchase.

Waiting at least 24 hours – or better still a week – before buying also gives you time to shop around on price.

Clear out 'cookies': Delete these regularly to avoid being bombarded with ads for items you've been browsing online. These constant reminders can wear down the resolve of even the most careful shoppers.

Once you get into the habit, it'll be easier to keep that New Year's resolution to save more and spend less...



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