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Navigating choppy waters

Many people become concerned when they see stock markets displaying the kind of high volatility they have in recent weeks.

Normally, share indices move up or down by less than 1% in a day, but over the course of September the FTSE 100 Index, which measures the performance of the largest 100 UK-listed companies' share prices, experienced massive turmoil. Falls of over 3.5% on the 5th and 22nd of the month resulted in 'stock market slump' media reports.

Volatility

Volatility is a response to uncertainty. When there is a broad consensus about the economic outlook, as there was during the economic recovery in 2009, stock markets often develop a steady trend. But when it is not at all clear what is going to happen next, share prices can go through periods of high volatility until a consensus does emerge.

Today, commentators cite two main causes of volatility: the ongoing euro crisis and fears about the pace of global economic growth. In both cases, there are wide differences of opinion about what is likely to happen. Some think a Greek default will lead to the break-up of the euro, others that the eurozone will muddle through. Some think the current slowdown in economic growth in the developed world and China is a temporary interruption of a recovery, others that it signals a recession.

The future is unknowable

It is important to understand that while stock markets are barometers – they reflect what *is* happening today – they are not that good at predicting what *will* happen. Nobel prizewinning economist Paul Samuelson, regarded as the father of modern economics, put it like this: "Commentators quote economic studies alleging that market downturns predicted four out of the last five recessions. That is an understatement. Wall Street indexes predicted nine out of the last five recessions!"

So if you have committed capital to the stock market for the long term as part of a balanced portfolio, you should not be too swayed by day-to-day movements – up or down. Such movements are 'the nature of the beast' – volatility is the price you pay for returns that have, over the long term, been higher than those from cash deposits or fixed-interest investments.

And if you are saving regularly, then in fact you may benefit from volatility, since it can lower the average price at which you purchase investments. If you do have concerns about your savings or investments, we will be happy to discuss these with you. Past performance is not a guide to future performance. Investments can go up or down, and you may not get back the original amount invested.



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In this issue: How low can you go? • What risk means to you • Platforms could make life easier • Will you live to be 100? • Emerging into the light? • Annuity rates continue to shrink • Getting ready for 1 October 2012 • Swiss tax agreement

financial focus

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‘The fall in yields has not been universal.’

How low can you go?

The base rate may not have moved, but some other interest rates are hitting ultra-low levels. It may be time to take a closer look at your investments.

The Bank of England base rate has been just 0.5% for over two and a half years and there are no signs that it will increase soon. The Governor of the Bank of England, Mervyn King, has even hinted that short-term rates might follow the pattern in the USA, where the Federal Reserve has said there is unlikely to be any change before mid-2013.

Although it is short-term rates which have attracted most attention, some medium and longer term interest rates have also been falling. For example, at the start of November 2009 it cost the UK Government 3.67% to borrow money for ten years via gilts (government bonds), whereas by the start of November this year that figure had dropped to 2.25%.

Where there have been falls in interest rates, these have had some significant and unwelcome effects.

Income drawdown

The rules for income drawdown – drawing an income directly from your pension fund – were revised in April 2011. In many instances the combination of this change and the decline in long-term gilt yields has substantially reduced the maximum amount that can be drawn for every £1,000 of fund – the figure now closely matches prevailing annuity rates. Difficult investment conditions over recent times have also had an impact.

If you have been taking drawdown for some years and are due for a review in the near future, you could find that the maximum you can withdraw will fall by up to 50%, according to a recent press report.

Easy access deposit rates

Banks and building societies are still offering new instant access internet accounts with gross interest rates of 3% and more.

However, these rates are now almost always achieved because of a

special bonus which lasts for one year. After that bonus expires, a much lower rate applies – possibly down to base rate. If you have any savings accounts which have been open for more than 12 months, the chances are that the rate you are receiving is much nearer to base rate – or even below it. The same could well be true of any variable rate individual savings accounts (ISAs) more than a year old.

With inflation uncomfortably above 5%, the buying power of money you leave in an easy access account is being steadily eroded.

Fixed-term deposit rates

Back in October 2008, as the credit crisis peaked, you could have obtained over 7% from a three-year fixed-rate bond. The likelihood that base rates will continue at current levels for some time means that today's fixed rate offerings are much lower – the best rate for three years is now under 4.50%. National Savings & Investments withdrew their five-year fixed-rate and index-linked savings certificates in early September.

If the decline in yields has affected you, a review of your investments may be worthwhile. The fall in yields has not been universal. For example, over the last year, sterling corporate bonds yields have generally increased because of concern about the state of the global economy and borrowers' ability to repay. The same worries have seen UK share prices fall and dividend yields rise correspondingly since the start of the year.

The value of your investment and the income from it can go down as well as up and you may not get back the full 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.



Did you know that HMRC have now published the form (APSS227) which must be completed if you wish to claim 'fixed protection' for your pension benefits from next tax year? The deadline for the form's return to HMRC (in Nottingham, not your local office) is 5 April 2012. While the form is relatively simple to complete, the decision to do so is anything but straightforward. For example, opting for fixed protection effectively means all your pension contributions must stop after the end of this tax year. Advice is essential before taking any action. The value of tax reliefs depends on individual circumstances and tax laws can change.

What risk means to you

Like most emotive words, 'risk' means different things to different people. When such an emotive word is used in the context of money, it can cause not just anxiety but confusion.

So like most financial advisers today, we try to clarify what 'risk' means – and this is usually as much to do with you as it is to do with the nature of the investments and markets you invest in.

Risk is a function of prices going up and down and also of your attitudes, needs and circumstances. Put more succinctly, risk is 'in here' as well as 'out there' .



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What is a risk profile?

The end product of discussions and questionnaires on the subject of risk is usually called a 'risk profile'. It is the document that we, as your advisers, will use as the basis for any savings or investment recommendations we make. It may incorporate the output from a discussion and questionnaire, but will also include your adviser's assessment of your circumstances and needs. Often it will include a short description of the kind of pattern of risk and return you are prepared to accept.

The risk profile is used to determine how much of your capital can be allocated to different types of investment, so you can think of it as the basis of 'risk management'. Today, financial advisers generally consider a risk profile should have three quite different components:

Tolerance of risk. This is what you feel about risk, especially your feelings about losing money, and is usually quite easy for you to express. It is also easy to discover where on the 'risk spectrum' you are by completing a questionnaire or in a discussion. These are sometimes described as 'psychometric', which simply means they are aimed at measuring your attitudes, so indirect questions are often used. The output from such a questionnaire is usually a score on a simple numerical scale.

Need for risk. This relates directly to your aims. For example, if you have an ambitious target for early retirement, you may need to generate a high return from your savings in order to have enough capital to generate your target income. In this case you would have to take high levels of risk to achieve what you want. After discussing this issue with us, you may decide to lower your target in order to reduce the level of risk you need to take.

Capacity for risk. This relates to your circumstances. For example, if you are retired, you cannot replace any capital you lose with income from work, so your capacity for risk is likely to be lower than that of someone who is in employment. We are duty bound to consider especially your capacity for loss, in other words to evaluate what the consequences of any loss would be for you. If a loss would cause you severe hardship, we may allocate you a risk profile below the level derived from your questionnaire responses.

We create a risk profile for every new client, and will also 'refresh' existing clients' risk profiles when their circumstances change, to ensure that our recommendations are still appropriate. Creating a risk profile cannot prevent you from suffering loss. But it can ensure that you understand why you are taking on a certain level of risk, and may ensure that if market prices fall, your losses are within a range you can cope with, both practically and emotionally.



Did you know that there has been a minor change to HMRC advisory fuel rates, which apply if your employer reimburses you for fuel used on business mileage in your company car? Rates are now reviewed quarterly, with any change taking effect from the beginning of each calendar quarter – on 1 March, 1 June, 1 September and 1 December. The relatively harsh tax

treatment of 'free fuel' means that unless your private mileage is high, employer reimbursement is generally preferable. As ever, there is no substitute for crunching the numbers to be sure. The FSA does not regulate tax advice.

Platforms could make life easier

Imagine a world in which every investment you bought generated at least three different pieces of paper that arrived separately by post.

Each of those investments also generated a further two or three postal items every year. And the only way you knew the value of what you had was by calculating prices for each item and adding up their values. You will probably think that this would not just be tiresome for you, but it would also be expensive. That is why 'platforms' or 'wraps' are now increasingly being used to administer clients' investments, with big gains in efficiency and communication.

Platforms are simply administration machines. They are custodians of your money (regulated by the Financial Services Authority) and have no power to do anything with it unless your adviser instructs them, which we can only do with your authorisation. For various reasons, not everyone is suited to the use of a platform. These reasons could include a low risk tolerance or a wish to invest only in the short-term.

Platforms are designed to help people who have a number of assets to manage, and may attract additional costs (for example adviser and fund charges, and the platform itself may have an additional charge linked to the value of the investments held). Some platforms do not permit the registering of assets elsewhere. In short, we will only recommend you use a platform if it meets your circumstances and needs.

Platforms hold investments and provide tools to manage them. That means they supply statements encompassing all the investments held on the platform, categorised by type (such as equities, fixed interest, cash), making it is easy to understand your overall portfolio. Moreover, the platform can incorporate different types of account, for example an ISA and a pension, and can present statements of your investments both within each separate account and as a combined package. Some clients may hold as many as four different accounts on the same platform, in which case being able to get an overview of the whole of your investments can be very helpful.



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Most platforms enable clients to access their accounts online via secure login and to see their current valuations at any time. Platforms incorporate a 'cash account', to which dividends and interest are paid. It is easy to set up payments from this cash account to your bank account, so that you have just one monthly or quarterly incoming payment from all your investments to keep track of.

Some platforms market direct to the consumer, in which case they provide no advice and you have to make all your own investment decisions. The platforms used by advisers tend to have more sophisticated reporting, analytical and investment planning tools. Please talk to us to see if a platform is right for you.

Will you live to be 100?

The chances of reaching your century are probably greater than you think.

In the summer, the Department for Work and Pensions (DWP) issued some new calculations about the chances of anyone alive today living to the age of 100. Its work briefly grabbed the morning headlines and radio reports on an August day thin on news.

The DWP was probably using a quiet time for the press to garner support for the department's plans for increasing the state pension age. After all, 65 looks like rather an early retirement age if you can hope to live to 100. As the brief extract from the DWP's tables show, in the future the monarchy could be kept very busy with congratulatory messages to centenarians.

Chance of living to 100						
Age now	20	30	40	50	60	70
Men	19.5%	16.5%	13.7%	11.4%	9.5%	8.2%
Women	26.6%	23.2%	20%	17%	14.5%	12.6%

Source DWP August 2011

The fact that at age 60 nearly one in ten men and over one in seven women are expected to reach age 100 is one reason why annuity rates are not as attractive as they once were. Let us know if you want to discuss your financial planning for old age.



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Emerging into the light?

If the developed economies are in such a mess, what about emerging market investments?

Growth in the UK has virtually ground to a halt. It's so weak that the Bank of England has just started buying £75 billion worth of gilts. In the rest of Europe, meanwhile, peripheral economies are in such a state that there are real fears some may go bankrupt. So if the core developed nations don't present vibrant investment opportunities, what about the emerging markets?

Growth differential

Certainly, if you are looking to put money into younger economies with better growth profiles, you can find emerging markets that are likely to fit the bill. For example, China's growth hasn't dipped below an impressive annual 9% since 2001, although it is forecast to drop below 9% in 2012, while Brazil's economy, bolstered by demand for its natural resources, surged 7.5% last year to become the world's No. 7. Don't forget, this is the country selected to host the FIFA world cup in 2014 and the Olympics two years later.

Debunking the 'no dividend' myth

One common misconception is that emerging market stocks don't pay dividends, making them a longer term growth plan rather than income generators. It is true that some merely pay lip service to returning shareholder value – in the last week of October, India's benchmark index, the Sensex, yielded just 1.3%, while South Korea's Kospi yielded only 1.4%. But better returns are available – 3.5% from Thailand, and – no surprises – an alluring 4.2% from Brazil. Those returns compare favourably with 3.5% on the FTSE

All-Share, and dwarf the S&P500's measly year-to-date return of 1.3%.

Beware of 'crowded exits' and political exposure

It's not all plain sailing. You should be aware that your fellow investors have a tendency to withdraw their money from emerging markets in concert – as was seen when the 2008 financial crisis struck – which can mean big losses. And you can easily end up with political risk in your portfolio – many flagship emerging market companies are majority-owned by their governments, leaving stockholders vulnerable to the whims of politicians in need of re-election as well as the vagaries of the global economy. There's also foreign exchange risk to consider, because emerging currencies are notoriously volatile in tough times.

With core developed economies in dire straits, emerging market stocks look an attractive option. But they bring their own risks, and should the global economy worsen they won't be immune from the consequences. Emerging market investments are high-risk and therefore not suitable for everyone.

The value of your investment and the income from it can go down as well as up and you may not get back the full 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.

Annuity rates continue to shrink

Falling government bond yields and increasing lifespans are just two factors pushing down annuity rates.

Annuity rates are currently at the centre of a perfect storm:

- Yields on long-term government bonds are at historically low levels (see 'How low can you go?' on pages 2 – 3). For instance, 15-year gilts are currently yielding around 3%.
- Life expectancy continues to increase rapidly – witness the Government's efforts to increase the state pension age.
- Forthcoming new EU rules, known as Solvency II, are making it more expensive for insurance companies to underwrite annuities.
- From 21 December 2012, all new insured annuities will have to be written on a unisex basis, meaning that men will no longer receive higher annuity rates than women of the same age.

For a man aged 60 with a pension fund of £100,000, the current top-of-market rate for a level (non-increasing) annuity is around 5.6%. The corresponding figure for a woman of the same age is 5.3%. Include inflation-proofing and these rates drop by nearly a half. If you are about to draw benefits from a pension plan, such numbers are not good news. They reinforce the need to review all your retirement income options. These include:

Open market annuities Not all pension plan providers compete in the annuity market. Therefore you should never accept the annuity rate from your pension plan company without first checking what is on offer elsewhere. Annuity rate setting has become increasingly refined in recent years. For instance, some companies now set rates according to your home postcode. If you are a smoker, or have less than perfect health, you may be entitled to an enhanced annuity rate. Annuity rate tables in the weekend press give a very limited snapshot and cannot show the full range of your annuity options.

Phased retirement Phased retirement involves drawing on your pension plan in stages, with each year's 'income' consisting of a tax-free lump sum and annuity payment(s). This route has the advantage of avoiding the one-off annuity purchase, but it does involve investment risk. Part of your pension plan will remain invested after your retirement income begins and annuity rates could fall further.

Income drawdown Income drawdown – drawing your income directly from your pension fund – is normally only a viable option if you have other sources of retirement income. It offers considerable flexibility – if you have £20,000 or more of other secure pension income, you may be able to withdraw as much as you wish. Bear in mind that the charges are far more than for an annuity. However,



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the normal 'capped withdrawal' rules will limit your maximum initial income to much the same as an annuity can provide and income withdrawal arrangements virtually always carry investment risk. If you are concerned by the possibility that your income could fluctuate as a result of the ups and downs in the stock market, an annuity could be a better option.

In view of the complexities surrounding your retirement income choice, it is particularly important that you review your objectives and options with the help of expert pensions advice. Phased retirement and income drawdown are higher risk, more complex products and therefore advice should be sought.

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Have you remembered that if you missed the 31 October filing date for your 2010/11 paper tax return, then you must file online by 31 January 2012? The penalties for late filing

are now much higher than they used to be – the starting point is £100, even if you owe no tax.

31 January is also the date for paying any outstanding tax due for 2010/11 and the first payment on account for 2011/12. If you expect to pay less income tax for 2011/12 than 2010/11, you can make a claim to reduce your payments on account using HMRC form SA303. The FSA does not regulate tax advice.

Getting ready for 1 October 2012

It may be nearly a year away, but if you are an employer, you should be preparing for 1 October 2012.

Most new laws affecting businesses now start to operate from 6 April or 1 October. Thus 1 October 2011 brought a rise in the national minimum wage, the introduction of new rights for agency workers and the final abolition of the default retirement age. 1 October 2012 will see two more significant changes, which have been long in preparation:

- The start of a four-year phasing in of auto-enrolment – largest firms first – into workplace pension schemes for employees and other workers; and
- The official launch of the National Employment Savings Trust (NEST). NEST has been designed as the default pension where no alternative arrangement is offered by the employer.

Unlike the existing stakeholder pension access arrangements, there will be no exemption for employers with fewer than five employees: if you have just one employee, you could need to auto enrol them in a workplace pension. Broadly speaking, only individuals under age 22, over state pension age or earning less than the personal allowance (£7,475 in 2011/12) are not subject to auto enrolment.

Once an employee is auto-enrolled, you have to make pension contributions unless the employee decides to opt out. (Remember that those who opt out must be auto-enrolled every three years.) The minimum employer and total contribution levels are set as a percentage of 'band earnings' and are being phased in over five years (see table below). However, the band has not yet been finalised as the Government is awaiting earnings inflation data. In practice the band is likely to be between about £6,000 and £40,000 a year.

The phasing in of auto-enrolment means that most employers with less than 50 workers will not begin to auto enrol until at least March 2014. That may seem comfortably distant, but many employers will prefer to be ready before the legislation forces them to act.

Date	Min. employer contribution* %	Min. total contribution* %
Oct 2012 – Sep 2016	1	2
Oct 2016 – Sep 2017	2	5
From Oct 2017	3	8

* Based on band earnings
+ Employer plus employee gross contribution (i.e. including 20% tax relief)

Swiss tax agreement

The UK Treasury has signed an agreement with Switzerland about UK tax evaders.

In these hard-pressed times, HM Treasury is more anxious than ever to collect tax revenue. Its latest effort in this direction has been to reach an agreement (subject to parliamentary approval) with Switzerland concerning funds held in that country by UK taxpayers. The details released so far are that:

- The existing funds of UK taxpayers held in Switzerland will be subject to a one-off deduction of between 19% and 34% to cover past tax liabilities. Those who have already paid the UK taxes due will not be charged.

- A new withholding tax of 48% on investment income and 27% on gains will apply to UK residents with funds in Swiss bank accounts from 2013. To avoid these charges – which closely correspond with the top rates of tax – the investor would have to authorise a full disclosure of their affairs to HMRC.

- In 2013 a new information sharing provision between the two countries will be introduced. The Treasury believes this will make it easier for HMRC to find out about Swiss accounts held by UK taxpayers.

The Swiss deal is a further reminder that, as well as being illegal, tax evasion does not pay. The FSA does not regulate tax advice. Levels and bases of, and reliefs from, taxation are subject to change.

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