SimplyMoney

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A better design for your financial independence

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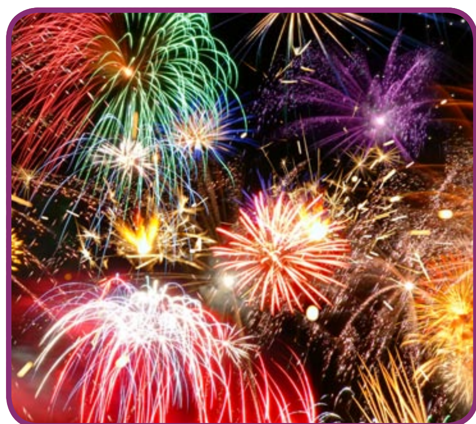


The recent increase in VAT may not have such an adverse impact as predicted. This is not a really significant increase, it does not apply to everything and, even where it does bite, prices should only increase by just over 2%.

Of course, this will be inflationary, but commentators will already have fed this into their economic models, so there should be no need to fear an unexpectedly harmful effect.

What is far more important to us all is whether The Coalition Government's plans to cut spending are actually successful in reducing the ever-growing budget deficit. Things will be difficult for most of us, but the potential rewards are a more stable economy and the state eventually representing a smaller proportion of gross domestic product.

This is important to us all whether investing for the medium or long term, because the economy needs to grow strongly in order to provide initial further investment and it is more likely to do so if the private sector represents a larger – and more productive – proportion of the national cake than the state. After all, the private sector makes and sells things, here and abroad; The Government simply provides the essential services including welfare, which is important but not economically productive.

There is every reason to believe that businesses that survived the recent economic downturn are far stronger – and leaner – than before and that they will be the powerhouse of the economy, as well as presenting good investment opportunities for the future. The FTSE100 remains below its long-term trend (at the end of December 2010, it stood at 5,899.9, compared with an estimated 6,401.94 had it followed its trend since 1984).

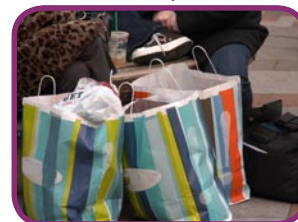
While there are no guarantees in investments, there is no reason currently to assume that investment returns – both in terms of capital values and dividend yields – should not continue to grow over the longer term; and investments are, of course, usually about the longer term.

2011 could be a crucial year for investors; if investment values do strengthen, now could be a good time to be re-entering the market. With the ISA season soon upon us, it is important to ensure that you have made use of your annual allowance (£10,200 for everyone over age 18) before the close of business on Tuesday 5th April.

If you would like to review your current investment and retirement planning arrangements, please contact us.

INSIDE

Will the pension changes affect you?



Protecting borrowings

ISAs revisited

Mortgage advice is important

Back page Briefing: Market volatility

Will the pension contribution changes affect you?

As part of last year's spending review, The Government has radically changed the amount that can be invested into a pension plan from 6th April 2011. For the majority, there is unlikely to be a significant change, because the new 'annual allowance' is £50,000 (down from £255,000), which is far more than many of us would have been contributing in any event.

It will, however, affect high earners with a long service history who are members of a defined benefit (final salary) scheme, or anyone wishing to use an inheritance or lottery win to boost their retirement fund. If you fall into either of these categories, please contact us.

Main changes

The principal changes are that:

- Tax relief will be available at up to 50% for those on the top rate; and
- It will be possible to 'carry forward' unused relief from up to three previous years

An important side-effect of this is that some people who have been prevented from increasing their pension contributions this year by virtue of earning above £130,000 a year may be able to invest more after April.

For example, depending on 'Pension Input Periods', an executive earning £200,000 who had been putting £30,000 a year into his pension for the past five years would not have been able to increase his contribution this tax year. Thanks to the new rules he could, after April, make a contribution of £50,000 on which he would receive tax relief at 50%, as well as contributing an additional £20,000 based on the annual allowance 'carried forward' from this tax year. He would, of course, only receive 40% tax relief on this, because that was the highest rate allowable for 2010/11. A gross contribution of £70,000 will still only cost him £37,000!

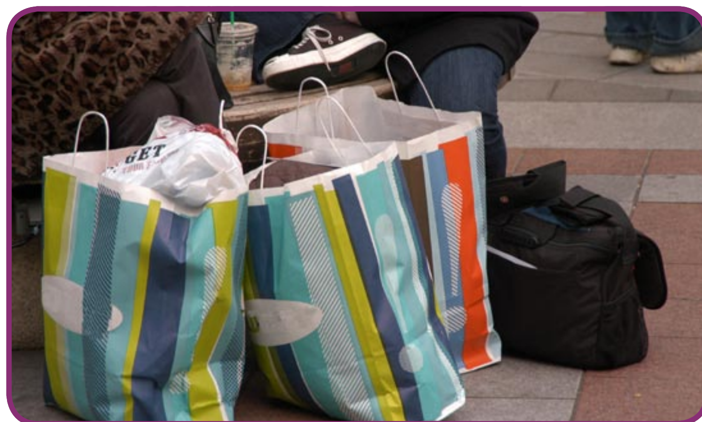
Other changes

The total amount that a pension fund can reach before a lifetime allowance charge (at anything up to 55%, depending how the money is taken) starts being reduced from April 2012 to £1.5 million from £1.8 million.

There is also a change to the way that contributions to 'defined benefit' pension schemes are compared with the annual allowance; the 'factor' used is changing from ten times to sixteen times. This will have the effect of making a relatively smaller increase in benefits reach the annual allowance more quickly. Again, those likely to be affected should ask for individual advice.

Protecting borrowings

Data from Credit Action in November 2010 showed that individuals throughout the UK owed a massive £1,455 billion; more than the gross domestic product of the UK for last year. On the other hand, the rate at which we are borrowing is growing far more slowly than 30 months ago. This appears to have been the trend for some time. Despite many people seeking to reduce their borrowings, there is no significant fall in overall credit.



According to the Office for Budget Responsibility, household debt will reach £1,823 billion by the end of 2015 – a growth equivalent to £159 million every day. In fact, average household debt could be as much as £72,341 by then – and if you exclude those households that have no debt, the figure is even higher for those households that do!

Does this matter?

Too much borrowing can potentially be inflationary – more money is chasing the goods and services available, so prices tend to rise. On the other hand, it suggests that there is still demand for commodities, so the fragile economic growth we have seen recently could continue.

At the individual level ...

The real potential problem occurs at a personal level; if families owe massive amounts of money, what happens if their income dries up?

This can happen for various reasons including unemployment, long-term illness, or death. Any one of these events can be traumatic enough for a family, however, to be faced with massive – and potentially mounting – debts at the same time could impose a massive strain on your loved ones, just when they need maximum support.

What is the solution?

Fortunately, it is possible to secure insurance to protect your income in the event of such life-changing events and this need not be expensive. Policies can be arranged in a number of different ways to suit most requirements – in fact the choice is so large that it is a good idea to seek professional independent advice before making what might, at first glance, appear a relatively simple decision.

The greatest differences are likely to relate to health and unemployment insurance, where some activities – and even forms of employment – can invalidate cover, if you are not careful.

But even life insurance is not as straightforward as it might appear from some websites. Policies range from those that last for the rest of your life (the most expensive) to others that actually reduce in value each year (the least expensive). Knowing which is most likely to suit your personal circumstances is not as simple as looking at just the monthly premium.

News in brief (data compiled by The Insurance Marketing Department Ltd. except where otherwise stated)

Stockmarkets finished the year strongly with the FTSE100 ending at 5,899.9, having briefly scraped above 6,000 points during December. It now stands some 6.33% higher than at the end of the third quarter and 9% up over the entire year. The mid-cap FTSE250 ended the year 24.2% higher than at the start of 2010.

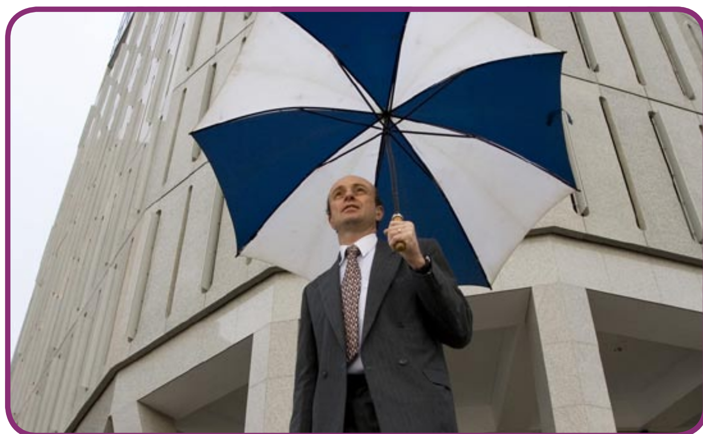
After a year during which average house prices rose during the first half and then fell back later in the year, they are now broadly in line with the start of the year. According to Nationwide, the price of an average home is now £162,763, that is 0.4% higher than in December 2009. During the last three months of the year, values fell by 1%.

The economy has continued to grow, albeit at a slower pace than had been hoped. Unemployment, which rose above 2.5 million during November, did not reach the high levels anticipated by some at the start of the recession, and it appears that new export-driven job creation within the private sector will more than offset public sector cuts.

One of the factors assisting exports has been a weakening of the pound, which ended 2010 some 3.46% lower against the US dollar, compared with the start of the year. Unfortunately, it ended 3.35% higher against the euro, which also represents a significant part of our overseas trade. Oil is 19.3% more expensive than at the start of 2010.

ISAs revisited

Last April, the maximum level of investment that adults under 50 could put in an Individual Savings Account (ISA) was increased to £10,200 a year, the same as for over-50s. Within this overall limit, up to half can be invested in cash and the balance in stocks and shares. Those aged between 16 and 18 are limited to the cash element only (up to £5,100). Younger people have no ISA allowance at all, although there may soon be a 'Junior ISA' version to replace the soon-to-disappear Child Trust Funds.



Tax benefits of ISAs

ISAs continue to offer a flexible way to invest without having to worry about the impact of tax. Unlike pensions, the money you invested does not receive tax relief. While it is invested, however, no UK tax is charged other than 10% on dividends from shares in UK companies and there is no liability to capital gains tax.

More importantly, when you take your money out, it is free of any form of tax. You can withdraw your money at any time (unless the fund managers apply restrictions, as can sometimes happen with property-related funds) either as a lump sum or an income.

In addition, the maximum amount you can invest is set to rise in line with inflation each year – which used not to be the case – and you can irreversibly switch money you have invested in cash within the ISA into the stocks and shares element (including collective investments like Unit Trusts) without affecting your annual investment limit. In other words, if you have £20,000 in cash within your ISA and decide to switch half of this into the 'shares' part of the plan, you can still invest your full £10,200 (for an over-18) into your ISA during the same tax year.

Does this really help?

Sheltering your money from tax can have considerable appeal but there are two issues that you need to be aware of.

First, charges under some ISAs can be higher than those applying to alternative forms of investment. Secondly, there is little point in protecting your money against tax if it makes no gains that could be subject to tax! It is therefore important to consult a professional Independent Financial Adviser, who can help you avoid some of the more expensive and poorly performing funds.

ISAs offer a highly flexible way of investing for the medium to long term. Your investment strategy should, however, also reflect the fact that you may require access to money for emergencies or special events relatively quickly. This means ensuring that some of it is readily available without you having to give notice – or suffer a loss of interest – if the money is needed. It also means that you should not invest too high a proportion of your money in assets that involve significant dealing costs. These could reduce the value of your investment should you need access to it shortly after making an investment.

Mortgage advice is important

With a slow housing market you might wonder whether the services of a professional mortgage adviser are necessary; would you not be better off walking into a building society or bank, or searching the internet instead? In fact, the answer is a resounding "no" for several reasons.

Not least of these is that the mortgage market is moving rapidly and it can be difficult to predict, from one week to the next, which lenders are most active in the area you are interested in. They also charge different levels of fees, which can be confusing.

It is also important to be aware that the lowest 'headline' interest rate is not always the most suitable for each borrower, because terms and conditions may be attached that make it less suitable in some cases; for example, where a higher deposit is required, or there is an early repayment charge before you can move to another lender, or even a new arrangement with the same lender.

Horses for courses

Different lenders have their own specific lending criteria and also tend to be more competitive in various parts of the market. For example, a lender offering good terms for first-time buyers may not be so attractive for those moving home, or even simply wishing to rearrange their mortgage without moving home.

Similarly, if you are interested in a mortgage to buy a property that you can let, it is unlikely that your existing 'owner-occupier' lender will necessarily be the most suitable one for you.

Which type of mortgage will suit your needs?

Offset mortgages are becoming increasingly popular, because they are highly flexible and you only pay interest each month on the difference between your outstanding mortgage and the amount you have in your current and deposit accounts with the same bank. The excess reduces your mortgage balance.

This can result in much faster repayment of your borrowings, but only if you keep a reasonable average balance in your account – if you do not, much of the benefit is lost and, as interest rates can be higher for this form of borrowing, the overall cost might be higher, even if you do manage to shave a few months off the overall term.

Don't panic!

Consulting a professional mortgage adviser can help you avoid all these potential pitfalls, their in-depth knowledge of the market will greatly reduce the time it takes to find the right mortgage for you.

The Financial Services Authority does not regulate some forms of mortgages. Your home or property may be repossessed if you do not keep up the repayments on your mortgage. A fee may apply for mortgage advice and you must ask your adviser for details before making any decision relating to a new mortgage as the actual amount will depend on your personal circumstances, but typically it will be 0.5% of the loan value (on a typical £100,000 mortgage, this would be £500).

Back page Briefing

Market volatility

Anyone looking at stockmarkets over the past few years could be forgiven for wondering what is going on. Of course, volatility is one of the factors that investors have to accept and, in many ways, this is not always a bad thing.

After all, investments should be seen over the long term and in most cases – especially where they are being bought on a regular basis – occasional falls in value need not be a matter for real concern. When share values fall, you get more of them for a given investment. What really matters is the value of your shares when you want to sell them in order to get money back.

Are markets really volatile?

Recent share price fluctuations made us review the degree of market volatility over the past 20 years or so. What stands out in particular is not so much how markets have moved (on a monthly basis) since the start of 2008, but how little they did so during the previous four years.

Looking at the FTSE100 on a monthly basis, movements ranged from +11.5% in May 1990 to -13% in September 2008; but only in a handful of cases were there more than three or four consecutive months of decline.
Equally, only in a few instances were there long 'bull' runs, where values increased each month for more than six months.

Putting this into context, at the end of December 2010, the FTSE100 was almost 150% higher than in January 1990, so volatility in the intervening years has not done much harm over the longer term. If you look at the 15 years since January 1996, the FTSE100 grew by 60%, while it currently stands 12% lower than at the start of 2000. The last five years have seen this index grow by just 5%, which reflects recent economic and market conditions.

The key message is that markets are inherently volatile and short-term movements (upwards as well as downwards) should not overly concern investors. This does, however, also reinforce the importance of high quality independent financial advice, if you are to select the right asset mix and fund selection to match your risk tolerance.

It is important to take professional advice before making any decision relating to your personal finances. This publication represents our understanding of law and HM Revenue and Customs practice as at the date of publication. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK, please ask for details. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from taxation are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.

The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get back the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency. Your home may be repossessed if you do not keep up the repayments on your mortgage. A fee may apply for mortgage advice and, if applicable, you must ask your adviser for details before making any decision relating to a new mortgage as the actual amount will depend on your personal circumstances, but in most cases is unlikely to exceed 0.5% of the loan value (on a typical £100,000 mortgage, this would be £500).