

money wise

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SIGNET FINANCIAL SERVICES
INDEPENDENT FINANCIAL ADVISORS



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Start planning early if you want to retire early

Many people yearn to retire early – well before their 60s if possible. The trouble is that this is hard to achieve without careful preparation; relatively few people achieve a comfortable early retirement, and it may even be getting harder.

Part of the problem is that early retirement has become increasingly expensive:

- Many employers with final salary pension schemes are facing substantial deficits and can no longer afford to offer generous early retirement terms as a way to soften redundancy.
- Life expectancy has continued to rise, increasing the period over which pensions are paid and hence their cost.
- Annuity rates have fallen since the turn of the century, due both to rising life expectancy and generally lower long-term interest rates.¹

Two future changes, already legislated for, will further constrain your early retirement options:

- From 6 April 2010, the normal minimum age at which you can draw pension benefits will rise from 50 to 55. In practice retirement before age 55 is usually too costly: for example, at current annuity rates a 52 year-old man in good health would need a pension fund of nearly £220,000 to provide a level pension of £1,000 a month gross. Add inflation protection to the pension and the cost nearly doubles.²

If you are in the affected birth date range and are considering drawing your pension benefits (including tax-free cash) now rather than at age 55 or later, please contact us as soon as possible. Experience suggests

that turning a pension fund into retirement benefits can be a slow process, particularly if your pension fund is spread across several providers.

- From 6 April 2010, the State Pension Age (SPA) for women begins a phased increase that will see men and women have an equal SPA of 65 by 6 April 2020. Four years later a further phased increase of one year will be introduced, raising the SPA to 66 by 6 April 2026. Another year will be added in 2034–2036 and 2044–2046, so that by 6 April 2046, the SPA will be 68.

If you want to retire before the state thinks you should, your starting point should be to arrange an initial discussion with us. We can then assess what would be required to meet your retirement objective, taking into account your existing pension provision and investments.

Even if the result is that you need to rethink your retirement age – not an uncommon outcome – you will be better informed about when you can realistically stop work.

Levels and bases of, and reliefs from, taxation are subject to change and their value depends on individual circumstances.

1. *National Statistics, October 2009 and www.employeebenefits.co.uk, November 2009.*

2. *FSA comparative tables (10/11/2009).*



Asset allocation is the key to successful investment planning

Asset allocation took a beating in 2007 and 2008, largely because investors found they seemed to be losing money no matter what securities they favoured. That has led to doubt about its worth, so it is useful to take another look at this approach to investment portfolio design in the light of the past two years' performance.



Asset allocation is based on the theory that the choice of assets you invest in will have the biggest impact on the level of returns you make – rather than the individual funds selected. Research by Paul Merriman supports the view that a very high proportion of investment returns come from the choice of underlying assets.

The first step in the investment planning process is to assess your risk profile, followed by recommending how your investments should be deployed across the main asset classes. Then individual funds are selected to fine tune the portfolio – the reverse of the traditional approach.

The idea is that different asset classes normally move in broadly different ways. In theory, you can increase performance and smooth out the ups and downs of an investment portfolio by combining different asset classes – described as 'diversification'.

The numbers show that the model largely held up in the market mayhem of 2007, 2008 and so far in 2009, although there have been times when all main asset classes fell together. In 2004, 2005 and 2006, property was the best performing asset by far, followed by shares, and fixed-interest securities were the laggard – although all three made positive returns for investors. 2007 and 2008 saw that order reversed, with property posting losses while fixed-interest securities and shares made very small gains. So far in 2009, the trend of 2004–2006 has been restored.¹ This demonstrates that no one asset class is always a winner and that over time, diversifying really can smooth out returns.

Your risk profile assesses how much risk you can afford. With this established, asset allocation can be optimised. Those with higher risk profiles can look to riskier strategies, such as commodities or hedge funds. Remember, with all asset classes, the value of your investments and the income from them can go down as well as up; you may not get back the amounts you have invested and past performance is not a guide to future performance. It is important that you take expert advice before making any investment.

1. www.castlestonmanagement.com, 12 November 2009.

Investor interest is growing in commercial property funds

Interest rates remain at their lowest on record,¹ making the returns available on commercial property enticing. Broadly speaking, there are three kinds of property funds, each with drawbacks and opportunities.

But remember, investing in property involves a lot more risk than holding cash. The investment could fall and you might not get back the amount you put in. Past performance is not a guide to future performance.

Funds specialising in direct property investment are also termed 'bricks and mortar funds'. They are typically structured to pay an income derived from rental on properties held in the fund. Eventually, when investors withdraw capital, they should receive their investment, plus any capital growth (or less any loss) in the value of the properties themselves. One problem with these funds can be the delay in getting access to capital. But they provide returns which are closely linked to the commercial property market in terms of capital growth and income. Their assets are not publicly traded and are sometimes hard to value on a day-to-day basis.

A less direct way to access the property market is to buy shares in stock market-listed large builders or property management companies – typically through specialist funds. When the market flourishes, so will such businesses. Investors receive income based on dividends from the companies, and – when they withdraw cash – any capital growth is based on the traded value of the shares.

These shares are normally easy to trade, so the liquidity of such funds is excellent. However, their price is usually linked to share prices generally.

Real estate investment trust schemes (REITs) are generally businesses listed on the stock exchange. Their primary function is managing a portfolio of income-producing properties. Most profits are typically distributed as dividends, and so their share price is normally linked to the portfolio value of the underlying properties. REITs are designed to offer the liquidity of stocks, and close ties to rental income and property prices. In practice, they score well but not perfectly on both counts. However, the market is new and somewhat untried, and offers limited investment choice.

UK commercial property has shed up to 40% of its value in the past two years,² but if the worst is over, and you are thinking of investing, it is important that you take advice.

1. *Bank of England, 08/10/09.*
2. *Financial Times, 21/08/09.*



Your retirement income choice could have a lifelong impact

The choice you make when turning your pension fund into a retirement income is one that needs great care. Get it wrong and you, and possibly your dependants, could spend many years regretting an irreversible error.



In summary, your two main options at present are:

Annuities The most popular way of producing a regular income from a pension fund. Its key attraction is that once payments start, they continue throughout your life – however long that is. Payments are guaranteed, unless you choose an investment-linked annuity. The main drawback of lifetime annuities is that they are inflexible; once they have been started they normally cannot be changed.

A number of major insurance companies actively compete in the annuity market, but some quote rates only for their own pension policyholders. This makes it vital that you check with us what is available in the market place before accepting your pension plan provider's offer.

Income drawdown A type of 'unsecured pension', income drawdown is a higher risk, more complex approach, generally only suitable if you have a variety of other income sources in retirement and can afford to

dispense with the security offered by an annuity. Under income drawdown, withdrawals from your pension fund provide your retirement income. The maximum initial withdrawal level is set by HM Revenue & Customs (HMRC) – there is no minimum – and withdrawals must stop by age 75.

Income drawdown has a number of important advantages over annuities, which need to be weighed against the reduced

security and additional running costs:

- The value of your remaining fund can be paid out as a lump sum if you die before reaching age 75. A flat 35% tax charge would apply, but normally inheritance tax would not.
- You can vary your income at any time, so long as you stay within the HMRC maximum. However, the higher the income you choose, the greater the chance that it may not be sustainable.
- Your pension fund investments remain under your control.

We can provide you with detailed advice on all your options and help you in making that all-important retirement choice.

Past performance is not a guide to future returns. The value of investments and income from them can go down as well as up, and you may not get back the original amount invested.

What inflation really means

Inflation erodes the value of your savings because, as prices rise, the same money buys you less. So unless your investments are growing faster than prices, you are losing money in real terms.

It is hard to open a newspaper or magazine without being told of strange inflation behaviour. Whether inflation is slowing down or speeding up, is too high or too low, there have been plenty of doom-laden headlines in recent months. One measure struck 5.2% a year ago in October 2008, its highest for 16 years and more than twice the Bank of England's target of 2%. Since then it has dropped right back down, and was just 1.8% in July.¹

While that is reassuring, it is also important to remember that there is more than one way to measure inflation, and that the rate favoured by the Bank of England today is not the one most of us are used to. In 2003, the Bank switched from targeting the RPIX measure of retail prices minus mortgage costs to using CPI, or consumer price inflation.² At the time of writing, the RPIX was running at just 1.2%.

The most relevant measure of inflation for you is the one that most closely matches your expenditure, and for many of us, that is neither of the above: it is the RPI measure of retail prices, also known as 'cost-of-living inflation'.

RPI includes many expenses that are really relevant to day-to-day living, such as council tax. The good news for your savings is that the RPI is, at time of writing (October), negative at -0.8%.³

Independent control

Also worth remembering is the Bank of England's remarkably consistent record for hitting its 2% inflation target. Since the Bank gained independence from political tinkering in 1997, inflation has been extremely stable. The fluctuations triggered by the credit crunch, while alarming, represent the first really volatile period seen since politicians were barred from interfering with interest rates.⁴

1. *Bank of England inflation report, August 2009 and Guardian, 2008.*
2. *Office for National Statistics, August 2009.*
3. *Office for National Statistics, November 2009.*
4. *www.commonleader.gov.uk, November 2009.*



A financial roller coaster of a year

That was the year that was! 2009 started gloomily and for much of the first three months the outlook grew ever blacker. Then, just as it seemed Armageddon was inevitable, the infamous 'green shoots' were spotted and world stock markets began to recover.

Despite the return to somewhat calmer economic weather, you cannot ignore the consequences of the global financial storm. One is that personal tax rises are on the way:

- In April 2010, the new 50% top tax rate (42.5% for dividends) starts for gross income over £150,000.
- Also from April 2010, the personal allowance will be phased out if your income is over £100,000 and removed completely if your income exceeds £112,950.
- From April 2011, national insurance contribution rates for employers, employees and the self-employed all increase by 0.5%.

It is unlikely that these will be the only tax increases although, with an election in the offing, the precise details of any further pain will probably be kept under wraps for now.

The changing tax landscape needs to be incorporated into a year-end review of your financial planning. The sooner a review is started, the more scope there is for reducing the impact of the tax changes already announced and pre-empting possible future imposts. For example, it could pay you to increase your income in 2009/10 before the April 2010 tax rises take effect. For the longer term, you may also need to restructure some of your investment holdings to shelter income from immediate tax.

In addition to tax issues, your year-end review also needs to address your health and life protection arrangements. The effect of inflation over the last 12 months is minimal, but your circumstances may have changed, for example through increased borrowing.

The Financial Services Authority does not regulate tax advice. Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances.



Simon Gordon BSc, ACII, CertPFS

Signet Financial Services

Independent Financial Advisors
16-16a Accommodation Road
Golders Green
London NW11 8EP
Tel: 0208 455 8555
Fax: 0208 455 3388

Email: enquiries@signetfinancialservices.co.uk

Website: www.signetfinancialservices.co.uk

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Directors

Simon Gordon BSc ACII CertPFS
Cheryl Gordon MA

