

money wise

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SIGNET FINANCIAL SERVICES
INDEPENDENT FINANCIAL ADVISORS



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The Emergency Budget

The first Budget after an election is usually the most taxing. George Osborne, the new Chancellor, did not stray from the tradition.

The Budget on 22 June was variously billed as 'the Emergency Budget' and 'the Austerity Budget'. In the event, it was the now familiar Budget mix of immediate tax increases and deferred tax increases with the odd (low cost) sweetener:

VAT The standard rate of VAT will rise to 20% from 4 January 2011, the first working day of the new year.

Capital gains tax (CGT) This was the hot topic in the run up to the Budget, but the revisions announced, which took effect from 23 June 2010, were less draconian than feared. The annual exemption remains at a generous £10,100 and will continue to be index-linked.

Capital gains (after the annual exemption) are now taxed as income, but at special rates. The main rate of tax is 18%, but for gains which fall into the higher and additional rate bands, a 28% rate applies. The lifetime limit for entrepreneurs' relief was raised to £5 million.

Business tax The main corporation tax rate will fall by 1% a year for four years from April 2011, leaving a 24% rate from 1 April 2014. The small profits rate (formerly the small companies' rate) will be cut by 1% to 20% from April 2011. However, the annual investment allowance will fall from £100,000 to £25,000 in April 2012.

Personal allowance and tax bands The personal allowance will rise by £1,000 in 2011/12 to £7,475, but if you are a higher rate taxpayer you will not benefit because the starting point for 40% tax will be reduced to

claw back the potential tax saving. The higher rate tax starting point will then remain frozen for 2012/13, again potentially creating more 40% taxpayers.

National insurance contributions (NICs)

The previous Government's planned 1% rise to all the main NIC rates will go ahead for 2011/12. However, adjustments to the NIC bands will temper the impact of the higher rates.

Pension contribution tax relief

The Chancellor has abandoned the much-criticised 'high income excess relief charge', which had been due to replace the 'special annual allowance charge' from 2011/12. However, he plans to impose new restrictions on pension contribution tax relief, probably by reducing the annual allowance from £255,000 to between £30,000 and £45,000. As a result of this proposal, 2010/11 may be the last tax year in which you could benefit from full tax relief on a substantial pension contribution, whether made by you or your employer. There were also moves to end the effective requirement to buy an annuity by age 75.

Tax credits The fact that families with income of over £50,000 can still receive child tax credit always looked like low-hanging fruit for a revenue-hungry Chancellor. Mr Osborne announced a range of money-saving 'reforms' to the tax credit system.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.

Anyone for some income?

The base rate has remained at 0.5% for well over a year now. There are few signs that it will rise much in the near term.



The Bank of England cut the base rate to 0.5% in March 2009. The Bank's calculations, revealed in its May 2010 Inflation Report, show that the base rate is now not expected to reach 3% until the beginning of 2013.

If you rely on bank or building society deposits for income, the expected slow progress of interest rates back towards normality is unwelcome news. It means that even fixed term rates are relatively low, with a 4% gross rate unavailable for terms below three years.

One way to increase your income is to move away from deposit-based investments. You will lose the security of capital which deposits provide, but if your

ultimate goal is income, you may consider that to be a price worth paying. With the right type of investments, your future income would be free from the ups and downs of short-term interest rates. However, alternative investments are not directly comparable with deposit accounts, which is why it is so important to take independent financial advice before investing. The type of investments you choose should depend on your individual circumstances and attitude to risk.

The potential list of investments includes:

- Fixed interest funds which invest in interest-paying securities issued by companies, governments and a variety of other bodies.
- UK equity income funds which generally invest in higher yielding UK company shares. These types of funds have long been popular because of their potential to provide rising income in the long term.
- Overseas equity income funds which are the global equivalent of UK equity income funds, mostly covering geographic areas, eg Asia.

All of these funds can be held within individual savings accounts (ISAs). The fixed interest funds make especially attractive ISA income investments because there is no tax on the interest. If you have an existing cash ISA – perhaps one that started life as a TESSA – you can transfer it to a stocks and shares ISA and invest in income funds. This is a one-way transfer – there is no going back to the security of cash – and your ISA provider may levy transfer charges.

Past performance is not a reliable indicator of future performance. 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.

Socially responsible investment

Sustainable and ethical investment is growing in popularity, from investing in clean power to shunning child labour. It is meant to be good for everyone – but is it bad for your rate of return?

Socially responsible investment (SRI) has been active in the UK since 1984. British savers had put more than £9.5 billion into green and ethical retail funds by the end of Q2 2010.

What is SRI?

Early funds selected stocks to buy using 'negative filters' to exclude unethical operators or producers of morally controversial products and services. This filter catches companies that may, for example, pollute or destroy the environment, exploit workers, abuse human rights, be involved in the weapons trade or produce alcohol and tobacco products.

However, more popular today are 'positive filters'. These favour companies that are, for example, active in environmental technology, clean energy, healthcare, or have been successful in promoting human rights, equal opportunities or welfare standards throughout the supply chain.

Increasing choice

The huge variety of decision-making approaches demonstrates one thing very clearly – there is no universal definition of what is ethical.

Fortunately, the growth of the market means there is now plenty of choice. Those seeking green and ethical funds for their portfolio can choose from around 100 different funds, compared with just a handful a decade ago.

But what about performance?

The key reservation for potential investors is performance: do such 'virtuous' funds generate inferior returns? When it comes to performance, the answer is, as always, it



depends. If sectors that these funds cannot invest in are doing well, they are likely to underperform, and vice versa.

But this may change as more companies adopt sustainable business practices and activities that enable them to be branded ethical. The investment universe for these funds will grow, removing obstacles to performance. There is also great potential for green companies to benefit from government and legislative support, while surging commodity prices mean that sustainable energy generation and recycling make sound economic sense for a business. Those who get in early are likely to benefit most.

Growing opportunities

There is a multiplying range of ethical funds out there, but there is some evidence that their performance lags behind that of their unfiltered peers. While this discrepancy may decrease in the future, it is something savers need to consider when making investment decisions.

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Good things in small packages?

The ongoing worries about BP and its tattered share price show how vulnerable a big firm can be when public opinion swings against it. It's worth taking a look at funds that invest in small and mid-sized companies.



Companies with the largest market capitalisation have a lot to offer. They are frequently well diversified internationally, by business type, or by customer base. They also typically have a reputation for paying regular and reliable dividends, allowing fund managers a degree of confidence in performance.

So it came as a shock when BP announced in June that it was suspending dividend payments to shareholders – and the company's share price has been equally shocking. A number of ethical funds decided to drop the company entirely. The bigger they are, so the saying goes, the harder they fall.

However, savers in the UK can choose from a wide variety of stock funds,

including those that focus solely on small and mid-sized companies. While these companies don't have the advantage of size, a lower profile makes them less vulnerable to swings in public sentiment.

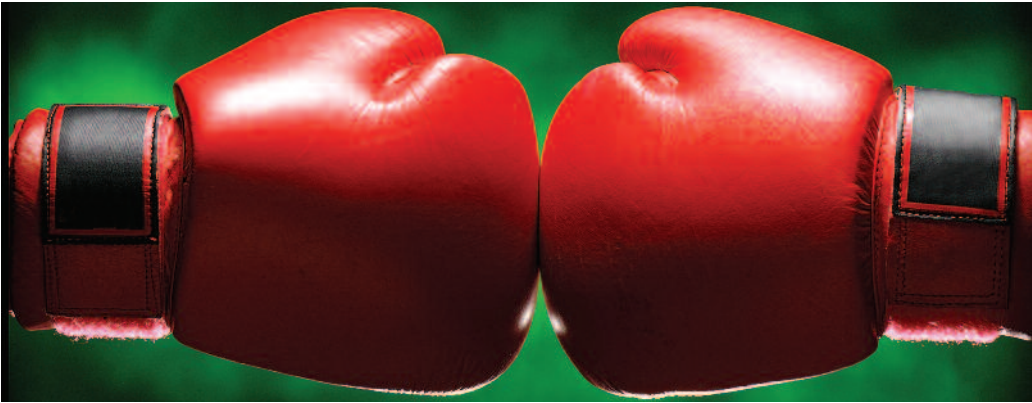
A smaller size can make them more adaptable to changes in technology or the business cycle. They are also often keen to please shareholders, using dividends or returning shares. With some big-capital companies disappointing, savvy fund managers can pick up stocks with good potential at very low prices.

The Government has cut corporation tax from 21% to 20% for smaller firms (companies with less than £300,000 of profits) from 2011/12, and for larger firms from 28% to 24% by 2014/15. The threshold on employer national insurance has also been raised. All good news for companies, but a good fund manager is essential.

Smaller capital funds bring a host of advantages to savers, and diversifying your investments is always important. But smaller firms, though well-placed to benefit once economic recovery takes root, may struggle as long as the economy remains subdued, leaving these firms highly vulnerable to a double-dip recession.

The values of shares in smaller companies are often more volatile than those of larger corporates. Past performance is not a reliable indicator of future performance. 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.

Battle of the indices: CPI vs RPI



One surprise in the Emergency Budget on 22 June was the Government announcement that it would use the consumer prices index (CPI) rather than the retail prices index (RPI) for benefit, tax credit and public sector pension increases from 2011.

A few weeks later the Pensions Minister, Steve Webb, sprang another surprise by stating that CPI rather than RPI would also form the basis for statutory increases to private sector defined benefit pensions from 2011. The move from RPI to CPI may not sound significant, but it could make a big difference to your retirement income.

The CPI measure of inflation is generally lower than the more familiar RPI. For example, between January 1990 and January 2010, the RPI rose on average by 3% a year against 2.5% for the CPI. Over 20 years that 0.5% difference translates into a total inflation of 82.3% on an RPI basis and 63.8% for the CPI – over 22% less.

If you are a member of a defined benefit pension scheme, you may not automatically be worse off; for example your scheme may offer more generous pension increases than the statutory minimum. As is often the case in pensions, the devil is in the detail and, crucially, this is distinctly lacking from all sides at present.

Did you know that the biggest single piece of good news for investors in the Budget was that individual savings account (ISA) ceilings have not only been maintained at the increased rate set by the outgoing Government, but have finally been index-linked? This frees the savings industry from the yearly round of lobbying the government to raise limits just to avoid inflation erosion. If inflation holds close to target, the current individual £10,200 allowance, £5,100 of which can be saved in cash, should rise by about 2% each year. For the 20 million people who already hold an ISA, higher capital gains tax makes them all the more valuable.

Tax planning to the fore

June's Emergency Budget means that tax planning is more important than ever.

The headline Budget increase was to capital gains tax rates and, from 2011, VAT. However, hidden among the Budget announcements, there was a variety of other measures to help reduce the Government's deficit. For example, the Chancellor confirmed his predecessor's intention to raise all national insurance contribution rates by 1% from 2011/12. Next tax year will also see a cut of around £1,650 in the starting point for higher rate tax, compared with Mr Darling's plans, and this threshold will not move in 2012/13. There was also a range of tax credit 'reforms', which could effectively amount to tax increases for you because they set a lower income ceiling for eligibility.

Realistically, there is virtually no chance of the tax environment improving for the duration of this Parliament. Government borrowing will still be higher in 2015/16 than it was last year, according to the newly created Office for Budget Responsibility. Indeed, taxes could increase further if the spending cuts to be detailed in October do not work as planned.

If you want to minimise the impact of the Emergency Budget changes on your household, your first action should be to review your tax planning. Tax plans put in place two or three years ago may now be out of date. For example, the independent taxation of married couples and civil partners now offers more scope for planning than it did before 6 April 2010. As ever with tax planning, the DIY approach is not the one to choose: in this complex area you need expert advice to avoid the pitfalls.

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