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Helping you face the future with knowledge and confidence

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I started our newsletter in August with a brief synopsis of the unexpected series of events we had witnessed in the first half of 2016 and suffice to say that these continued for the remainder of the year. I don't think that anyone could have seriously predicted the outcome of the referendum and the US Presidential election or indeed how the investment markets would behave subsequently. It certainly feels like a rather different world to twelve months ago and I think we are all now used to expecting the unexpected! I find I turn on the news in the morning with anticipation to find out what Mr Trump has been tweeting overnight but it would be more amusing if he didn't happen to be the President of the United States.

Despite these huge political events in Europe and America it would seem that business has decided to simply get on with it and carry on as best it can and seek to exploit any positives that can be taken and this has certainly been reflected in the main investment indices with the FTSE 100 and DOW reaching new highs in February. Following the decision to leave the EU and the impact on sterling, these events have consequently led to particularly encouraging portfolio valuations, especially when comparing them with available deposit rates and inflation. It is also promising that the general global economy is showing signs of recovery but there remain significant concerns over Brexit negotiations and major elections across Europe which, whilst one would like to think these have been priced in, we still believe there will be a shocks over the coming months. More of this in Investment Matters.

Philip Hammond's Spring Budget was expected to be fairly low-key and so it transpired, unless you are self-employed or a business owner taking dividends as part of your remuneration package, in which case it was not good news! Class 2 national insurance contributions for the self-employed are to be abolished from April 2018. The main rate of class 4 national insurance contributions is to rise from 9% to 10% in April 2018 and then by a further 1% in April 2019. In April 2016 a £5,000 tax free dividend allowance was introduced for individuals, meaning that the first £5,000 of dividend income they receive in the tax year, whether from their investments or from the shares they own in their limited company, is free from income tax. Any dividend income received in excess of the tax free dividend allowance is taxed at 7.5%, 32.5% or 38.1% depending on the individual's marginal rate of income tax. This dividend tax free allowance is going to be reduced to £2,000 from April 2018. There was, however, some good news…..Mr Hammond confirmed that there will be a green paper published later this year setting out the government's view on some of the options that could be considered to help to meet the long term challenges of funding the social care system. The chancellor ruled out the option of a "death tax", a tax on the estates of everyone who dies, which had been put forward by the most recent consultation paper. Looking after the interests of an ageing population continues to be one of the biggest challenges facing this and future governments.

For Fraser Heath it has, as ever, been extremely busy and we are looking to increase our team further. With new pension freedom and the complexity that comes with it our services are in more demand now than ever. We have a new financial planner starting in March and plan to grow the adviser team further in short order, as well as bringing in extra support in the para-planning team. Congratulations must go to Miranda Wood and Michelle Lewis who have recently celebrated 10 years with the company and we thank them for the great work they continue to do for Fraser Heath.

I hope you find the newsletter helpful and informative.

Jim Collier

In this issue…

Investment Matters

2016….the year of surprises! According to bookmakers, the odds on Leicester City winning the football Premiership, the UK voting to leave the European Union (EU) and Donald Trump becoming leader of the United States would have seen a modest £1 bet turn into a £4.5 million fortune! It was a disastrous year for pollsters, who consistently got it wrong, and, arguably, a great year for the underdog!

When I sat down to write Investment Matters this time last year, markets were worried. There were concerns over the strength of the Chinese economy, worries about the impact of expected interest rate rises in the US on Global emerging markets and uncertainty over whether David Cameron would be able to persuade his European counterparts to give up enough ground for him to be able to win the day in the upcoming referendum. Well, one year on, the Chinese government have helped to stabilise their economy for the time being, interest rates in the US only rose once, in December 2016, instead of the predicted three times and Mr Cameron?……..well he failed!

Following the vote to leave, we saw a changing of the guard at 10 Downing Street, with David Cameron's resignation and Mrs May's appointment as the new PM. She quickly appointed an "inclusive" cabinet of colleagues from either side of the argument, with Boris Johnson perhaps her most controversial appointment as Foreign Secretary. She appointed David Davis, one of the other leading voices for the Leave campaign in the run up to the referendum, as Secretary of State for Exiting the European Union. He will obviously have a crucial job to do in the next couple of years once the Government triggers Article 50 to start the formal process of extricating the UK from the EU, which is expected to happen next month.

The most obvious immediate impact from the referendum result was the fall in the value of sterling when compared to all other major currencies. This currency devaluation has also helped propel the FTSE 100 Index to an all-time high, given that more than 75% of the earnings of the constituent companies within the index come from outside the UK. This means that our investment and pension portfolio valuations have looked good in the last six months or so, especially for investors who have been willing to accept more risk.

Despite polling approximately 1 million fewer votes than Hillary Clinton, Donald Trump was elected President of the United States in November 2016. The first month of his presidency has been punctuated by controversial appointments to senior positions, a raft of Executive Orders including a ban on immigration from 7 specified countries and ongoing spats with both his own security services and the press! From an economic perspective, whilst the markets approve of his plans to invest heavily in US infrastructure he has reaffirmed his intention to "Put America First", one of his campaign pledges, which has provoked concerns around the World about the threat of the rise of "protectionism".

2017 will be a big year for elections in Europe. Following on from the resignation of Italian Prime Minister, Matteo Renzi, after defeat in the Constitutional Referendum in December 2016, voters in both France and Germany go to the polls later this year. The significance of Renzi's resignation is that he was one of the most pro-EU of all of Europe's leaders and, should Marine Le Pen be successful in the French general election in April, the very future of the European Union will be called into question yet again. Le Pen has promised a referendum on France leaving the EU if she is elected. Angela Merkel will also fight an election this year, in September. Each of these votes will have the potential to trip up investment markets and so fund managers are cautious about prospects for European equities this year.

Instead of European equities, global managers have been adding to their Japanese holdings in recent months, as Mr Abe's plans to propel the Japanese economy forward have now entered their fifth year. In truth, his economic revival plan known as "Abenomics" has stuttered so far. However, he has presided over two consecutive years of strong stock market growth (for sterling investors) and there is a consensus among fund managers that Japanese stocks could well have another good year.

The prospects for Asian markets have also improved in recent months and, as Asian equity managers will tell you, these markets do not have to worry about many of the problems that equity investors in the UK, Europe and the US are worried about. Valuations and yields in Asia look attractive, especially compared to the US, and this region is unlikely to face the same level of political uncertainty as the West.

UK commercial property fund prices have started to recover following a rash of fund suspensions after the referendum result. Many funds were suspended to allow managers to sell holdings to pay redemptions for those investors looking to exit. This strategy allows managers time to secure a good price for the property but does, understandably, cause confusion and worry for investors. All of the funds reopened by the end of last year and are making progress again now. We continue to like commercial property as an asset class and so we retain a healthy exposure to it in our model portfolios.

So, in summary, 2017 is likely to be a challenging year both politically and economically. Investors may well be asked to exercise patience and hold their nerve at times this year. However, as long-term investors, we should continue to trust the skills of fund managers with proven track records and not get carried away by the "noise" in the markets that often distorts the real position.

Mark Fletcher

Pension News

Pension Lifestyling

Lifestyling is the term that the pension industry gives for the gradual way in which the nature of the funds in your pension changes as you approach retirement. There was a time when this reduced risk, but two changes, one to the economy and the other in legislation, means that if you have this strategy in your pension, you may be taking a lot more risk with your pension pot than you thought you were.

A traditional lifestyling strategy will see the funds in your pension pot move from being in a mixed portfolio of different investments, mostly in company shares, to being invested 25% in a cash fund and 75% in a Pension Protector fund. When you look under the bonnet of a Pension Protector fund you find that it is invested in gilts and corporate bonds with a long date until maturity. This is because an annuity provider will invest in these instruments when they convert your pension pot into a guaranteed income for life. Being invested in these investments protects the buying power of your fund when it comes to buying an annuity.

The change in economic conditions over the past quarter of a century has seen an ever-dwindling income from long dated gilts and bonds. 10 years ago, the income for a 15-year gilt was over 5% but is currently around 1.5%. This low yield means that small changes in the expected direction of interest rates can have a big impact on the value of the investment. For example, in the 12 months to 31st January 2017, the value of the average Pension Long Bond fund has been more than twice as volatile as the UK Stock Market as measured by the FTSE 100.

The legislative change is that since the introduction of Pension Freedom in April 2015 your pension pot does not have to last your lifetime and you do not have to buy an annuity. If you prefer, you can cash your pension pot in at retirement or keep it invested and access money from it flexibly. In this case, if your pension is lifestyling into long dated bonds, your pension fund is increasing exposure to an investment that has been twice as risky as the stock market with the dubious benefit of protecting the buying power of an annuity that you don't intend to buy.

Many pension companies, but certainly not all, have introduced changes to lifestyling so that you can choose a strategy that targets cashing the pot in or targets accessing your money flexibly. These updated versions will follow an appropriate strategy if you select them. To avoid a potentially nasty fall in the value of your pension just before you retire, particularly if you are within five years of retirement, we recommend that you check the strategy your pension is following.

Your Final Salary Pension

The personal finance pages of the Sunday papers are full of discussion around the high transfer values that some pension schemes are quoting for members of final salary schemes. The low income that schemes now get from the bonds and gilts that they must hold to meet the income requirements of their members, means that they need to have more reserves available to provide the income they have promised. These higher prices are reflected in the transfer values they quote.

The introduction of Pension Freedom means that for some people who already have the prospect of a secure income in retirement that will meet their needs, transferring a part of their Final Salary pensions into a Personal Pension can provide a lot more flexibility. It can allow you to spend part of the pension fund spread over the early years of your retirement, rather than over your lifetime, potentially improving the quality of this part of your retirement.

When assessing whether to transfer is right for you we start from the assumption that it will be best to stay in the scheme. After all, what is there not to like about a guaranteed income for life? For many people it simply doesn't make financial sense to give up this benefit.

But some clients are in the small minority that should seriously consider their options. This might include people with more secure income than they need, those who feel comfortable taking an investment risk and can cope if the investment strategy doesn't work as well as hoped, those who are single who would otherwise have a pension that factors in a widow's pension that will never be used and those with a shorter than average life expectancy. If you are close to your retirement and have a final salary pension scheme, make sure to speak about it with your adviser at your next review meeting.

Miles Hendy

Pension Contributions and High Earners

The "Annual Allowance" is the maximum we can contribute to a Pension in a tax year, currently £40,000. Since 6 April 2016, the Annual Allowance is reduced by £1 for every £2 that income exceeds £150,000, potentially falling as low as £10,000. Importantly there is a wide range of income that counts towards the threshold including pay, bonuses, benefits in kind, employer pension contributions, and investment income. The tapered reduction may not apply if your income before employer pension contributions is under £110,000.

If you are caught by the restriction you may need to be prepared to pay income tax at your highest marginal rate on the contribution exceeding your Annual Allowance. This may well catch out high earners in company pension schemes, especially this year. If you are caught by this, you may be able to make use of any unused Annual Allowance from the three previous tax years and avoid the tax charge.

Be careful when taking your benefits.

The new Pension Freedom rules with the ability to draw on your pension pots flexibly is naturally very useful but it is important to avoid the pitfalls. As soon as you start to withdraw any of the pot other than the tax free cash using the new rules, the amount you can contribute back into your pension is reduced from the standard Annual Allowance to what's called the Money Purchase Annual Allowance.

From April 2017, the Money Purchase Annual Allowance reduces from £10,000 to £4,000. So before dipping into your pension pot, it is vital to consider what further pension contributions you might want to make afterwards. A particularly dangerous pitfall for the unwitting is if you had a small pension and decided to cash it all in you will have taken more than just the tax free lump sum and you will be stuck with the £4,000 Money Purchase Annual Allowance in the future. If you are considering drawing on one of your pensions but are still planning to continue working, please contact us for advice before acting on it.

In view of these significant changes, it is important that you contact us if you feel you may be affected and have not had an opportunity to discuss this with your adviser.

Jim Collier

Notebook

AS A REMINDER …….

Are you receiving state pension? Your chance to top this up is running out.

As you may know from previous newsletters, if you are a man born before 6/4/1951 or a woman born before 6/4/1953 and are in receipt of State Pension it has been possible to 'top up' their additional State Pension. This scheme is available to all pensioners who reach State Pension age before the introduction of the new State Pension on 6 April 2016. However, the scheme closes on 5 April 2017 and so time is running out. The State Pension top up will give pensioners an option to boost their entitlement by up to £25 a week and is index-linked to protect from inflation. In particular, it could help some women and those who have been self-employed whom, historically, tended to have low earnings-related State Pension entitlement. This will also be of interest to those where taxable income is within the personal income tax allowance. The Government have launched a calculator to illustrate the cost of purchasing extra State Pension which can be found at www.gov.uk/state-pension-topup

The Lifetime Allowance and Protecting Your Pensions

As you will all know, the Lifetime Allowance (LTA) now stands at £1,000,000. The LTA has gradually reduced from its peak of £1.8 million in April 2012, to £1 million in the current tax year. We have discussed the various different regimes of how to protect your LTA if you qualify and keep it at a higher level than the current LTA. It is still possible to apply for Individual Protection 2014 and acting before 5th April this year is the last chance to do this. If you had pension funds valued at over £1.25 million at 5/4/14 you can still apply and for Individual Protection 2016 you would need pension funds in excess of a £1 million as at 5/4/2016. If you have made no pension contributions this financial year you can also still apply of Fixed Protection 2016 in order to preserve your LTA at £1.25 million but you can make no further contributions – this was covered in our August Newsletter.

In a similar way to the reduction in the annual allowance for high earners, the reduced level of LTA will have a significant impact on a large number of people, particularly people with long careers in final salary pension schemes and if you have not discussed and investigated the issue we would recommend that you get in touch with your financial adviser to discuss your situation as a matter of urgency.

What's next for Mortgage Rates?

On the base-rate front, although last autumn there was talk of further cuts to the historic-low rate of 0.25%, in fact opinion has since swung the other way, with sentiment now suggesting the next change will be upwards.

Depending on whom you believe, however, this could happen anytime between now and 2019.

This market shift has led to a rise in swap rates which influence fixed rate mortgages, therefore putting lenders under pressure through inflated funding costs.

As a result, some experts believe mortgage rates are likely to rise in 2017 and homeowners should take advantage of low rates and remortgage to secure reduced monthly repayments while they still can.

As one expert commented 'the age of low interest rates is certainly not over but there's no question that rates will eventually rise'.

All in a good cause

On a completely separate note, I would like to direct you to the Common Oars Website. My nephew Oliver Buck is one of a team of four who are trying to break the world record for rowing around UK non-stop and unsupported whilst trying to raise £75,000 for the Nuvasive Spine Foundation. Having suffered with back trouble myself and knowing the impact it has on an individual and their family's lives, I think this is an excellent cause.

The challenge is due to start in May 2017. For each of the rowers It will mean from the moment they leave from beneath Tower Bridge, London, they will row 2 hours on, 2 hours off until they return and the challenge is completed. The current world record stands at 26 days 9 hours, 9 minutes and 4 seconds. They want to beat it and believe they can. This feat has only been completed by 14 people. To put that in to perspective, more people have travelled to the moon.

I hope you agree this is a good cause and feel able to help support it. For more information and details of how to give please go to www.thecommonoars.com

Jim Collier

Helping you face the future with knowledge and confidence.
Visit our website or call us today for further information

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