# 360

from **AW Financial Management LLP** **October 2011**

## In this issue



*Welcome* to our Autumn edition of 360. We hope that you have received this newsletter by an email link to our website, as we continue to be as environmentally friendly as we can. Please therefore do not print this newsletter unless you really need to. If we currently send you a paper version but you are able to receive this by email, please let us know your details so we may add your email address to our records.

The phrase "It's always darkest just before dawn" may well be appropriate for us at this time. We just don't know when the next bad news story is going to occur, although we're fairly sure there will be some - and this again could put markets into a tail-spin. However, at some point, we are confident that the pilot will get the plane under control and start to fly again.

The question is, how many passengers will he have left?

## Global Markets and your portfolio

Last quarter we commented that Equity markets had been volatile over the previous 3 months. But as the Eurozone crisis rumbled on, with the Summer holiday period came a huge wave of selling Equities and so global stock markets fell dramatically. The FTSE 100 index lost over 9% in the first week of August. So Equity values have yet to come good for the longer term investor, in comparison with other markets such as Fixed Interest and even Cash. So putting the same data as last quarter before you, you will note that the total return from the lower risk portfolios has been better again than for the higher risk portfolios (taking the 3 months from the date of writing - mid October):

| Description | AWFM risk model | 3 months | 1 year |
|---|---|---|---|
| Low risk | 3 | -5.34% | -3.86% |
| Low to medium risk | 4 | -6.09% | -2.03% |
| Medium risk | 5 | -8.22% | -2.87% |
| Medium plus risk | 6 | -11.21% | -4.16% |
| Medium to high risk | 7 | -12.90% | -4.84% |
| Adventurous risk | 8 | -14.18% | -4.99% |

So even the more defensive lower risk portfolios have struggled in both the short term and the medium term which is concerning. It is perhaps interesting to ask ourselves the question, where do we think we are on the "emotional investment" graph shown on page 2 ?

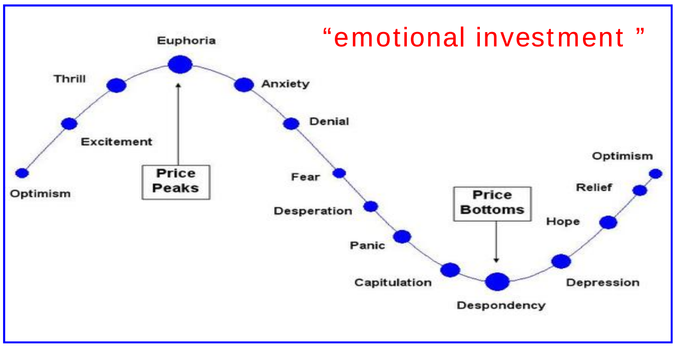
"Watch out! Be on your guard against all kinds of greed; life does not consist in an abundance of possessions."
Luke 12 verse 15

## Global Markets and your portfolio cont…

It has been a long and painful road for many thus far, and many will be tempted to quit.

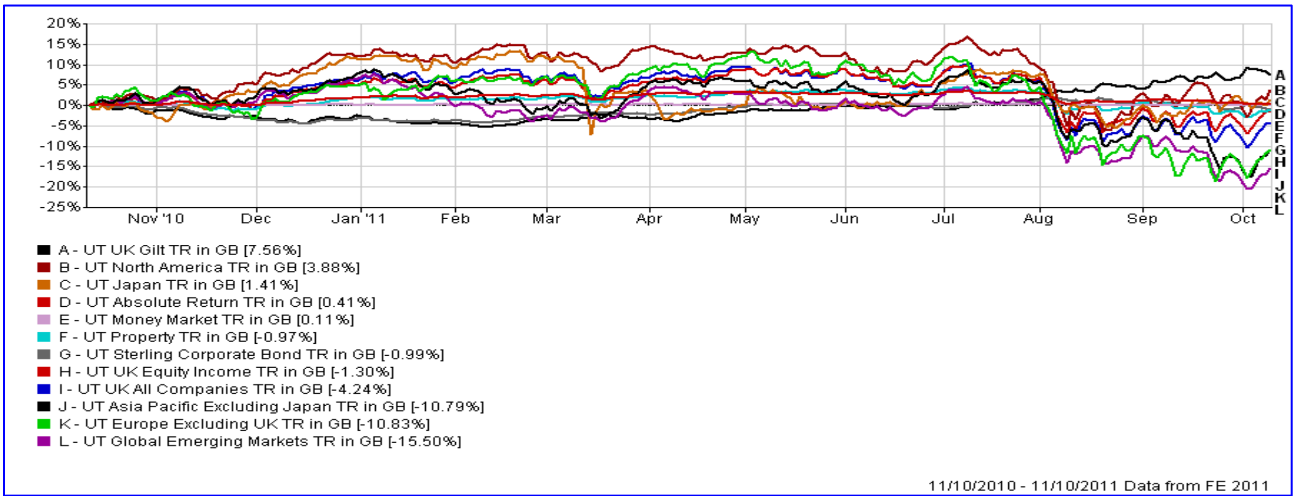
Looking at the graph of "emotional investment" which may be new for some, you see that the point of maximum return starts at the point of "despondency" which has followed on from—"Fear, Desperation, Panic and Capitulation".

These are negative emotions which to some extent we can all relate to.




## Investment Returns

Taking this thought process one stage further, we ask ourselves, what might be one of the most attractive sectors to invest in right now? The answer might well be Europe! Whilst many fund managers (see below) view the sector as "Negative" over the next 12 months, we should also recognise that there are many European companies who continue to operate on a robust financial basis and as such, could offer significant returns in an improving market. We therefore believe it prudent for the time being to retain our portfolio asset allocations broadly in the region of 2-8% in the European sector.




Turning now to what is in front of us, we consider what are likely outcomes for investment sectors over the next few months and years. Using the same indicators as we did in our last newsletter (the Sentiment Indicator produced by Skandia) we remind you that the indicator seeks the views of 26 fund managers on various investment themes for the coming 12 months. Skandia's latest publication included the following analysis which we have summarised below:

| | | |
|---|---|---|
| POS | **A POSITIVE outlook -** the fund group believes the index they are using as a benchmark will rise in excess of 5% over the next 12 months. | Fund managers include UK and US Equities, Emerging Markets, Far East excluding Japan. Coming into the positive sector this month are Japan and BRIC. |
| NEU | **A NEUTRAL outlook -** the fund group believes the index they are using as a benchmark will have either a positive or negative movement of between 0% and 5% over the next 12 months. | Sectors now include UK Property, UK Corporate Bonds and Global Bonds |
| NEG | **A NEGATIVE outlook -** the fund group believes the index they are using as a benchmark will fall in excess of 5% over the next 12 months. | Sectors are now focused on Europe and UK Government Securities (Gilts) for perhaps very different reasons |

This analysis is very much in keeping with our own views that Equity funds are likely to offer the best returns over the mid term but we have to be prepared to put up with the volatility.


## Reduced Income

**PENSION INCOME DRAWDOWN**

If you are invested in Pension Income Drawdown, you probably need to take particular notice of this article. We are all familiar now with the problems associated with those who have retired in the last 10 years or so. The obvious impact has been with regard to loss of savings interest, but many will have been promised a higher pension income too through an annuity but when they have come to draw on their pensions, they have been astonished at the incredibly low rate of return offered by their annuity provider.

Many have opted for Income Drawdown which is a flexible income alternative. However, there have been some significant changes to the way Income Drawdown income is calculated and this has had, or will have a fairly major impact on an individual's retirement income. A more detailed appraisal of the rules can be found on our web-site www.awfm.co.uk /Fact Files & Downloads/New Income Drawdown - Dec 2010

We knew that some changes were likely and where possible, we have been alerting our clients to the likelihood that their income may need to be reduced but even we have been amazed at the dramatic effect of a convergence of issues which have in some cases required a client's pension income to be halved.

There are three main factors which together have caused such disruption to client's income when the client's 5 year review point for income is triggered:

1. Reduction in allowance. Prior to April 2011, the income that a client was able to draw out of their fund was 120% of the single life annuity rate. This was cut to 100% and so immediately saw a reduction of about 17% of the maximum income previously being paid. Furthermore the Government Actuary's Department (GAD) produced a set of tables to be used for Drawdown. GAD's 2006 tables applied until April 2011 at which point new tables had to be used. Using the age 65 male figure, this has reduced from £60 to £56 which is a further reduction of 6% or thereabouts.

2. Falling Values of Pension Funds. This factor has probably the least impact overall, but it is a factor. At the point the income is reviewed, if the fund is lower, a lower income will result until the income is reviewed again 3 years later. This factor may in some cases have applied a reduction of maybe 5% of the income, but is unlikely to have been much more than this.


3. Falling Gilt Yields. This is the most significant factor which also makes the alternative of purchasing an annuity extremely unattractive too. At the time of writing the 15 year Gross Redemption Yield is about 2.83% which for the purposes of the GAD tables has to be rounded down to 2.75%. In April 2006 the Gilt Yield was about 4.3% and reduced to 4.25% for the purposes of the table. This factor alone therefore has contributed about 35% of the reduction in drawdown income.

Clients will be constrained to this reduced level of income for 3 years until the next review unless they can prove that they have other pension income of at least £20,000 per annum. If they can prove this, they are entitled to continue to draw any level of income they choose using Flexible Drawdown.

Income Drawdown needs the demand in Gilts to fall away dramatically so that the price and value of Gilts decline, at which point the Gilt Yield should rise. They also need Interest Rates to rise again to improve the yields on Gilts. However, the latest round of Quantitative Easing recently announced is, if anything, going to push Gilts the other way in the short term and there is absolutely no sign of interest rates being raised any time soon thus the outlook is fairly bleak on this front. Annuity rates are also affected however and so this does not give any reasonable way out of the mire. As part of our client review process, we will be looking at the personal implications of this with those clients who are affected, but we felt it appropriate to give a general overview of the problem here.

KAMES CAPITAL

AEGON Asset Management has rebranded itself as Kames Capital with effect from 1st September 2011. We are informed that the new brand remains an integral part of the global Aegon Asset Management group of companies and will continue to manage funds on behalf of its sister company Aegon UK – itself previously known to everyone as Aegon Scottish Equitable.

| Previous Fund Name | New Fund Name | OBSR rating |
|---|---|---|
| Aegon Ethical Corporate Bond | Kames Capital Ethical Corporate Bond | A |
| Aegon Ethical Equity | Kames Capital Ethical Equity | AA |
| Aegon High Yield Bond | Kames Capital High Yield Bond | AA |
| Aegon Investment Grade Bond | Kames Capital Investment Grade Bond | AA |
| Aegon Sterling Corporate Bond | Kames Capital Sterling Corporate Bond | AA |
| Aegon UK Equity | Kames Capital UK Equity | AA |

The existing fund managers all remain in place and our fund research providers (Old Broad Street Research Ltd (OBSR)) remain comfortable to retain the funds existing ratings. We therefore do not intend to effect any immediate fund switches as a result of this change.

The funds detailed here appear in some of our client portfolios and have simply resulted in a logical name change.

## Mission News

Clients of Martin's — Jeff & Deborah Keys, who run a couple of businesses in Hodsoll Street, near Meopham, are just about to embark on a Mission trip to Brazil to work on a housing project called Open Hands.

The project re-houses families living in Brazil's worst slums or "favelas". Each new house costs around £5,000 to build and transforms the lives of the families that move in. The local church offers vocational and life skills training for these families and the local authorities provide running water and sanitation.

**BEFORE**

**AFTER**

"We are paying all our own expenses but want to raise at least £5,000 on top to fund a new house." says Deborah, "This is an amazing opportunity to make a practical and sustainable difference for some of the world's poorest people."

We are supporting this initiative. If you would like to support the project too please send donations, payable to **Mission Direct**, care of Keys Solicitors, Unit 3 Pettings Court Farm, Hodsoll Street, Wrotham, Kent TN15 7LH.

Alternatively you can donate online at:
http://uk.virginmoneygiving.com/MissionDirectKeys

If you do donate, just mention AWFM in your online comments so that Jeff & Deborah know how you came to hear about their trip.

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