360

from **AW Financial Management LLP** **July 2013**

Welcome to our July edition of 360. This is our quarterly update on all things financial and we hope you find the articles, reports and commentary both useful and informative.

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Quantitative Easing

Stock-Markets have taken a bit of a tumble over the last couple of months. The trigger event for this was a comment from the Chairman of the US Federal Reserve (Ben Bernanke), indicating that they may begin cutting back their Quantitative Easing programme (currently printing $85b of new money each month to purchase US Government bonds) in the not too distant future, as the US economy is showing signs of recovery.

This announcement particularly sent Equity Markets (shares) downward due to fears that withdrawing this money printing programme will reduce the liquidity (cash flow) in the corporate markets, and therefore the earnings and profitability of companies. As ever there are two ways to view such news; on one hand the reduction in the flow of money could cause a slowdown in the future, but on the other hand, the fact that the US economy is looking more robust is probably good news.

Global Markets and your portfolio

These portfolio performance figures below provide a reasonable indication of the levels of return each investor will have received over the time scales shown, according to their risk profile.

Description	NEW AWFM risk model	3 to 5 year Portfolio (shortest term)		21 year + Portfolio (longest term)	
		3 months	1 year	3 months	1 year
Cautious risk	1	0.46%	3.60%	-1.61%	7.97%
Cautious to moderate risk	2	0.49%	5.59%	0.18%	15.71%
Moderate risk	3	0.04%	9.38%	0.12%	20.45%
Moderate to adventurous risk	4	-0.44%	13.95%	-1.33%	21.04%
Adventurous risk	5	-0.31%	23.66%	-2.19%	19.36%

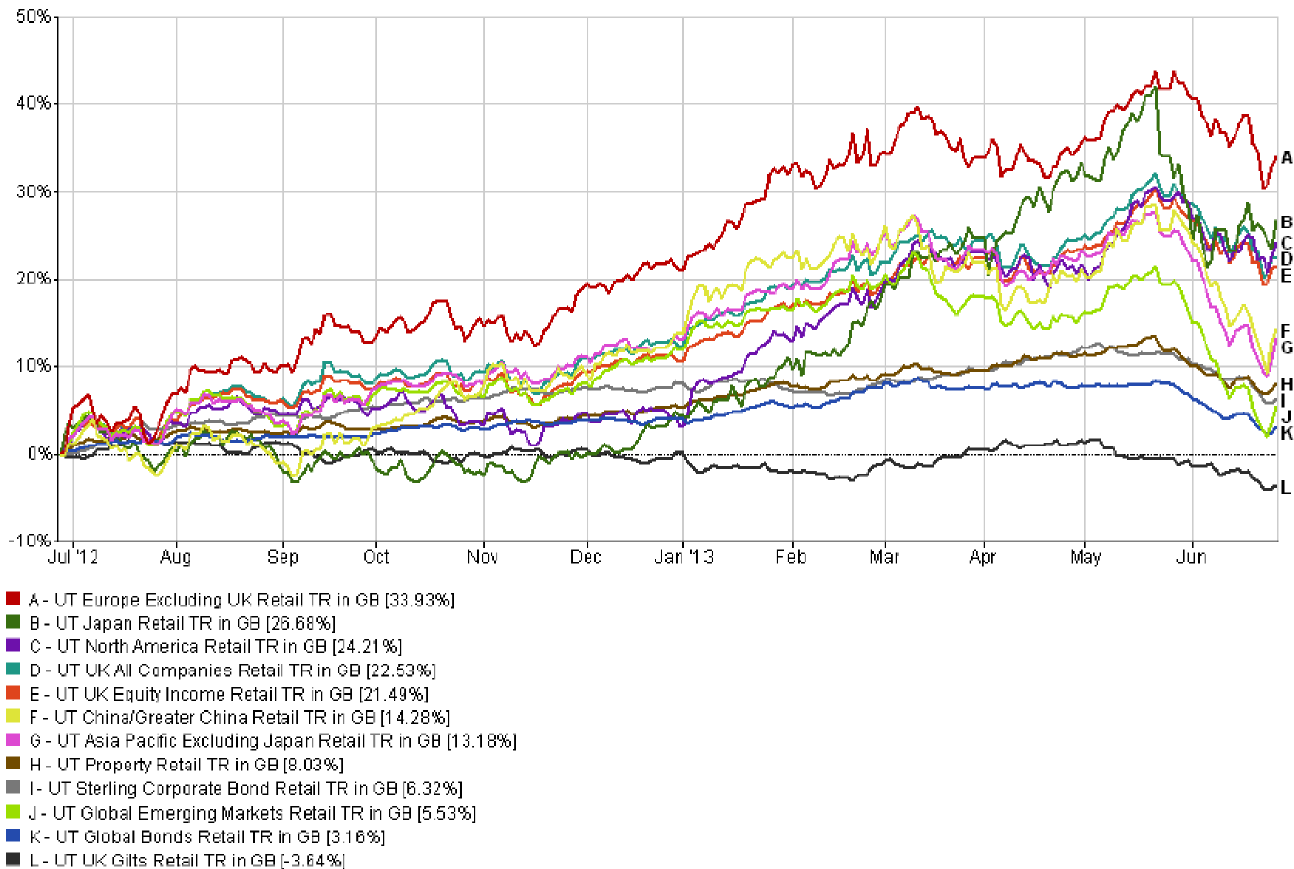
As mentioned above, Markets have taken a downward turn in last month or so, which is noticeable from the 3 month performance figures. The gains of up to 6% made from March to the middle of May were more of less handed back to investors over the last month. However, as the 1 year performance figures show, it's not all bad news! Most Markets have still gained significant ground over the last year.

It is particularly interesting to note the 3 month performance of our lowest risk portfolio with the longest investment term (Strategy 1 over 21 years +). The reason for this surprisingly larger drop than our medium risk portfolios is mainly due to the fairly significant position in Gilts (UK Government Bonds) which have struggled over the last 2 months, as you will see overleaf. The 3-5 Year version does not hold any Gilts at present for this very reason, as we took the decision to sell out of Gilts completely for this portfolio over a year ago. So far this seems to have been a good move!

Keep your life free from the love of money, and be content with what you have. *Hebrews 13:5*

Investment Returns & Outlook

Markets have continued to climb since our last newsletter, albeit with a quite a drop in the last month or so, as described on the previous page.



Again, UK Gilts are struggling and have now posted a negative return over the last year of -3.64%. Is this the end of the 32 year Gilt bull run? Will they drag the rest of the bond market with them?

Europe and Japan have both come out tops again but with a considerable amount of volatility (value fluctuation) - just look at that drop in Japanese Equities of about 15% in May to June.

Despite this recent downturn however, as you can see from the chart above, most markets, even Corporate Bond markets, have posted very strong total returns over this previous 12 months. Where will the markets go from here? The table below gives the consensus view from various fund managers about the future outlook from the various sectors represented.

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.	UK, Europe, US, Japan, Emerging Markets and BRIC (Brazil, Russia, India & China) Equities.
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.	Remaining in this category from last month are UK & Global Property, UK Corporate Bonds (although see note below) and Pacific Ex. Japan Equities. Coming back into the Neutral zone from Negative is the International Bonds sector.
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.	UK Government Bonds (Gilts) continue to be negative almost unanimously across all the fund managers but Corporate Bonds have half joined this zone as they are currently viewed as somewhere in-between Neutral and Negative.

Many commentators are saying that this recent lull is a great buying opportunity (purchase assets at a cheaper price and your gains in the long term should be even better). The most significant factor that is likely to affect all the markets is the withdrawal of the US Fed's QE programme as described overleaf.

We believe that Equity markets are likely to continue to perform well in the years to come, although this could come with some strong volatility in the short term. We continue to remain cautious about Bonds, particularly Government Bonds. Commercial Property continues to bring diversification benefits and acts as a stabiliser when Equity markets fall, as we have just seen. The growth prospects in the short term are unlikely to be exciting but the fundamentals of capital growth with regular rental income continue to be attractive in our minds. As ever, we continue to recommend investing in a wide range of assets to aid diversification and provide potential for good returns in different market conditions.

China—Debt Laden or Investors Dream?

China is causing problems in the markets at present, on top of the QE issues already outlined. Economic indicators are showing signs that the country's output is slowing. Gross Domestic Product (GDP—a measure of a country's economic output) for China was only 7.7% (annualised) in the first quarter of this year and this, coupled with the Government's efforts to stop Banks lending so frivolously and secretly, helped send equity markets down over the last month or so (particularly in the Far East).

But 7.7% is a fantastic growth figure you cry ! It is when compared to the UKs meagre GDP figures which are barely creeping above 0.3%. However, 7.7% is considerably lower than the countries 10%+ figures which have been precedent over the last 3 decades. The fact is, these 10%+ figures are unsustainable, driven by excessive borrowing and investments which are great for economic growth figures but not so good for a county's economic health overall. Rating agency Fitch says debt relative to GDP reached 198% at the end of 2012, which is a worrying increase from the already high figure of 125% in 2008.

What are investors to make of all of this? Surely this debt driving growth model that China is employing can't last forever? Will the government be able to stimulate growth whilst bringing the debt burden under control? A difficult task that we know only too well here in the UK. Our approach of using Global Equity funds in the main will give the fund managers the ability to decide whether to invest in China and the Far East or to trim their weightings. Currently many are trimming.

Gilt Yields Rising—Good News For Pensioners

The upside to this recent market slump is that Bond Yields have risen sharply over the last month or so, as when bond values fall, their yields go up (the interest being paid is the same but is a higher percentage due to a smaller value). For example, the UK 15 Year Gilt Yield has risen from 2.54% to 2.94% over just one month

But what does this mean for Pensioners? This is good news for pensioners because the mechanism used to calculate the maximum income they can draw from Income Drawdown pensions is based on the UK 15 Year Gilt Yield. The higher the Yield the more income they can draw out. For example, a 65 year old with £200,000 in an Income Drawdown pension could only draw out £13,440 p.a. with the 15 Year UK Gilt Yield last month, but with this higher figure they could draw out £13,920 p.a.—a £500 per annum increase. If the 15 Year UK Gilt Yield rises yet further to in excess of 3% then the maximum income would increase to £14,160 p.a.

Gilt yields have got a long way to go before they get back to historic levels of 4.50% back in 2006 but this increase over the last month or so will certainly help to produce more valuable income for some. It does of course depend on when your Income Review is due (usually every 3 years or every year if you are over 75). For some clients it is possible to request an Ad-Hoc Income Review which may be able to boost their income, particularly if they haven't had an Income Review this year. If this is something you would like us to consider for you then please do get in touch.

Of course this also good news for clients who decide to purchase an Annuity with their pension pot rather opt for Income Drawdown, as Annuity rates are also broadly linked to Gilt Yields. The question is—will these Yields continue to rise or have we seen the best of it?

New Man At The Top

Mervyn King (left), the outgoing Governor of the Bank of England (BoE) is also leaving the Monetary Policy Committee (MPC—the group who set the BoE base rate) and being replaced in both roles by Mark Carney (right), former Governor of the Bank of Canada and economist for Goldman Sachs.

Much speculation has been made as to whether Carney's approach will be similar to King's (allow inflation to keep above their 2% target whilst keeping interest rates as low as possible to try and stimulate growth). However Carney, although the new Governor, will only have one vote in the MPC meetings just like King. What difference will his coming really make? We will have to wait and see.

HEAD LINES

- George Osborne has announced further cuts of £11.5 billion to the public sector which is to be offset with a multi-billion 6 year infrastructure spending project
- The Department for Work and Pensions have put forward proposals for an increase in the protection offered from the Pension Protection Fund (PPF) for long serving employees (20 years plus) with Defined Benefit Schemes (Final Salary or similar). The suggestion is an increase from the normal cap of £31,380 to a cap of £45,000 per annum
- George Osborne has confirmed that he is looking for ways to sell the tax payer's holding in Lloyds TSB but the issue of what to with the tax payer's holding in RBS is still unresolved.
- Both the EU and now China are looking to find ways to prevent the need to bail out large national banks but are struggling to do so without spooking the markets
- Co-operative Bank Plc has had to renege on some of its debt repayments, offering a switch to Shares in the company but still posting significant losses for large bond holders, in a bid to raise more than £1.50 billion in order to balance the books - a bit of a farce considering Co-Op were about to buy a large number of Lloyds branches just recently
- In lighter news, the Office for National Statistics (ONS) have announced that there was no 'Double Dip' recession in 2012, as revised figures show growth was flat in the first Quarter of 2012—the recession that never was!

Discretionary Trusts Loophole Closed

Discretionary Trusts lose a significant advantage as HMRC announce simplifications to the rules surrounding Discretionary Trust tax charges. Whilst simplification of these complicated charges is welcomed, it means that Settlors can no longer assign a full Nil Rate Band (£325,000 currently) to each Discretionary Trust set up on different days. Instead they will have to share their Nil Rate Band across all the Trusts they setup, potentially causing tax charges for larger Trusts. This will probably stop Settlors creating very large Discretionary Trust funds.

In other news...

We are developing our future plans here at AW Financial Management LLP. As you will recall Jon passed the necessary exams to qualify as an Adviser last year. As of 1st July 2013 Jon has now **become an Associate Partner in the firm**. I'm sure you will join me in congratulating him on this significant achievement. Jon will continue to provide support to me over the next few years whilst he also begins to work with his own clients too. This will be gradual at first, whilst he combines his responsibilities of managing the office and helping me.

Edward has settled in well and is getting to grips with the various procedures and issues surrounding work in a busy professional office. Regrettably, I think he is now taller than me and can probably hit a golf ball further than me too (written with gritted teeth)! Edward is going to Tanzania again this year to help out at a school that members of our Church helped to build. If you are interested in what has been achieved in Tanzania, please see www.azar.org.uk.

As you will recall from the last 360 edition, Jon's wife gave birth to their first son on the 1st April 2013. We have now managed to secure a picture of young David which I'm sure many of you will appreciate.

Andrea, Toby and I are planning to stay at home again this year for our Summer holiday although we are hoping that we might have some decent weather so that Toby and I can get a few rounds of Golf in whilst Andrea lounges around in the garden! We'll see!

We all hope you have a really good Summer if we don't see you and look forward to seeing you again soon.

Contact us:

Tel: 0845 60 10 718
www.awfm.co.uk

Partners:
martin@awfm.co.uk
jon@awfm.co.uk

Administrators:
nicola@awfm.co.uk
edward@awfm.co.uk

PO Box 87
Crockenhill
Kent
BR8 9AP

If you have any questions about this newsletter or your existing investments, please contact us to discuss your situation further.

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