360

from **AW Financial Management LLP** **April 2014**

Welcome to our April 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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The 2014 Budget—A Budget for Makers, Doers and Savers

We have decided to devote our first newsletter of this year to the recent 2014 Budget announcements. There was much to sift through last week, including some real shocks and surprises, particularly to the Pension industry. Mr Osborne's plans to ensure that "no-one has to buy an annuity" hit the share prices of some Annuity providers hard, with Partnership's (special enhanced annuity provider) share price falling by as much as 55% in the first hour following the announcement.

In this issue we have tried to focus on the issues that we believe are most relevant to our clients and so we have focused on the changes to the Pension rules, the changes to the ISA rules including the new limit, the various new allowances and finally the new Pensioner Bond for those over 65. However, if you have any questions regarding the 2014 Budget that aren't answered in this Newsletter then please do get in touch.

Global Markets and your portfolio

The 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 the level of risk they wish to take and their likely investment term.

Description	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	0.22%	2.34%	1.27%	3.59%
Cautious to moderate risk	2	0.32%	3.40%	1.37%	8.31%
Moderate risk	3	0.28%	4.59%	0.87%	12.13%
Moderate to adventurous risk	4	0.29%	7.17%	0.19%	8.79%
Adventurous risk	5	0.04%	11.57%	-0.24%	7.20%

It is very encouraging to see such strong performance figures over the year, given the turbulence the markets have been through (and are still going through). Even our lowest risk strategy has provided a return over the year well above what is achievable in a current instant access bank account.

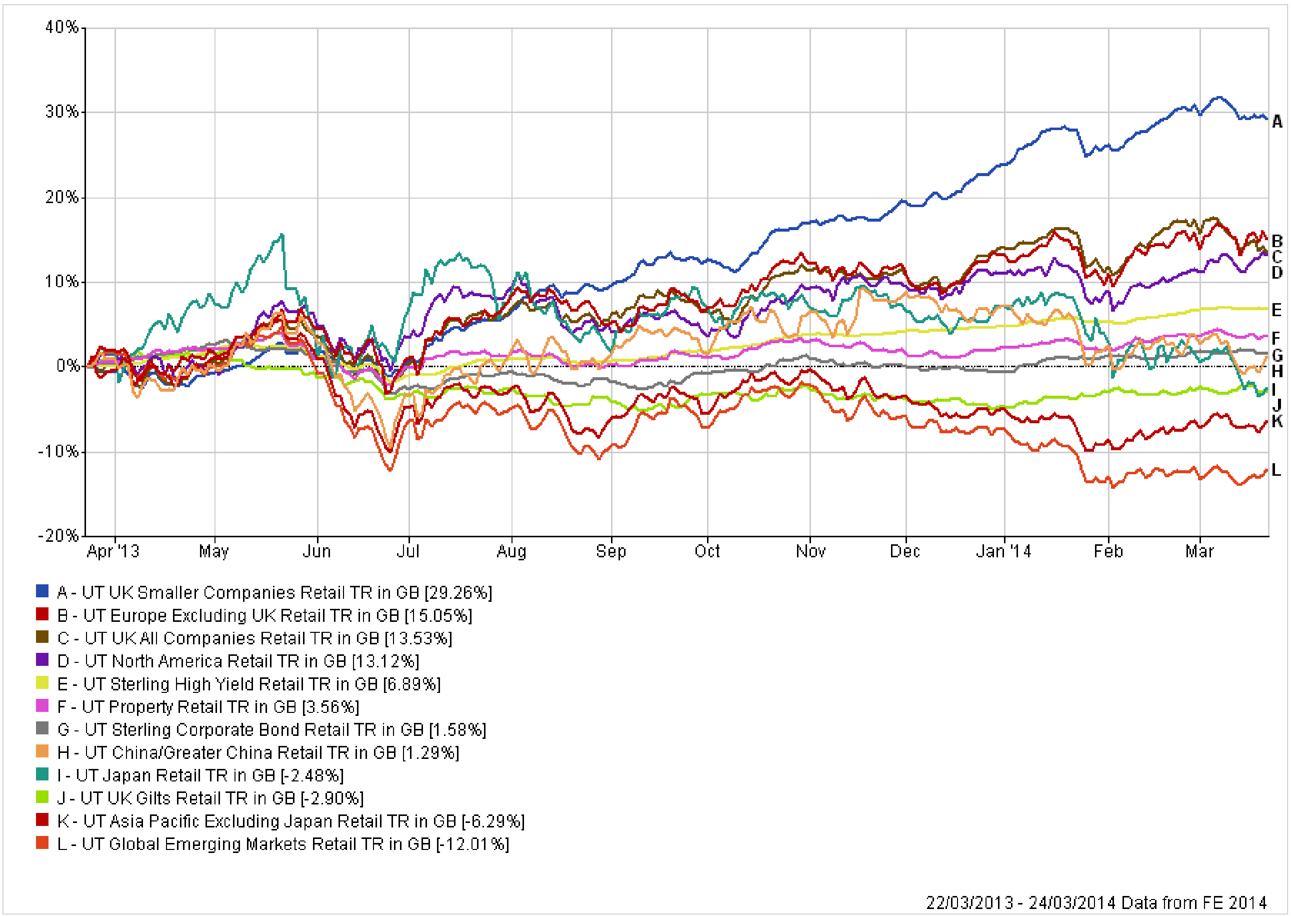
The key reason for the underperformance of our higher risk portfolios (Strategy 5 — 21 Years + and Strategy 4 — 21 Years +) against our medium risk strategy continues to be that Asian and Emerging Markets are struggling and remain at suppressed levels (see overleaf). Reports are mixed as to whether these markets will bounce back soon but over a 21 Years + investment term, it remains advisable to have a reasonable weighting to these higher risk and therefore potentially higher returns when those markets improve.

However, it is pleasing to see our portfolios holding their value well during a difficult market period (see 3 month figures). Overall, we have been delighted with the performance of our model portfolios against other benchmarks.

"Wealth gained hastily will dwindle, but whoever gathers little by little will increase it". *Proverbs 13:11*

Investment Returns & Outlook

Whilst Chinese, Japanese, Asian and Emerging Markets have fallen since our last full newsletter in October 2013, Developed Markets have continued to climb on the back of improving economic data from the States and the UK particularly. The clear winner over the last year has been UK Smaller Companies which have continued to soar despite commentator speculation that they are fully valued. Notably they have done so with much less volatility than one would expect.



As with our last Newsletter, it is again interesting to see Europe in second place, despite the continued struggle facing many economies in the Eurozone, with some commentators speculating that there is still more to come. Given the lows to which European markets fell in 2008/09, perhaps this is not overly surprising. It is also interesting to see Japan lurking near the bottom of the pack having soared to decent heights back in May last year. Commentators are predicting good things for Japan but we continue to believe a modest holding is appropriate for medium to high risk portfolios, given the uncertainty and the volatility involved.

Gilts have moved broadly sideways since our last Newsletter in October 2013 with investors dipping in and out of the asset class as the outlook for markets differ daily. We continue to recommend a low or nil weighting to Gilts where appropriate (except for very low risk clients) due to their perceived inflated values and the easing off of the US bond buying programme (QE), the outlook for Gilts still looks unattractive.

Looking ahead, the table below shows that the outlook remains fairly strong for the developed world's equity markets, with the exception of the US. Commentators believe that the US could be fully valued now and that, as with the UK market, company earnings need to catch up with the company share prices otherwise a correction in developed markets could be on the cards. Global Emerging Markets, Asia Pacific and BRIC countries (Brazil, Russia, India & China) are much more cheaply valued than there Developed counterparts. For some investment houses this is a sign to buy into these markets whereas others are still uncertain or believe further trouble is ahead. We sit in the uncertain category, understanding the cheap valuations and the potential gains they could bring, but conscious of the corruption, political risk and potential further headwinds facing these markets. We have therefore chosen to leave our weighting to these markets unchanged for the time being.

POS	**A POSITIVE outlook**	UK, European and Japanese equities remain in this category.
NEU	**A NEUTRAL outlook**	UK Property, Global Property, Emerging Markets & International Bonds remain in this category. However, the US has been downgraded to Neutral and Asia Pacific, BRIC countries have been upgraded to this category.
NEG	**A NEGATIVE outlook**	UK Government Bonds (Gilts) continue to be negatively viewed as do Investment Grade UK Corporate Bonds.

As ever, nobody really knows what future investment returns will be and we continue to recommend a diversified portfolio is held over a medium to long term, rather than aiming to make short term gains.

New Pension Rules

In his 2014 budget, George Osborne has announced some very significant and grand changes to Pension Legislation. Some of these changes are effective now and some have been raised at this point for consultation with the Pension industry and potentially become effective from April 2015. We have split the changes into the two categories for greater clarity:

New Pension Rules effective from 27th March 2014

* Pensioners who use Income Drawdown (or 'Capped Drawdown') will now be able to take up to 150% of the 'basis amount'. The 'basis amount' is calculated by the Government Actuaries Department (GAD) and is chiefly linked to Gilt yields and age. However, for a reasonable comparison one could assume the 'basis amount' is a level, single life annuity. This is great news for pensioners with Income Drawdown who want more out of their pension fund now and clearly aims to make Income Drawdown even more attractive for retirees.
* The 'Minimum Income in Retirement' (MIR) threshold has been reduced from £20,000 to £12,000 for those who wish to take up 'Flexible Drawdown' rather than 'Capped Drawdown'. The qualifying pensions for the MIR test are still the State Pension and Benefits, Scheme Pensions and Annuities. Most other forms of retirement income (such as Property Rental for example) do not count.
* The 'Triviality' rules have changed to increase the threshold that *combined* Money Purchase Pensions (both Company Schemes and Personal) must be below in order for all pensions to be drawn as a lump sum (either all at once or separately). This was £18,000 but is now £30,000. The minimum age restriction of 60 still applies however.
* The rules regarding small pensions have also changed. The new rules stipulate that Money Purchase Pensions (both Company Schemes and Personal) worth less than £10,000 can be taken as a lump sum, regardless of the 'Triviality Rules'. Only three pensions can be taken in this manner however. Previously the threshold under these rules was only £2,000 and only two pensions could be drawn in this way. The stricter Company or Public Sector Pension restrictions still apply and the lump sum taken will still be taxed at normal rates (with 25% tax free).

Potential New Pension Rules April 2015

The greatest potential change George Osborne has announced is that Money Purchase Pension Plans will be able to be drawn as lump sums rather than by purchasing an Annuity. The current options of Income Drawdown and particularly Flexible Drawdown are very similar to this but with certain restrictions. This has raised concerns that many pensioners will now be driving Lamborghinis and relying on State help when they have run out of money! However, as any lump sum will be charged at the normal rates of Income Tax, after the normal 25% Tax Free Cash allowance, it would be inadvisable for pensioners to draw the full amount in one go and so potentially suffer 40% or even 45% in tax on a portion of the pension. Opposition to Mr Osborne's announcement have concerns as to whether the general public have the discipline for this approach and worry that some pensioners will leave themselves short in their later years. However, schemes such as this have proven successful in other countries such as Australia. We will have to wait and see if we are as careful and prudent as our friends down under.

Pension Glossary

<u>Annuity Purchase</u>
Where the pension pot is handed over to an Annuity provider, after the Tax Free Cash of 25% has been taken (usually), and the Annuity provider guarantees to pay out a certain level of regular income to the Annuitant. The income is taxed at the normal Income Tax rates. Increasing Annuities and Spouse's Protection can be included into the Annuity, as well as lots of other options, all at a cost of a lower income however.

<u>Income Drawdown ('Capped Drawdown')</u>
Where the Pension pot is left invested and in the owners control. After some or all of the Tax Free Cash of 25% has been taken, an income is drawn from the fund by selling assets from the investments on a monthly, quarterly or annual basis. The income is taxed at the normal Income Tax rates. The income can also be nil if desired but can go no higher than the Government Actuaries Department's (GADs) maximum set levels. The Income has the potential to increase as the underlying pension investments increase, although it could decrease if markets perform poorly. The pension pot can be handed onto a dependant for them to draw an income from (providing they are under 23, over 55 or dependant as a result of a disability) or take as a lump sum (after a tax charge).

<u>'Flexible' Drawdown</u>
Exactly the same option as above but without the GAD maximum set levels, i.e. the whole fund can be drawn in one go if so desired (taxed at the normal Income Tax rates). In order to qualify for this option a pensioner currently has to have at least £20,000 of guaranteed income, known as the Minimum Income in Retirement (MIR) level. This has now been lowered however, as detailed above.

ISAs Just Got NISA!

From 1st July 2014, all current ISAs and new subscriptions to ISAs will automatically be converted into 'New ISAs' (NISAs). These 'NISAs' will do away with the current rule separating Cash ISAs and Stocks & Shares ISAs and will merge the two together providing greater flexibility for ISA investors with their asset allocation. Savers with Cash ISAs who want to convert them to Stocks & Shares ISAs will still be able to do so, but following the changes in July 2014 it will then be possible to transfer a Stocks & Shares NISAs to cash account NISAs.

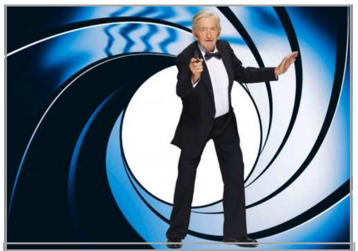
Importantly, the NISA limit will be £15,000 for 2014/15 and will likely increase in line with inflation moving forward. In the interim period between the 6th April and 1st July 2014, the total amount paid into Cash ISAs will still be capped at £5,940 and £11,880 for Stocks & Shares ISAs (minus any amount contributed to Cash ISAs). However, from the 1st July 2014, further money can be added to either a newly converted Cash or a Stocks & Shares NISA or indeed a new NISA (a new New ISA!) up to the increased £15,000 limit.

Clearly these changes will bring a greater degree of flexibility to ISAs, as well as allowing more to be saved tax free, and can only serve to make ISAs and saving in general more attractive.

New Allowances & Limits

As with all Budget announcements there are various allowances and limits that change. Here we provide a brief summary of the major changes:

- Many will be pleased to hear the announcement that the maximum an individual can invest into a NS&I Premium Bond is increasing from £30,000 to £40,000 from the 1st August 2014. There will also be two £1m monthly prizes instead of just one. The limit will be further increased in April 2015 to £50,000.
- The Personal Allowance (the amount every UK Resident can receive in income, tax free) will increase from £9,440 to the £10,000 the Liberal Democrats were so eager to see through.
- Those who are born after 5th April 1938 and before 6th April 1948 will continue to benefit from an increased Personal Allowance of £10,500, not increased from last year however. Equally those born before 6th April 1938 will continue to receive a £10,660 Personal Allowance. It had been thought that these would be phased out.
- A new concept introduced in this Budget is that married couples will be able to transfer £1,050 of their Personal Allowance to their spouse or civil partner from 6th April 2015, so long as neither is paying more than basic rate tax. Sorry Higher Rate Tax payers. In practice therefore, this only really potentially saves a couple £210 of tax a year. Still every little helps!
- Mr Osborne has reduced the Basic Rate Band from £32,010 down to £31,865 meaning those who earn more than £41,865 will pay Higher Rate Tax at 40%. The net result is an increase from last year however where individuals became Higher Rate Tax payers when they started earning over £41,450.
- The Capital Gains Tax (CGT) annual allowance (the level at which you can make capital gains without incurring CGT) will be increasing from £10,900 to £11,000 for the 2014/15 and 2015/16 tax years.
- The amount individuals can contribute into a Pension (of any sort) and still receive tax relief is reducing from £50,000 to £40,000 from April 2014. This is a huge drop from the £250,000 per annum level it was at two years ago.
- Sadly the Inheritance Tax Nil Rate Band threshold has stayed at £325,000 and will be frozen at this level until 5th April 2015



Not that sort of Bond!

New Pensioner Bond

Those of you over 65 will no doubt be very pleased to hear of the Chancellor's new "Pensioner Bond", available from January 2015. Up to £10bn worth of the new bonds will be issued by NS&I and are likely to be snapped up quickly. The estimated rate of interest is currently 2.80% for fixing in for 1 year or an attractive 4% per annum for 3 years. More precise details will follow in the 2014 Autumn Statement. These rates of interest will be most welcome to those who have had to suffer low interest rates for over 5 years now. The interest will be taxable at the normal rates of tax but can be paid tax free for those who are eligible. The maximum that can be contributed to the bond is looking likely to be about £10,000 per bond, allowing married couples to invest up to £40,000 between them as they will be entitled to hold both a 1 and 3 year bond each.

AWFM News

As ever our client numbers are growing steadily due largely to you recommending us to your friends and family. We continue to welcome these introductions and are always very glad to meet new clients. We still have capacity to take on many more clients as we have been improving our systems and procedures, year on year.

Our funds under advice have recently topped £50m which is a real mile-stone for us. From the foundation of the business in 1997 we have achieved good steady growth delivering a top-rate friendly, yet professional service to our clients.

David, Jon's son, will be celebrating his first birthday on the 1st April 2014, hopefully not making a fool of his parents, despite the date! Jon has kindly provided an up to date picture of David as many of you have been keen to know how David has been getting on. We all love a photo of a baby/toddler!

With thanks and Easter blessings from us all. Martin, Jon and the team.

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