360

from **AW Financial Management LLP** **April 2015**

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.

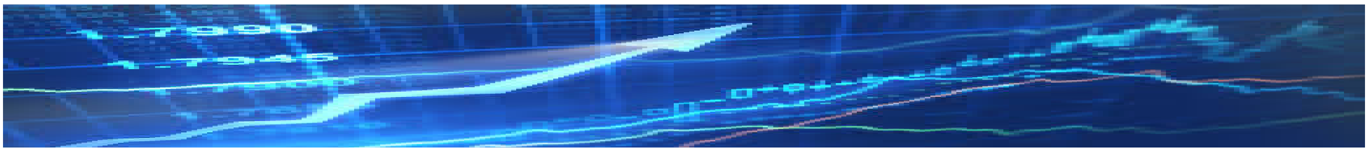
In this issue

The 2015 Budget

George Osborne has released his last budget before the General Election and, as you would expect, there are a few surprises in there! Have a look at page 4 for our summary of the key ideas being brought in, as well as an update on the usual allowances.

The budget included a few small give-aways that in truth don't really amount to much. The net effect of the budget however is a small revenue gain for the public purse. In Mr. Osborne's defence, he certainly is sticking to his guns as the "austerity" chancellor where others may perhaps at this stage been accused of vote chasing.

The biggest takeaway from the budget was the introduction of a tax-free allowance on savings income up to £1,000 for basic rate tax payers and £500 for higher rate tax payers. In truth this will only save tax payers up to £200 per year. Hardly huge savings but perhaps enough to make people feel a bit better about the "austerity" chancellor!



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.

It is very encouraging to see such strong performance figures both over just 3 months and over the full year. The FTSE 100 passed the historic 7,000 mark only a few weeks ago, the highest it has ever been. This seemingly impossible barrier has been hanging over UK Equity Markets for the last 15 years due to the unjustifiably elevated levels achieved in the "dot-com" bubble back in 1998/1999. With this mental barrier removed, and in the US too back in August 2014, investors have been able to focus more on the fundamentals of companies and economies rather than on worrying about the level of stock market indexes.

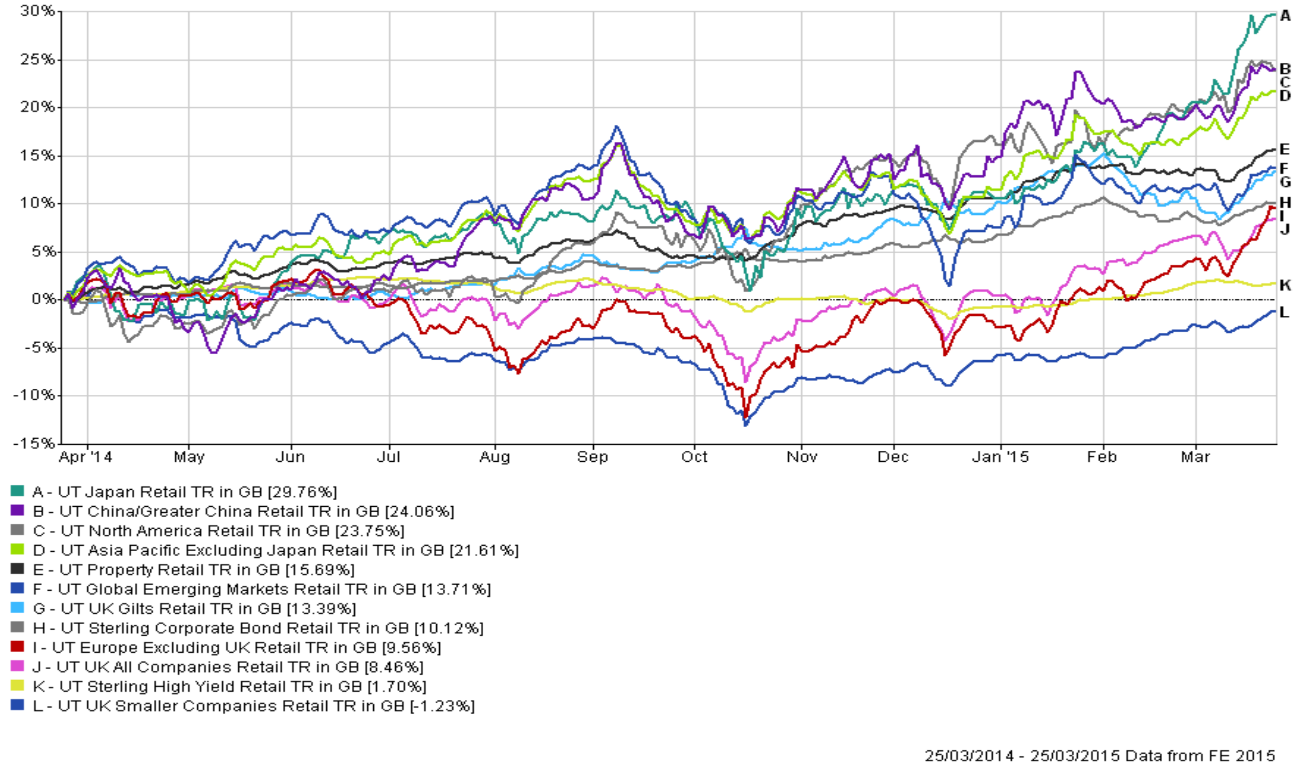
Description	AWFM risk model	3 to 5 year Portfolio (shortest term)		21 year + Portfolio (longest term)	
		3 months	1 year	3 months	1 year
Cautious risk	1	1.04%	2.16%	5.04%	12.77%
Cautious to moderate risk	2	1.84%	4.27%	5.47%	11.94%
Moderate risk	3	3.31%	5.99%	6.38%	9.88%
Moderate to adventurous risk	4	4.84%	7.87%	6.88%	12.10%
Adventurous risk	5	7.00%	10.00%	7.13%	12.81%

You can see that over the full year, our lower risk strategies have produced just as strong a return as our higher risk strategies, which may seem odd. The strong performance of Developed Nations Government Bonds and highly rated Corporate Bonds has driven the strong performance in lower risk portfolios with more exposure to these areas. These assets have become incredibly inflated in the last few years, as described in more detail on page 3. This is a position which we expect to reverse in the next few years we believe.

"Do not toil to acquire wealth; be discerning enough to desist. When your eyes light on it, it is gone, for suddenly it sprouts wings, flying like an eagle towards heaven." Proverbs 23: 4-5

Investment Returns & Outlook

The chart below makes for interest reading when comparing this with our newsletter from this time last year. Back then, UK Smaller Companies had soared to a total return of nearly 30%. Now, having had their most changeling year since 2008, they have just managed to claw their way back to a small loss. For those in our medium and higher risk portfolios with long investment terms, this has been a big factor holding back part of the returns this year.



At the opposite end, China had only made a small gain of about 1% this time last year, Japan was nursing a loss of 3%, Asia ex-Japan a loss of 6% and Global Emerging Markets losses of about 12%!. This year the tables have completely turned, as often they do, and now Japan is the best performer this year with a 30% gain, China a 24% gain, Asia a 22% gain and Global Emerging Markets have erased their loss from last year with a 14% gain. We continue to be wary of placing too much of a portfolio into these areas due to their higher levels of price volatility and in the case of Emerging Markets, often poor Corporate Governance. For high risk portfolios a greater weighting is right however in an effort to seek after the potentially stronger long term returns.

You can see from the chart that the UK and Europe have struggled in comparison to their stronger performing cousin over the Atlantic. The US economy has been going from strength to strength and the US stock market has reflected this, returning about 24% compared with around 8-10% for the UK and Europe. These are still strong returns in what has been a challenging year.

Property has been a stand out performer this year, producing total returns of about 15% with very low volatility and very little, if any downside movements. This is unlikely to be the case every year but for now, the prospects look good for UK Commercial Property, as the UK economy slowly improves.

Lastly, lower yielding, higher credit bonds and longer dated bonds, including Developed Nations Government Bonds have continued to perform very well again this year, contrary to what one might expect. With the interest rate rise "can" constantly being kicked down the road and lots of reasons to feel downbeat about investing (wars and many struggling economies), bonds have continued to climb to worrying heights. More on our outlook for Government Bonds overleaf.

POS	A POSITIVE outlook	All Equity markets are viewed positively at present with the exception of US Smaller Companies and Brazil, Russia, India & China (BRIC).
NEU	A NEUTRAL outlook	UK Property, BRIC country Equities and UK and Global Corporate Bonds are currently considered to have a neutral outlook.
NEG	A NEGATIVE outlook	UK Government Bonds (Gilts) continue to be negatively viewed.

Looking ahead, the table to the left shows that the outlook remains fairly strong for almost all Equity markets, which is an improvement on the picture 6 months ago. However, the outlook for US Equities is shifting towards Neutral due to the expensive looking valuations of most US companies. Gilts continued to be negatively viewed by most investors, which is not particularly surprising when these bonds are yielding so little and interest rate rises are potentially around the corner.

As ever, we continue to recommend a diversified portfolio is held, rather than aiming to make short term gains on market sentiment.

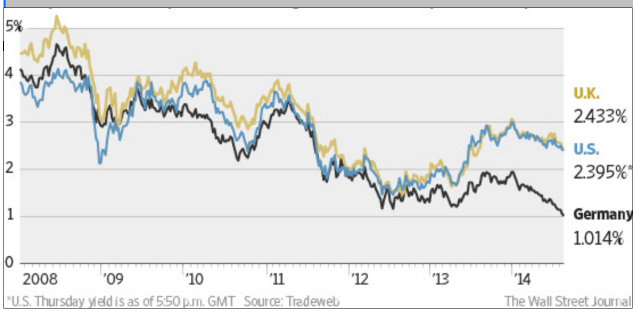
Europe Bites The QE Bullet!

The UK, the US and Japan have undertaken huge money printing programmes, called Quantitative Easing (QE), nearly doubling their debt relative to GDP in a bid to boost economic growth. For the most part this seems to have worked, particularly in the US where economic figures are looking much healthier and are still improving. The European Central Bank (ECB) has finally joined the party, although arguably somewhat late, with an announcement by the ECB president, Mario Draghi (pictured) in January that they will print €60bn a month until September 2016 or until inflation reaches 2% again.

The ECB's QE plans had been heavily resisted by Germany, who had concerns that the QE idea would cause uncontrollable inflation. However, when Europe slipped into deflation (negative inflation where prices are falling) of –0.2% in December 2014, this argument seemed to hold little water. Germany also resisted the idea on the legal front, arguing that the ECB would be acting outside of its mandate by buying its own constituents' Government Debt (essentially what QE involves). Again, this idea was kicked into touch by Cruz Villalon, an Advocate General of the European Court of Justice, paving the way for Draghi to "do whatever it takes" to save the Eurozone by bringing in the QE programme.

As we stand today, markets have reacted well to the news with European stock markets up about 10% since the announcement. Here at AWFM we had anticipated this move and decided to place slightly more into European Equity markets through the introduction of the Artemis Global Income fund to most of our portfolios. Since the introduction of this fund to our portfolios in November 2014, it has risen by about 15%! By comparison one of the key funds we removed from our portfolios, the Aberdeen World Equity fund, has only produced a return of about 6% over the same period.

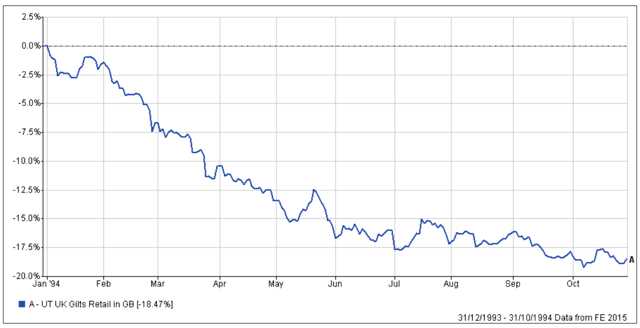
Clearly, we are pleased with this call so far and continue to favour recovering and therefore cheaper European markets over expensive looking US markets. The US will most probably continue to grow strongly but with US shares uncomfortably higher than their average 15 year prices, we continue to prefer tilting portfolios to where we still see potential for upside, rather than to areas where assets are looking more fully valued. Of course, we do still hold sizeable positions in US shares in our portfolios, as one would expect from well balanced portfolios. However, holding significantly less than the FTSE WMA benchmarks that we track has contributed to our underperformance against these benchmarks this year, along with our underweight position to Government Bonds for similar reasons (see more detail below). However, we believe this will stand our portfolios in good stead over the next few years, where we believe outperformance should start to come through again.



Where Next For Gilts?

We have commented on the incredibly surprising performance of Gilts (UK Government Bonds) and other developed nations Government Bonds during many review meetings throughout this year. As the capital value of Bonds increases, the yields on the bonds decrease. This is the very nature of *Fixed* Interest (the value of the interest payments stay the same but the percentage value—the yield—changes). Therefore, as 10 year German Bund yields have fallen from around 4% back in 2008 to 0.26% now, you can imagine how far the *capital* value of these bonds has increased. As global investors have had a whole host of reasons to be worried over the last 6 years really, many have flocked to safe haven assets such as Government Bonds, pushing up their prices. This, coupled with the new European QE programme described above, has now caused 5 year German Bunds and a number of other developed European Government Bonds to fall to *negative* yields. This means that investors are now actually paying countries like Germany in order to lend to them! Surely this is not sustainable!

However, the UK and US Government Bond market isn't quite at the same extreme levels, although they are not far off. 10 Year Gilt yields have fallen from 4% back in 2008 to around 2.40% in 2014, as you can see from the chart top left. They have since fallen further to about 1.75%. Each year the price of Gilts have risen and each year ,for the last 3 years or so, we have been saying to clients that this trend is sure to stop—and yet it continues! To say that Gilts and other Government Bonds are looking expensive would be a gross understatement at present and so we must stick to our guns. The key changer will be when the US Fed and then the Bank of England raise interest rates, which is looking likely later this year, for the US at least.



The chart to the right shows how the capital value of Gilts performed in 1994 when interest rates were increased by the US Fed. Losses of 19% can hardly be considered a low risk investment! Is history going to repeat itself? With such extreme valuations and such low bond yields, negative even in some countries, surely it will? We are therefore very nervous about the outlook for Gilts and US Government Bonds particularly and remain underweight in our portfolios.

2015 Budget Summary

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

The "Usuals"

* The Personal Allowance (the amount every UK Resident can receive in income, tax free) will increase from £10,000 to £10,600.
* The basic rate tax band has increased from £31,865 down to £31,785 meaning those who earn more than £42,385 will pay higher rate tax. In 2014 the higher rate tax threshold was £41,865 and so Mr. Osborne has followed the trend of recent years in increasing the threshold, reducing the number of higher rate tax payers.
* The Capital Gains Tax (CGT) annual allowance (the level at which you can make capital gains without incurring CGT) will be increasing from £11,000 to £11,100. Hardly a huge increase but still more than current inflation!
* Mr. Osborne has decided to further reduce the Lifetime allowance (the value a total pension savings can grow to without paying extra tax charges) down to £1m. It was £1.8m only 3 years ago and is therefore starting to affect more clients.

New Announcements

* One of the big new ideas announced by Mr. Osborne in the spring budget was a secondary market for Annuities. Essentially this would allow those who have purchased lifetime Annuities to sell the guaranteed income for a cash lump sum. As with the pension freedoms announced last year, concerns have been raised again about the risk this might pose to those who need a guaranteed retirement income but are drawn to the attraction of a cash lump sum.
* Another big announcement was the introduction of "Help to Buy ISAs" for first time buyers, available from Autumn 2015. With this product you can save up to £200 per month and the government will add 25% to the pot (£50 for every £200). The introduction of this product has been driven by the problems first time buyers are still having with getting on the housing market. Whilst this Help to Buy ISA may well encourage people to save more and help them towards their deposit, with house prices so expensive compared to salaries, it is unlikely to make any real impact.
* Lastly, a new tax-free Savings Allowance of £1,000 for basic rate tax payers and £500 for higher rate tax payers will be introduced from April 2016. At this point banks will stop taking tax at source on bank deposit interest and those who earn less than £16,800 a year will not pay any tax on their savings, thanks to the alteration of the Starting Savings Rate from 10% to 0% tax and increasing this Savings Rate level from £2,880 to £5,000 (Personal Allowance of £10,800 in 2016, the £1,000 tax-free Savings Allowance and the £5,000 Starting Savings Rate gives you £16,800).

Key Changes from 6th April 2015

- Money Purchase Pension Fund holders aged over 55 will be able to access any amount up to 100% of their pension fund should they choose to.
- Child Trust Funds will be able to be transferred to Junior ISAs
- ISA savings can be inherited on death by a surviving spouse, keeping the tax free ISA wrapper intact.

AWFM News

The big news for AWFM this spring is that we are taking on a new member of staff. David Foot will be joining us from the 7th April as a trainee Para-Planner. After spending a considerable time learning the ropes and undertaking the necessary study, David will take over the main Para-planner role from Jon, allowing him to get out and see more clients. We have high hopes for David. He has a good head for numbers and an analytical mind as evidenced by his degree in Mathematics! We look forward to introducing you to David when you are next in the office.

After 9 years in the office, we decided that it was long overdue a coat of paint and so over the last week or so, we have been dealing with the upheaval of having the decorators in. Having waivered initially on whether the upheaval was entirely necessary, once we cleared the rooms for the decorators, we realised how overdue the decorations were. Nicola has overseen the project and has done an excellent job—the woman's touch!

Finally, if you are in the area (Bexleyheath) and would like to come along to our Church's Easter services, we would be delighted to see you. The main services are Maundy Thursday at 8pm, Walk of Witness in Bexleyheath Broadway on Good Friday from 10:30am and Easter Sunday at 10:30am. If you are thinking of coming then please do let us know.

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

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