



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.

Bank of England - New Normal Base Rate of 2.50%

The main focus of markets at the moment remains fixed on the central banks and particularly the Bank of England who look first to break ranks and raise interest rates later this year or early 2015. We look at some of the features the Bank of England have employed in order to cool the housing market on page 3, as well as looking back over Mark Carney's first year as Bank of England Governor.



Right now however Mr. Carney is urging investors to consider a new normal of 2.50% for the Bank of England base rate, rather than the 5% it has been historically. His argument is that economic conditions post financial crisis are unlikely to support interest rates that are that high. Clearly he is keen to avoid plunging the markets and the economy back into another recession with a heavy handed approach and so we can be fairly confident that when (and it is when rather than if!) interest rates rise, they will be gradual and flexible depending on how the economy and markets are performing.

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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 desired to take and their likely investment term.

Annual returns continue to remain strong as the US and UK economies particularly are showing signs of a good recovery. This is all despite the various issues the markets are facing including Ukraine, potential deflation in Europe and interest rate rises looming.

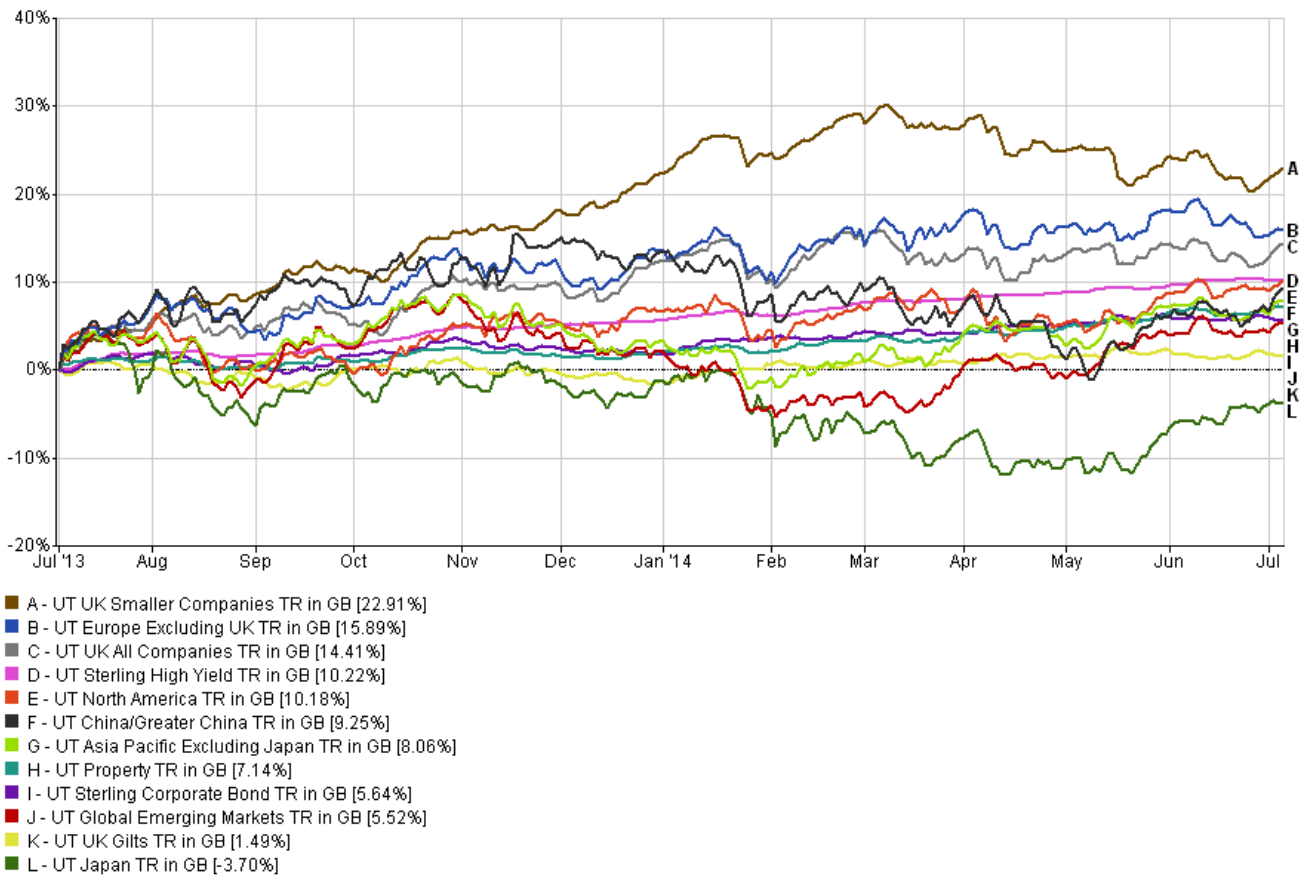
The medium and higher risk portfolios with larger weightings to medium and small sized companies have fared the worst over the last 3 months with the exception of our highest risk strategy (Strat 5–21+) which has benefited from a strong rebound in emerging markets. There has been somewhat of a reshuffle of investors' portfolios over the last quarter which has resulted in some areas being sold heavily, causing falls in value, and some areas being heavily bought and buoying the asset prices further.

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	0.43%	2.30%	1.31%	6.16%
Cautious to moderate risk	2	0.74%	3.66%	2.22%	10.22%
Moderate risk	3	0.20%	4.72%	-0.75%	10.80%
Moderate to adventurous risk	4	-0.56%	6.77%	-0.07%	9.66%
Adventurous risk	5	-0.91%	10.36%	0.93%	10.12%

Whilst some portfolios have struggled in the short term as part of the above mentioned reshuffle, we remain pleased with the makeup and performance of our model portfolios against other benchmarks.

Investment Returns & Outlook

There has been a strong reversal in performance for the countries and sectors at the top and bottom of the chart since our last newsletter. UK Smaller Companies still come out on top but, as we suspected, they have come off somewhat from their arguably fully valued prices to a more reasonable level. Emerging Markets on the other hand have rebounded very strongly now showing gains of 5.52% over the year having shown losses of 12% in our last newsletter.



04/07/2013 - 04/07/2014 Data from FE 2014

Japan has recovered a little over the last quarter but is still at the bottom of the pack largely due to its lofty starting position in July last year. Europe continues to press on despite all of the bad news in the region with the UK and the US not far behind. Property and Corporate Bonds have continued their stellar run providing strong and fairly steady gains helping offset some of the price volatility of Equities for those with a balanced portfolio. Gilts (UK Government Bonds) have recovered reasonably well from the losses shown in our last newsletter and are amongst the top performing asset classes since the start of the year. Over the full year however Gilts continue to produce little gains with yields so low by historic standards that they are really only acting as a stabiliser for many portfolios.

The table below provides the consensus view of several different Investment Houses on asset classes and their potential for returns over the coming 12 months. Looking forward therefore US Equities, Emerging Markets and, following their sell off, UK Smaller Companies look set to provide the most attractive returns going forward. Emerging Markets is an area we are still hesitant on, as explained in our last newsletter, as there are still many headwinds facing this region. However, as can be seen from the chart above, clearly cheap valuations and a change in investor sentiment has helped drive this region forward

P O S	A POSITIVE outlook	UK smaller companies, Europe and Japan remain in this sector but Emerging markets and BRIC countries have now been added along with UK Property and US
N E U	A NEUTRAL outlook	Global Property remains in this category but the UK and Pacific regions have been downgraded to this category.
N E G	A NEGATIVE outlook	UK Government Bonds (Gilts) and UK Investment Grade Corporate Bonds continue to be negatively viewed and International Bonds have now joined this category.

and the consensus view is that this will continue. We continue to only recommend a notable weighting to Emerging Markets for investors who can afford and are willing to accept the risk. For most investors a small proportion is generally more appropriate for diversification purposes.

It is surprising to see the UK fall to the Neutral category, given the strong recovery seemingly taking place in the UK. However, with the FTSE 100 only a few points off its all time high, you can understand why investors may be nervous.

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.

Mark Carney 1 Year On

Mark Carney was the first foreigner to take the reigns of the Bank of England since it was established in 1694 and now 1 year on many are saying he has done a good job. The UK Economy seems to be undergoing a strong recovery under his leadership and Markets have taken this on board.



Mark Carney's first contribution from being in the "chair" was to introduce "Forward guidance" in August 2013, which he hoped would help investors and businesses plan ahead and continue to invest without fears of a collapse in the Economy or Markets. This forward guidance started with a promise that interest rates wouldn't rise until unemployment fell to below 7%. Technically speaking Mr Carney didn't break his promise here, as interest rates didn't rise! However, when unemployment did fall to below 7% in February of this year and the economy wasn't ready for a rate rise, Mr Carney had to provide a new set of Economic Conditions that would serve as a better guide for the markets.

Despite his accommodative stance towards investors in order to ensure financial stability, the new Bank of England Governor isn't afraid to surprise the markets from time to time. His speech at the Mansion House in June of this year really threw the cat amongst the pigeons with his comment that the first rate rise could come "sooner than markets currently expect". Despite a fall in the markets in the days following this announcement, investors have taken this latest update reasonably well, on the understanding that any rate rises will not take place until the UK Economy is ready and in need of them, and even then they will be gradual and non-excessive.

The latest tool Mr Carney has pulled out of his bag has been to introduce stricter measures for high loan to income mortgages, in an attempt to cool the overheating housing market (see below). Overall, Mr Carney seems to have stepped into the role well and using the various tools at his disposal, and some new ones too, he has provided a degree of stability in what has been a challenging and volatile time for Markets. Most would argue he has done the job well.



Bank of England – Mortgage Cap

As highlighted above, the latest piece of action from the Bank of England has been to recommend to lenders that they should limit their loan values to no more than 4.5 times a borrowers income and that these type of mortgages should account for no more than 15% of lenders' books. At the present time, 9% of all loans nationally are at 4.5 times income but this jumps to 19% for London which presents a problem for the regulator of these firms (FCA), as to how to implement this strategy without causing unrest. Will London just be allowed to account for the 15% nationally?

As house prices have risen strongly across the UK and astronomically in London, it is not surprising that the Bank of England has taken measures to try to prevent any kind of housing bubble. This has been a first for the Bank of England who historically have not previously taken direct measures to prevent a housing boom. However, it is debatable as to whether these measures will make any significant impact. In Norway for example, lending standards have tightened but household debt has remained high. In contrast in South Korea tightening on lending has prevented defaults and reduced the demand from speculative investors. Only time will tell whether the Bank of England's new guidance to lenders will be effective in preventing a housing bubble inflating further.



What are the US Fed and ECB Doing?

We have noted what measures the UK central bank (Bank of England) has taken and is likely to take as the UK Economy improves, but what actions are the US and EU central banks taking that will have an effect on UK and Global Markets alike?

The gradual reduction in the US Federal Reserve's (Fed) Quantitative Easing (QE) programme has been well documented and we have written about this in past newsletters. The QE programme has now diminished from printing £85bn dollars per month down to £35bn as of June 2014. At this rate the QE programme should finish in October/November this year. However, inflation is staying stubbornly low at around 1% for the US, a point that the Fed are well aware of. As a result, the Fed's base rate has remained at 0.25% since 2008 and is expected to remain there until 2016 at the earliest.



Over the pond in Europe low inflation is even more of a problem, with the consumer prices index at around 0.50%. As such, in early June the European Central Bank (ECB) took the bold decision to cut its main interest base rate further to 0.15% and in a first for a major central bank the ECB also cut its deposit rate from zero to negative territory. This means that the ECB will now be charging banks for making deposits with them and so encourage more lending which will hopefully stimulate some growth. On top of this the ECB is also pumping more money into the system with around 600bn euros planned to be lent to businesses. The ECB is doing everything short of printing money (QE) as the US have been doing in an attempt to kick start the faltering European Economy, and they haven't ruled QE out yet.

Central Banks policies will continue to be the talking point for investors and their policies will continue to have a marked impact on Economies over the next few years. What is concerning some Investment Managers however is what effect will these Central Bank policies have on future inflation and asset prices and our concern is how this will affect you.

HEAD LINES

- * **NISA has Landed** - As many of you will know, the New ISA has come into effect from the 1st July 2014 and now allows individuals to invest up to £15,000 in either a Cash NISA or a Stocks & Shares NISA or a mixture of both. An important feature is that investors can now transfer Stocks & Shares NISAs to Cash NISAs, as well as of course Cash NISAs to Stocks & Shares NISAs, as was previously the case.
- * **1 in 7 Retire Without a Personal Pension!** - Recent research from Prudential has found that 14% of those planning to retire this year have made no personal pension provision and are relying either entirely or heavily on the State Pension. Auto-Enrolment should help sort this issue out in the long run although whether people will put aside enough pension funds for retirement remains to be seen.
- * **Lib Dems Will Make "Triple Lock" Permanent if Elected** - The Liberal Democrats have vowed to make it permanent legislation that the State Pension will increase by either earnings, prices or 2.50%, whichever is higher (the "Triple Lock"), if they are elected in May next year.
- * **Annuity Rates Rebound Following Spring Budget** - Annuity rates fell 0.22% in April 2014 following the budget announcement that pensioners will potentially be able to fully access their pension savings next year. Rates fell further in May but have now bounced back by 0.60% in June. Don't write Annuities off yet!
- * **House Prices Reach 2007 Peak** - House prices across the nation are up 11.80% from last year, although of course for us in the south east it has been much more marked than this with London prices up 26%! Such increases haven't been seen since the late 1980s boom—perhaps one can see why the Bank of England has put barriers in place to try and cool the demand for London properties.
- * **PMI Data Suggests UK GDP Possibly Passed Pre-Crisis Peak** - recent data from "Markit" indicates that the UK's most important sector for GDP, the Services Sector, expanded strongly in June. GDP is expected to grow by 0.80% in the second quarter taking GDP to a new all-time high.



New Intestacy Rules

New rules for those who die "intestate" (without a Will) come into force from the 1st October 2014. Previously, a surviving spouse with no children from the marriage would only receive a fixed legacy of £450,000 (assuming the Estate is worth more than this) plus a life interest in half of the remainder of the Estate. The new rules will see that the surviving spouse receives the full value of the estate where there are no children from the marriage. Where there *are* children from the marriage the children will continue to receive half of the Estate over £250,000. Importantly however the new Intestacy Rules continue to make no provision for "common-law" spouses or partners and no provision for step-children either. For those who are single without any children their Estate will

continue to pass to their parents, if living, or brothers and sisters, grand parents, uncles and aunts etc. Therefore, whilst this change is a positive step, for the vast majority it is still entirely appropriate to establish a Will so as to provide clear, legally protected direction as to whom one's assets should pass to on death.

AWFM News

We have just completed our 4th year end as AW Financial Management. How time flies! A further mile-stone for Martin has been reached this year as he has completed 30 full years in the work-place. What does that mean? It means he has sufficient years' service to qualify for a full State Pension! —although he has another 20 years before he can claim his entitlement!!

But we would like to express our gratitude to you for your part in helping us develop as a business. We aim to provide the very best service in a friendly and intelligible way. Thank you too for the very many of you who have introduced friends and family members to us over the years. This really is very much appreciated and we will do our utmost to reward the faith and trust that you have showed when recommending us.

The business has grown remarkably in the last 4 years and we are continuing to look at ways to improve the way we provide our services to you and we hope never to lose the "personal touch". We publicly thank God too for giving us the skills and abilities to do the job and for wisdom and discernment.

Have a really great Summer. Regards from 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.

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