# 360

from AW Financial Management LLP — October 2013


***Welcome*** to our October 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



## Good news/bad news

The theme running through this entire update is that there is good news and bad news. In particular, it is apparent that Stock Markets have come under pressure again over recent weeks mainly because of the good news we discussed last time, namely that things are looking brighter for the US economy!

On one hand, the IMF recently upgraded the forecast for growth in the UK from 0.9% up to 1.4% - good news. However at the same time *global* growth has been cut from 3.2% to 2.9% - bad news. Then of course there's the US politicians failing to agree on fiscal policy thereby shutting down half of the government— bad news.

Unemployment in the UK (measured by those claiming Jobseeker's allowance) fell to its lowest level since February 2009 to 1.402m - good news, but against that, those in part-time work who couldn't get a full-time job rose to highest levels since 1992 - bad news!

## 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 their risk profile.

The year to date figures are very impressive compared to returns from a bank or building society. However, this table demonstrates quite clearly the potential losses that can be incurred when investing, as set against the potential rewards.

Probably the most significant factor over the last year was the relative underperformance of Asian and Emerging Markets equities against the UK, US, China, Japan and Europe (see page 2). This is the key reason for the underperformance of strategy 5 (21+ Years) against strategies 4 and 3 over the year.

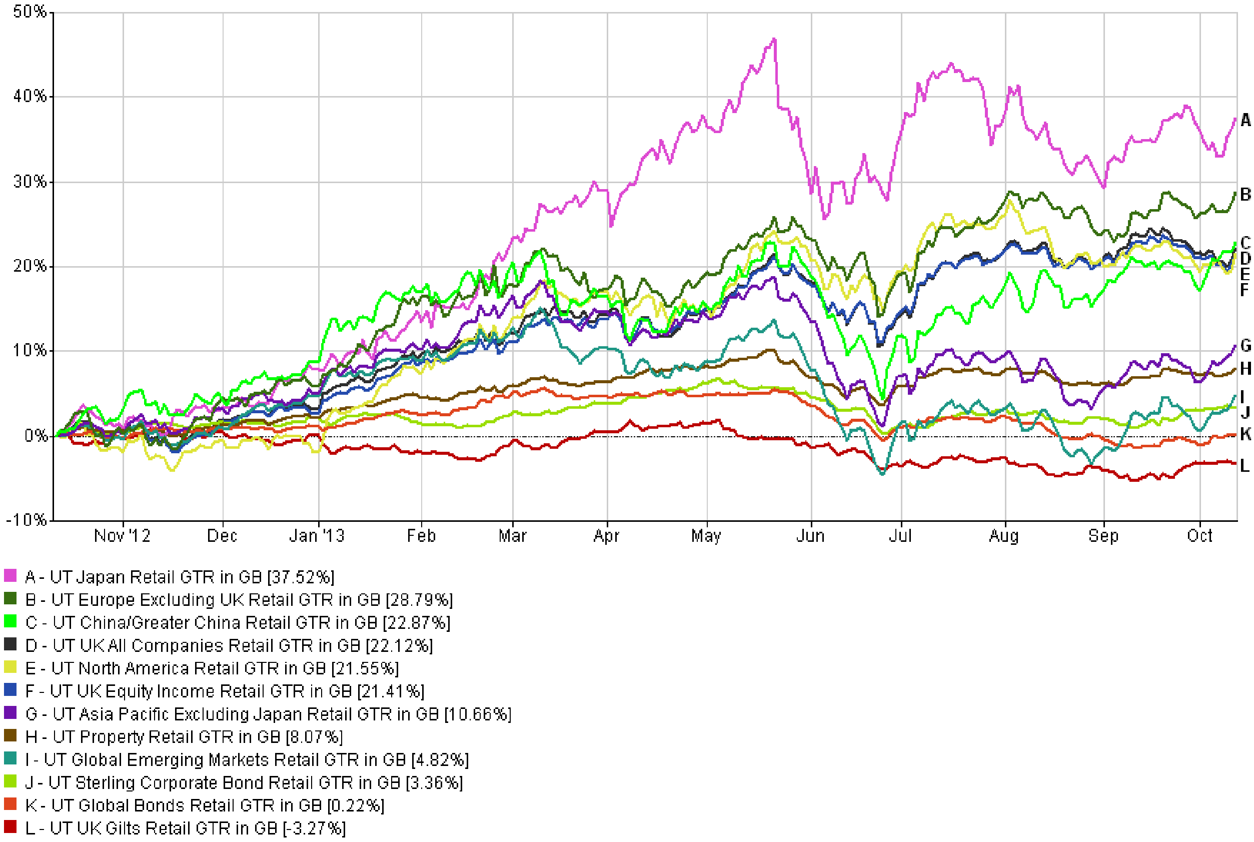
| Description | AWFM risk model | 3 to 5 year Portfolio (shortest term) | | 21 year + Portfolio (longest term) | |
|---|---|---|---|---|---|
| | | 3 months | 1 year | 3 months | 1 year |
| Cautious risk | 1 | -0.23% | 2.98% | 0.04% | 6.91% |
| Cautious to moderate risk | 2 | -0.57% | 4.36% | -0.84% | 11.30% |
| Moderate risk | 3 | -0.97% | 7.07% | 0.11% | 16.56% |
| Moderate to adventurous risk | 4 | -0.42% | 11.26% | -0.55% | 16.63% |
| Adventurous risk | 5 | 0.21% | 19.84% | 0.00% | 15.66% |

As ever, investing is about the longer term but it is interesting to see the shorter term movements as well. Overall, we have been delighted with the performance of our model portfolios against other benchmarks.

Come to me, all you who are weary and burdened, and I will give you rest. *Matthew 11:28*

# Investment Returns & Outlook

Markets have to some extent moved sideways since our last newsletter, if you ignore some fairly significant volatility as seen by the chart below.




It is again interesting to note that the best two performing sectors over the last 12 months have been Japan and Europe, who are retaining their shine for the time being. China has also come through the pack in the last few weeks to secure 3rd place over the last 12 months but prior to that has been mid to bottom of the table. The UK and US performed well over the period with nowhere near as much volatility as some other areas. That deals with the top half of the chart. Total returns of a minimum of 21% over the last 12 months is certainly worth noting.

What is equally interesting is the bottom half of the chart. Asia Pacific, which includes areas such as South Korea, Taiwan, Hong Kong, Malaysia, Singapore, Thailand, Philippines, as well as China, Australia and India in many cases definitely underperformed as far as Equities are concerned, due in the main to risks of cut-backs in the West and a likely strengthening of the US dollar hurting companies exporting to the US. The Global Emerging Markets sector, which would include some of the countries in Asia Pacific but would also include African and South American areas as well as Russia, performed even worse but for much the same reasons as Asia Pacific. A higher investment risk profile has not necessarily been rewarded over the last 12 months.

Commercial Property has started to produce far better returns with the sector producing about 8% growth in the last 12 months. However, it is Fixed Interest assets which have produced the worst returns over the last 12 months with the sector average for UK Gilts producing losses of over 3%. Corporate Bonds produced better returns but were still fairly modest. In some ways, back to the old good news/bad news theme, there is good news where Gilt Values have fallen. As Gilt values fall, the Gilt Yield rises, which in turn increases annuity rates and maximum Income Drawdown rates. Good news for pensioners and those approaching retirement. See our previous newsletter for further details about this mechanism.

| | | |
|---|---|---|
| **POS** | **A POSITIVE outlook** | UK, Europe, US & Japan equities. |
| **NEU** | **A NEUTRAL outlook** | Remaining in this category are UK & Global Property. Emerging Markets has risen into this category from negative as have International Bonds. |
| **NEG** | **A NEGATIVE outlook** | By consensus the areas to avoid would be Asia Pacific, BRIC countries, Corporate Bond and Gilts. |

Looking ahead, the following table below shows that the outlook remains fairly strong for the developed world's equity markets. Global Emerging Markets are beginning to look attractive again whilst Asia Pacific and Brazil, Russia, India and China are likely to produce a low or negative return over the next 12 months.

As ever, nobody really knows what the future investment returns are going to be. As with previous editions of this publication, we continue to recommend a diversified portfolio is held over a medium to long term, rather than aiming to trade on possible gains or losses.

## Help to Buy Scheme II

There has been a lot of talk about Help to Buy recently and indeed we commented on it in our previous issue. But this second phase of the scheme is worth taking a closer look at.

Because this second phase of the scheme is protected by the Government when the mortgage lender agrees to be part of the scheme, at the time of writing, there has only been limited take-up by the mortgage providers (though more providers are starting to come on board now). It is therefore the interest rates that are likely to suffer where there is not much competition. Worse still, the Government are charging a fee to the mortgage providers to cover the guarantee which means the mortgage rates are higher again. The interest rate currently being punted around is in the region of 5% for a Help to Buy mortgage.

For anyone taking out an ordinary mortgage with a deposit of 20% or 30% the interest rate they would pay currently could be in the region of 3%. It is clear that the Government's insurance premium could be as much as 0.9% for this new scheme but it does also mean that for very little extra risk, the lenders are increasing their margin by over 1%. One thing is for sure, this will be expensive for the new homeowner.

**Help to Buy—the basics**

New scheme (any property)

* Available for homes (new or old) up to £600,000
* 15% of the mortgage guaranteed by Government over first 7 years
* 5% minimum deposit for homeowners

Older Scheme (new property only)

* Up to a 20% equity loan provided by the Government
* Must be a new-build property up to £600,000
* Government's 20% loan interest free for first 5 years. Thereafter 1.75% per annum increasing by RPI plus 1% per annum
* Government participate in equity growth in property

And it's an interesting comparison to make now between the two schemes. The first scheme offers *Interest free* payments over the first 5 years, which would in theory make the new-build option particularly attractive. This interest free period, if used wisely, could help the homeowner pay back a significant part of the Government's equity stake. The fact too that 20% is available on the older scheme rather than just 15% may mean a more expensive (larger) property can come into view but is only appropriate for those willing to purchase a new home.

Both of these mortgage options are definitely designed for those who do not have access to capital from parents or through their early success in the workplace and as ever, if you can avoid using these schemes, it will probably be far more beneficial.

A key question in the press and in our minds is whether this will create and continue to fuel a "bubble" in house prices. It is certainly our real fear that this may be the case. Negative Equity and all of the pain and hardship that was caused in property ownership in the mid 1990's may to some be just a painful memory but at the time it was a huge issue for many. The Government are very keen to promote their two schemes and therefore all we can do is now hope that they have this right. Only time will tell.

## Online Bank Money Management Tools

We were chatting in the office the other day about setting and maintaining personal budgets. "Wouldn't it be good if each of the items of expenditure had a code so that our online banking could recognise what we spent on fuel and at the supermarket etc. It couldn't be *too* difficult could it?"

Well Barclays had already thought of it. With Barclays online banking there is a "Money Tools" section which not only carves up your income and outgoings by category but you can also set a budget for each item so that throughout the month you can see whether you are over-spending or under-spending on any particular category.

For outgoings, there are plenty of basic categories to use and also some sub-categories. If you want to add your own more definitive sub-category you are able to do that too. It really is very flexible. It can't possibly know how to categorise every payment out of your account and so it has an "Uncategorised" element. Each item that is uncategorised is listed easily for you to find and it is a very simple process of attaching a spending category to the item.

Now we know that we go on about the importance of knowing where your money goes and the benefit of setting and maintaining budgets for each spending category, but this type of online banking system really does make the job a whole lot easier. Barclays enable you to download the data to excel if you want to. As far as graphics are concerned, again the Barclays system is excellent and it is also very easy to use.

We have only managed to establish for sure that Barclays offer such a system and so we would be very interested to get your feedback on whether your Bank offers such a facility, and if so how easy is it to use and how useful is it? Please do give us your feedback.

# HeAD LInes

* Home owner lending is up 15% from last year and first time buyer lending is up 33% over the year but buy to let lending is down slightly
* In the run-up to the privatisation a city Stockbroker was quoted as saying that they believed Royal Mail had been undervalued by about 80% by the government. On launch day they went from 330p to 455p however, a jump of 38%
* The Treasury has applied for EU approval to split up the Royal Bank of Scotland in a move that would smooth over the process of carving up the state-owned bank
* The sale of a 6% stake in Lloyds Banking Group has raised £3.2bn and therefore a profit of £61m for the Treasury
* The Government has extended the Equitable Life payment scheme until mid 2015, to ensure as many people as possible receive the compensation they are due
* The first deadline for paying back some €1trn (£844bn) of ECB loans is over a year away. But that looming date is already making investors nervous. The rates at which banks lend and borrow to each other in European money markets have begun to rise
* A slowing economy, sky-high debts and a weak banking sector mean Ireland will need support from the EU when its current bailout ends later this year, the IMF has said
* A sharp pick-up in sales, orders and hiring intentions across Britain has added to the growing weight of evidence that an economic recovery is rapidly taking hold
* Surging business confidence in rich countries has put the global economy “back on track” to resume a steady recovery, according to the latest Brookings Institution-Financial Times tracking index
* The proportion of female directors of FTSE 100 companies has risen to 19 per cent, a study has revealed, up from 12.5 per cent two years ago

## Only In America!

The US Government has failed in its attempts to extend the deadline for the decision on their debt ceiling, leaving just 3 days left to come to an agreement before the government runs out of money on the 17th October and about 700,000 government employees still unemployed. Rather unsurprisingly, this is making worldwide investors rather nervous.

So what exactly are the republicans and democrats disagreeing about? The Republican controlled House of Representatives is trying to delay or cancel funding for the Patient Protection and Affordable Care Act (Obamacare), signed into law in 2010, and the Obama supported and Democratically controlled Senate is very keen to see this through. So far it is looking like an agreement is going to be difficult. But would the government really allow the potential chaos that will erupt from their indecision? Surely not! Only in America...

## Christmas Must Be Getting Expensive!

Did you know there are about 10 weeks left till Christmas? Advent calendars, Christmas cards and even mince pies have already started appearing in our shops. But with costs rising you may be wondering how you can afford Christmas this year? Well a solution is at hand! If you are over 55, you can release some equity from your property to do your Christmas shopping, according to equity release provider Key Retirement Solutions. The trouble is, the *minimum* amount you can release from your home is £15,000! A rather expensive Christmas!
Many are condemning this advert as irresponsible.

Dean Mirfin, group director of Key Retirement Solutions, said: “The principle behind this is to allow readers to consider the different options available to them to make purchases that they plan to make and to consider the best way for them to fund this.”

Equity Release is an option available to those who may need to pay for long term care or who may find themselves with little income and/or capital in retirement. We believe Equity Release should always be used as a last resort for those who have few other options. Is it really an appropriate option for Christmas shopping? We think not...

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