SIMPLYWEALTH

Cogent Financial Planning

clear financial thinking

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YOUR WINDOW ON FINANCIAL MATTERS

INSIDE THIS ISSUE

WHY MACROECONOMICS MATTER

For investors there will always be concern about the global economy.

Uncertainty over macroeconomic factors such as global growth and increased volatility have become recurring themes and risks that can depress stock markets returns come in many forms - from negative interest rates, political upheavals in Europe, slowdowns in emerging markets and declining commodity prices.

ECONOMIC OUTLOOK

The start of the year was characterised by volatility and fears of a global recession, with the slowdown in the Chinese economy being a key concern. Prior to the EU Referendum, many economists saw less signs of recession on the horizon, pointing to a variety of positive factors such as the continuing growth in the US economy, performance in European markets which was better than forecast, and signs that the Chinese economy may be stabilising.

However, following the historic 'Brexit' vote on the 23rd of June, the decision brought uncertainty and confusion to the markets, sterling and the political landscape. What is unclear is how long that uncertainty and confusion will persist. What is clear is that lower growth forecasts mean we can all expect to see lower returns as stock markets around the world respond cautiously to macroeconomic data.

COPING WITH CHANGING ECONOMIC SCENARIOS

Against this ever-changing backdrop of world economic data, what should investors do? The mix of assets in a portfolio is one of the important determinants of performance. The fundamental key to investing is to ensure you don't invest exclusively in one asset or market. Spreading your money around the different asset classes – helps reduce your exposure to concentrations of risk and volatility. Revisiting your risk appetite over the years is important too. While younger investors with time on their side happily accept a greater degree of risk, those approaching retirement may find their appetite for risk diminishes and may prefer to opt for a more conservative investment strategy which gives them less exposure to risk.

While focusing too much on short-term gains or losses is unwise, so too is ignoring your investments altogether. If you haven't reviewed your portfolio for a while, it could be time to do so. Your adviser will be able to check that your asset allocation is still right for you, and undertake any necessary portfolio rebalancing that the review highlights.

The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated.

SIMPLY PUT

Active v passive fund management explained

If a fund is actively managed it will be run by a fund manager or investment team. These professional managers are responsible for all of the fund's investment decisions, including when to buy or sell assets.

Passive funds tend to track or replicate a market or index and include tracker funds or exchange traded funds (ETFs). The fund management fees tend to be far less in comparison with their actively managed counterparts. These types of funds are often run by a computer and select all of the assets in a specific market, to provide a return that reflects the performance of that market.

Active fund managers aim to deliver a superior return to the market. Through extensive research and analysis into markets, sectors and specific companies, active fund managers assess their prospects before making a decision whether to invest or not.

An actively managed fund can offer the potential for higher returns than a market provides if the manager makes the right decisions. This tactical management means when a particular sector looks attractive, or a certain region starts to suffer, the fund manager can move money accordingly to access this growth or avoid potential losses. People pay a premium for active management.

ISA – FLEXIBLE RULES ON WITHDRAWALS

Individual Savings Accounts (ISAs) continue to take centre stage, especially as the Government has recently introduced more products including the Help to Buy ISA and the newest entrant, the Lifetime ISA which launches in April 2017.

The Chancellor pledged a *"radically more flexible ISA"* as a major step in his plans to overhaul the savings industry and encourage everyone to adopt the savings habit.

FLEXIBLE FEATURES

With the ISA allowance at a generous £15,240 for the 2016-17 tax year, you can choose to invest in stocks and shares, save in cash or choose a mixture of the two. You can also transfer back and forth between cash, stocks and shares, or from stocks and shares to cash, all without losing the valuable tax benefits.

Under changes in the rules introduced in April 2015, you can inherit an Individual Savings Account (ISA) from your spouse or civil partner and retain the tax benefits. The surviving spouse or partner is entitled to an additional allowance, an 'additional permitted subscription' that covers the value of their partner's savings as well as their own. They can receive the extra allowance, even if the ISA itself has been left to someone else.

In addition, in another move designed to encourage people to continue to save and retain the tax benefits of doing so, from April 2016 if you take money out of your cash ISA and replace it during the same financial year, you won't lose your tax-free entitlement.

And in further good news for home buyers using the Help to Buy ISA, if they withdraw funds for an intended house purchase, if the house purchase doesn't proceed they can reinvest their savings back into their Help to Buy ISA account and retain the tax advantages.

For those who feel more adventurous, there is in addition the Innovative Finance ISA, said by some to be a half-way house between a cash ISA and a stocks and shares ISA. This type of ISA makes savers using peer-to-peer lending platforms eligible for tax free interest.

And for those who are saving for children, Child Trust Funds can be transferred to Junior ISAs, giving them a wider choice of investments.

CHOOSING TO DIVERSIFY YOUR PORTFOLIO

Successfully achieving your long-term investment goals requires balancing risk and reward. By selecting a broad range of assets in line with your attitude to risk, objectives and time horizon, diversification aims to provide the potential to improve returns for your elected level of risk.

DIVERSIFICATION CONSIDERATIONS

Building a diversified portfolio including a mixture of different asset classes, involves identifying holdings whose returns have historically moved in opposite directions. This aims to ensure that, if a certain part of your portfolio is performing poorly, the rest of your portfolio is hopefully thriving. You can therefore potentially offset some of the impact of poor performance on your overall portfolio.

By selecting different geographic regions and sectors you can diversify further within each asset type. You can also diversify by market capitalisation (small, mid, large cap). Not all caps, sectors and regions prosper at the same time, or to the same extent, so you may be able to reduce portfolio risk by spreading your assets.

You should also consider styles, such as income, capital growth, or a mixture of the two, according to your objectives.

FINDING THE RIGHT BALANCE

Collective investments, such as unit trusts, OEICs (Open Ended Investment Companies), investment trusts and ETFs (exchange traded funds) allow for risk diversification by providing investors with access to a portfolio of holdings through purchasing one or more unit or share. There are thousands of pooled investment funds available, focusing on different sectors and countries. So rather than purchasing one direct equity, a fund will provide you with a whole array of underlying equities. Individual equities have a valid place in a larger portfolio.

Selecting the right amount of funds is important; if you choose too many, you run the risk of over diversification, diluting the impact of the individual funds. The ideal scenario is to select enough funds to diversify, allowing conviction in your investment strategy.

It's also important to analyse the underlying holdings in a fund to minimise duplication and over concentration in a single stock.

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MEETING THE NEEDS OF LAST-TIME BUYERS

Many commentators have pointed out that one of the keys to resolving the UK's housing crisis is to release properties onto the market held by 'last-time buyers (LTBs)'.

Analysis from Legal & General[1] shows that the over-55s now account for £820bn of property, some 18% of the £4.5 trillion housing wealth in Great Britain. Strikingly, 3.3 million (63%) of this group, who have on average two or more unused bedrooms, are keen to downsize when the time comes.

However, one of the main obstacles to this is the lack of suitable housing for them to move to. What LTBs want by and large is well-designed, affordable property close to family, friends and facilities.

A ROOM WITH A VIEW

As many organisations that cater to the needs of older people are quick to point out, there are a range of design features that can make living in retirement more comfortable and enjoyable. Elderly people can remain independent for longer if their accommodation is designed with their specific needs in mind. So good design details such as electrical sockets at waist height, wide doorways that can cater for wheelchairs, walk-in showers and grab rails in bathrooms, good lighting, lifts rather than stairs, accessible local amenities including medical care, would all help to create the right environment that will encourage LTBs to move.

Whilst some developers are active in this sector of the market, they are still relatively few in number and the needs of this market remain largely unmet. Building more homes with different types of tenure – freehold, leasehold, shared equity and rental options would cater for a greater variety of LTB housing requirements.

The Royal Institution of Chartered Surveyors is one of many organisations that believe the way to tackle the housing problem is to put greater emphasis on building suitable retirement accommodation. They also believe that offering financial incentives would encourage older people to downsize. Reducing transaction costs, including cutting or abolishing Stamp Duty Land Tax on purchases made by buyers over a certain age, and offering council tax concessions could all prove attractive inducements to downsize.

[1]Legal and General, 2015

THE IMPORTANCE OF ADVICE – DEALING WITH MARKET VOLATILITY

Volatility is an inevitable part of stock market investing. It is paramount that investors realise the likelihood of price fluctuations and accept that a degree of risk is all part of investing. What you have to decide as an investor is how much risk is right for you.

While the process of building a portfolio includes strategies to reduce risk, it cannot be eliminated altogether, unless you select a 100% cash option.

Regardless of what amount you have to invest, your adviser can help recommend the most cost-effective way to achieve a mix of investments, suitable for you.

PHASED INVESTMENT

One way to deal with market volatility is to gradually introduce money into the market. If you have a lump sum to invest a plan can be set up to help you move this money into the market over a period of time.

When markets are experiencing periods of volatility, phased investment is often advocated as a way to help smooth out peaks and troughs.

REVIEW AND REBALANCE

It is recommended you get into the habit of meeting with your adviser at least annually to up-date your objectives and any changes in your personal circumstances which may affect your finances, such as buying a house, losing your job or receiving an inheritance.

Your adviser will devise a strategy and asset allocation which complements your investment goals. Where necessary, they will take action to rebalance your portfolio. Failure to rebalance after a good run in performance, could leave your portfolio with a risk level that is inconsistent with your strategy.

The value of financial advice comes in different guises and can include enhancement of return on investment, peace of mind, achieving goals and realising opportunities, all combined with future security, ultimately ensuring you have enough money.

Your adviser will be able to manage the inherent volatility of markets, so your savings have the best chance of growing for the future – without giving you sleepless nights in the process and help ensure you aren't taking too much, or too little risk with your money.

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THE NEW LIFETIME ISA – WHAT YOU NEED TO KNOW

The latest addition to the Individual Savings Account (ISA) range was launched by the Chancellor in his March 2016 Budget. Announcing the Lifetime ISA (LISA) he summed up what it had to offer by saying: *"For every £4 you save, the Government will give £1."* The new account will be available from April 2017. The total amount that can be saved annually into all ISAs will be increased from the current level of £15,240 to £20,000 in April 2017, underlining the Government's continuing desire to get us all saving more.

THE RULES

The LISA is designed to help young people get a foot on the housing ladder. They can choose to use some or all of the money they accumulate in their LISA account to buy their first home, or keep it until they reach 60. Whichever way, provided the account rules have been met, there is no tax to pay when you take the money out.

To qualify to open a LISA, you will need to be aged between 18 and 40, and any savings you put in before your 50th birthday will receive an added 25% bonus from the Government at the end of the tax year. There is no maximum monthly contribution; you can save as little or as much as you like up to the annual limit of £4,000. For savers who hold their account for the maximum allowable number of years and contribute up to the annual limit, this could mean they would qualify for total bonuses worth £32,000.

BUYING A HOME

After you've held your LISA for 12 months, your savings and the bonus can be used towards a deposit on a first home worth up to £450,000. If two first-time buyers qualify for the account, then they can both receive a bonus when they buy together.

If you already have a Help to Buy ISA you can transfer those savings into a LISA in April 2017, or continue to save into both (subject to the overall ISA limit of £20,000) but you should be aware that you will only be able to use the bonus from one to buy a house.

Unlike Help to Buy ISAs, which is cash savings only, the LISA can be saved as cash, or invested in stocks and shares. Cash LISAs will attract interest; growth in a stocks and shares LISA will depend on the performance of the stock market and will be free of capital gains tax, as with an ordinary ISA.

SAVING FOR RETIREMENT

You can continue to hold your Lifetime ISA until you reach 60 (although you will only receive the bonus up until your 50th birthday). After your 60th birthday, you can take out some or all of your savings tax-free. Whilst you can withdraw the money in your Lifetime ISA at any time before you turn 60, if you do so you will lose the Government bonus (and any interest or growth on this) and you will also have to pay a 5% charge.

If you want to save specifically for retirement, you should consider taking out a pension plan. Pension contributions attract valuable tax relief.

The final LISA terms and conditions have yet to be confirmed in detail.

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P/E ratio explained

The price to earnings ratio or P/E as it is more commonly referred to, is a useful tool for investors, providing an instant snapshot of a company's finances. Calculated by dividing the stock price by the earnings per share, the ratio shows how many times earnings investors will pay for one share in a company. It shows the premium the stock market puts on the stock of fast growing firms, compared with those experiencing slower growth.

The P/E is the most common financial measure of whether a stock is over or under-priced. The higher the P/E, the higher the market's expectations for strong future earnings growth and the more it is willing to pay, which could mean the share is overpriced. Companies that are not currently profitable don't have a P/E ratio at all.

P/E ratios are particularly valuable for comparing companies in the same industry. The ratio does have its limitations and is just one of many financial ratios for the potential investor to consider.