SIMPLYWEALTH

Cogent Financial Planning

clear financial thinking

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YOUR WINDOW ON FINANCIAL MATTERS

INSIDE THIS ISSUE

DISPELLING MYTHS ABOUT PENSIONS

Arguably, pensions are one of the most misunderstood areas of personal finance. With the introduction of a raft of new measures relating to the operation of defined contribution pensions, much has changed. Here we look to clarify some of the confusion.

MYTH: MY PROPERTY IS MY PENSION

Those who don't have a pension plan often say this. However, contributions to a pension plan attract tax relief, and gains made within the plan are not taxed. On retirement, a lump sum of 25% of the pot can be taken tax-free.

Viewing your main residence as your pension could mean downsizing in order to release cash – not everyone's choice. Property investments can attract Inheritance Tax and Capital Gains Tax. Buy-to-let landlords face tax restrictions on their profits from April 2017. Although property prices have enjoyed a period of sustained growth, there are no guarantees that this will continue.

MYTH: I'LL HAVE TO BUY AN ANNUITY

No-one has to buy an annuity under the new pension rules. However, for many people, being able to guarantee a fixed income for their lifetime and that of their spouse could offer the financial security they are looking for.

MYTH: MY PENSION DIES WITH ME

Under the new rules, if you die before the age of 75, your pension may be paid to the beneficiary of your choice as a tax-free lump sum. (As long as it is less than the lifetime allowance, £1.25 million in tax year 2015-16). There will normally be no Inheritance Tax to pay.

If you die **before** age 75 with your money in drawdown, your spouse, partner, dependant or beneficiary can stay in drawdown and take the income tax-free, take a lump sum tax-free, or buy an annuity where income will be paid free of tax.

If you die **after** age 75, or the funds are paid out more than two years after death, then they can take an income, subject to tax at their marginal rate, take the pension as a lump sum which will be taxed at 45% (expected to be at beneficiary's marginal rate from 2016/2017) or buy an annuity where the income will be subject to tax at their marginal rate.

It is a good idea to take advice from your financial adviser to help ensure you are taking advantage of all of the tax breaks available on your pension contributions.

NEWS IN BRIEF

UK Dividend Cover at Six Year Low

A succession of global and sector headwinds have taken their toll on the profits of some of the UK's largest firms, with coverage ratios also coming under pressure. The dividend cover of the UK's 350 largest listed companies has reached its lowest point in six years, standing at just 1.2 times.

A key ratio to consider when investing in direct equities, dividend cover is essentially the ratio of profits to dividends and of particular importance to investors seeking income.

The higher the dividend cover, the more secure the dividend should be – a reassuring sign that a company can afford and sustain its dividend pay-outs, unless some unforeseen setback occurs. Dividend cover of below one indicates that profits are lower than dividend obligations, and that the firm will be unable to maintain dividend pay-outs without incurring debt. A lower ratio could indicate a cut in the dividend is likely if profits fall.

This serves as a reminder to investors that dividends are not guaranteed.

KNOW YOUR NUMBERS

Ignorance isn't bliss when it comes to managing your money; it can be expensive and might mean that you're losing tax benefits, failing to plan adequately for the future, or missing out on better deals. So, here are a few figures it's worth knowing:

£15,240 - your ISA allowance for 2015-2016. If you haven't already contributed as much as you can comfortably afford, then there's still time. Don't miss out on this opportunity to save tax-efficiently.

Your state pension age - many still think that they'll be able to claim their state pension at 65, but the age limit is rising. Younger people might have to wait until they are 68 or even older. See the government's website (gov.uk) for details.

How long your savings would last if you couldn't work – with statutory sick pay at just £88.45 per week, it makes sense to have a cash cushion to fall back on if you were unable to work due to illness or unemployment. You can put in place insurance to cover the risk.

How much your jewellery and valuables are worth – making sure you can put an adequate figure on these items means that when it comes to home insurance, you won't run the risk of being underinsured. If you don't have the right level of cover, your claim might not be met in full.

The interest rate you're paying on your mortgage and when your current deal ends – although interest rates are currently low, they are predicted to rise in the future. Knowing these facts will help you plan ahead and get the most suitable mortgage for your needs.

The amount you can give away free of Inheritance Tax each financial year - you can make gifts of up to £3,000 in total, plus any number of gifts up to £250 per other recipient. Each parent of a bride or groom can give up to £5,000; grandparents or other relatives can give up to £2,500; any well-wisher can give up to £1,000.

Your home or property may be repossessed if you do not keep up repayments on your mortgage. A fee may apply for mortgage advice and, if applicable, you must ask your adviser for details before making any decision relating to a new mortgage as the actual amount will depend on your personal circumstances, but the typical amount is 1% of the loan value (on a typical £100,000 mortgage, this would be £1,000).

PENSION CONTRIBUTIONS WHY PUTTING IN CASH AT AN EARLY STAGE HELPS

As the old adage goes, 'never put off until tomorrow what you can do today'. This certainly applies when it comes to starting a pension plan.

For those just starting out in life, there can be a lot of calls on their cash - saving for a deposit for their first home, dealing with student debt, or paying off a credit card.

Pensions not only offer a great way of providing for your future, they come with the added benefit of tax relief on the amount you put into your plan, within HMRC's annual and lifetime limits. It makes good sense to review your pension regularly and think about topping it up whenever your finances permit. You'll be able to claim the valuable tax relief available on your contributions – 20% for basic taxpayers, 40% for higher-rate taxpayers.

It's worth remembering that for every year you put off saving into your pension, potentially the more you will need to contribute during the later years of your working life.

However, a simple example shows why starting to save in a pension plan at an early age really makes a difference.

STARTING EARLY PAYS

Starting early can have a real impact on the ultimate size of your pension fund. Take the example of someone saving £100 a month for 40 years (25 until 65 years of age); whilst they would put away the same amount into their pension pot as someone starting 20 years later putting in £200 a month, the early starter stands to accumulate a much bigger fund. Based on (a projected but not guaranteed) 6% investment growth throughout, the early starter would have a fund of around £190,000 whilst the later starter would have built up around £90,000.

WHAT THE STATE HAS TO OFFER

The equalised state pension age scheduled for 2018 is set to increase in stages from age 65, eventually reaching age 68 between 2044 and 2046. A full-rate new single-tier state pension will be £155.65 a week for someone reaching their state pension age after 5 April 2016.

CONTRARIAN INVESTING EXPLAINED

You may have heard the terminology 'contrarian investing', but what does it mean? In the same way that Mary was quite contrary, so too are several high profile fund managers, who are focused on finding long-term growth investments. In basic terms, a contrarian investor sees opportunity in trading specific investments when the majority of investors are doing the opposite.

HOW DOES IT WORK IN PRACTICE?

Contrarian fund manager Alex Wright describes his process: *"I look at unpopular and undervalued shares, I try to out analyse or look at things differently from the market"*. Two key elements to his strategy are downside risk management and unappreciated growth potential. He targets firms with cheap valuations and looks for events that could significantly improve their earning power but are not currently reflected in the share price. These factors include changes in the market in which the company operates or developments affecting competitors.

Strong research and analysis of stock fundamentals is essential. Managers are looking for balance sheet strength, a solid management team, innovative products, efficient processes and good profit margins – and the ability for a company to maintain these fundamentals.

BOTTOM-UP STOCK PICKING

Contrarian investors tend to be bottom up stock pickers, an approach which concentrates on the analysis of individual stocks, overlooking sector or macroeconomic factors and selecting a stock based on the individual attributes of a company. Once a stock is purchased in a fund, the manager will tend to consolidate the position; the skill then is selling at the right time, hopefully following a period of growth, without missing too much upside potential.

Contrarian managers continue their pursuit for strong companies with good growth prospects, in a bid to prove that going against the herd has its benefits and can help grow your portfolio. As with any investment strategy, there are no guaranteed returns with this method.

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.

FINANCIAL OUTLOOK WHAT CAN WE EXPECT TO SEE IN 2016?

The good news is that Britain is regarded by the International Monetary Fund (IMF) as a shining light amongst otherwise gloomy world economies. In October, the IMF revised upwards its forecast for UK growth in 2015, whilst at the same time downgrading advanced and emerging economies, with China being amongst those falling.

For 2016, the IMF predicts UK growth at 2.2%. It expects to see continued steady growth supported by lower oil prices and continued recovery in wage growth.

Following the release of these figures, Stephanie Flanders, who is now Chief Market Strategist for Europe at JP Morgan Asset Management, commented on her view of the UK's future prospects and the potential effect on investment returns; *"In the years after the financial crisis, it was great to be an investor, but perhaps not great for the economy. You had low growth, low inflation, low interest rates, and rising asset prices. But the signs are now that this is starting to change, for much of that period there was a high level of employment in the UK, but wages were low. It is almost as though the whole country took a little of the pain, jobs were there for people, but the wages were not great. But we are now seeing wage growth and we are also seeing productivity growth, which means that each worker is producing more, and interest rates will go up, this is likely to mean that soon it will be a good time for the economy, but a less good time for investors, who might have to get used to lower returns."*

THE WAY AHEAD

Against this economic scenario, the basic principles of sound investment remain constant. It pays to have a diversified portfolio with a mix of shares, bonds, property and cash, with a good market spread. Don't be spooked by volatility and be realistic about expected returns. If it's been a while since you last reviewed your portfolio, why not arrange to do so now?

WHAT IS AN INVESTMENT TRUST?

Investment Trusts are similar to Unit Trusts in that they are a form of pooled, collective investment. Like Unit Trusts, they are managed by a professional team responsible for defining the strategy and choosing the investments. Where they differ is that Unit Trusts are 'open-ended' which means they are, in theory, capable of increasing their size with no limit as to how large they can grow.

As more money is invested, new units are created and the fund expands. By contrast, Investment Trusts are 'closed-ended' which means their ultimate size is limited. This means Investment Trust managers won't have to buy and sell investments to match consumer demand for shares.

Investment Trusts are set up as companies and floated on the London Stock Exchange. Their shares may trade at a discount or premium to net asset value. As with any company quoted on the stock exchange, Investment Trusts have to publish an annual report and audited accounts. They also have a board of directors to which the manager is accountable and which looks out for the shareholders' interests. When you invest in an Investment Trust, you become a shareholder in that company.

BE AWARE OF THE EFFECTS OF GEARING

Unlike Unit Trusts and Open-ended Investment Companies, Investment Trusts can also borrow funds which can enhance returns, but can also increase their risk and volatility, potentially giving investors a bumpier ride along the way. This borrowing of funds is referred to as gearing; when a trust is performing well, shareholders enjoy an enhanced or 'geared profit'. However the reverse is true, if the trust performs poorly then the loss is similarly magnified. The managers will borrow to increase the trust's market exposure when perceived opportunities arise.

SOME BENEFITS THEY OFFER

Like other collective investments, Investment Trusts offer exposure to a diversified, professionally managed portfolio. Risk is spread as the managers can invest in a variety of assets, including property, bonds, company shares and cash, depending on the funds objectives. Investors can select from a variety of trusts according to their requirements, offering them exposure in the UK and other markets around the world, to the extent permitted by the Investment Trust's Memorandum and Articles of Association. They are usually liquid investments, meaning they are easily purchased and sold.

WHO ARE THEY RIGHT FOR?

It largely depends on your appetite for risk and your time horizon. Investors who are willing to take on slightly more risk often opt for an Investment Trust. You would also need to be prepared to invest for the medium to long term, say five years or more. It is important to realise that, as with all stock market investments, the value of your shares can go up or down and you could get back less than your initial investment.

As with all investment decisions, we recommend you take financial advice to help ensure you make the right choice for your financial circumstances.

It is important to take professional advice before making any decision relating to your personal finances. Information within this newsletter is based on our current understanding of taxation and can be subject to change in future. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK; please ask for details. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from taxation, are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.

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. If you withdraw from an investment in the early years, you may not get back the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency.