

REDUCING INVESTMENT RISK

Diversifying investments has long been recognised as one of the most important means of reducing risk. But the full benefit of diversification will not be felt if the investments held are likely to react in a similar way to the factors which affect financial markets – including interest rate movements, wars and US house price bubbles.

For this reason, investors have begun to think of diversification in different terms. Traditionally, the question was how to split a portfolio between shares and fixed interest securities, and how to split the equity element between UK, US, European and other markets.

However, one of the consequences of the increasing globalisation of companies and markets is that the major markets now tend to move in unison, particularly when interest rates are on the rise.

Commercial property is rightly considered to be a useful diversifier, but of late it has moved in the same direction as shares and fixed interest securities.

It is this which has prompted growing interest in so-called Multi Asset investing. This embraces a wider range of investment options, including gold, energy, hard commodities (such as minerals), soft commodities (such as wheat and corn) and financial instruments such as hedge funds.

The way to gain access to these types of investment is through Multi-Asset funds and some Multi-Manager funds. An increasing number of these funds are majoring on asset allocation rather than fund or stock selection, and in the hands of the right manager they provide an excellent starting point or core holding for a portfolio. They can also provide access to some investments which are not available directly to retail investors.

TIMING ANNUITY PURCHASE

Most holders of Personal Pensions and other forms of money purchase pension scheme convert their funds to annuity as soon as they retire, even though the rules permit them to leave the decision until age 75. But is this always the best thing to do? After all, roughly one in ten of today's 65 year olds will live to be 100.

Two main factors affect the level of income which can be secured by purchasing an annuity. One is the return which the annuity provider thinks it can achieve by investing the pension cash which it receives, and the other is the size of the pool of excess funds created by the death of those annuitants who live less long than expected.

At present rates, a 60 year-old man with a pension pot of £100,000 could buy a pension annuity of £6,500 a year. But this is only £1,000 p.a. more than the income from a Gilt-Edged security which, unlike annuity purchase, would leave the capital intact.

If, however, the man in question were to have waited until age 75 to cash in his pension pot, the £100,000 would have bought an annuity income of £10,300 p.a. And if his health had by then deteriorated it is possible that he could have achieved an annuity income of £15,000 p.a.

There are a number of ways of funding retirement income while delaying at least in part the encashment of pension pots. One is to live off the tax-free cash and perhaps the income from other investments. Another is to maintain pension funds in place and to draw an income from them ("income drawdown"). A third is to purchase a short-term annuity.

A further advantage of delaying annuity purchase is that with increasing age the number of unknowns affecting the selection of annuity options decreases.

CAPITAL GAINS TAX REDUCED

Not everyone welcomed the announcement in the Chancellor's pre-Budget Report that capital gains will in future be taxed at the flat rate of 18%. However, most investors will benefit from the abandonment of the complicated taper relief and indexation arrangements which currently provide the means of reducing the burden of gains tax.

One of the consequences of the change will be the importance of the selecting investment tax-wrappers, depending on whether the investment is designed to produce income or capital gains.

For example, an offshore investment bond permits the investment growth to roll-up free of tax, but the encashment value will be subject to income tax at the investor's highest marginal rate, whether the return derives from income or capital growth.

Currently, capital gains are taxed at the same rate as income, but in future it will be much more tax-efficient for UK investors to hold investments which generate capital gains (i.e. equity investments) within a Unit Trust or OEIC, which will benefit from the reduced gains tax rate.

On-shore Investment Bonds are taxed differently and their suitability will depend on individual circumstances.

The choice of wrapper for income-generating assets is also not clear-cut, though as far as deposits are concerned, basic and lower rate taxpayers are likely to be best served by holding these direct.

GUARANTEED INVESTMENTS

... can be summed up in the old Dutch saying "if I have to promise you more I'll have to give you less"

November 2007



Clairville York Limited
 The Bellbourne
 103 High Street
 Esher
 Surrey KT10 9QE
 Tel: 01372 470 477

