

RIDING OUT THE STORM

All investments carry a degree of risk, and as depositors in Northern Rock discovered, this also potentially applies to cash deposits. But most people need to save – perhaps against a rainy day or to improve their retirement – and saving means investment. So there is no avoiding the need to take some risk. The important thing is that the risks individuals take should be consistent with their experience and their willingness to look beyond temporary setbacks.

Tracing the progress of stock markets over the past century, what is surprising is that the major setbacks barely register a blip in what is otherwise a steady upward progression. Even the dramatic decline of the early 1970s, when the market fell from 520 points to a low of 147 – the most devastating fall in recent memory – hardly registers on the chart.

So the first point to make is that investors need to take a long term view. This makes it easier to remain reasonably relaxed while the lemmings are piling into 'flavour of the month' stocks or rushing for the exits. When the sun is shining all news is good news, but when sentiment is negative, good news tends to be ignored.

Different economic conditions favour different sectors. In 2007, for example, the property market, which had become over-inflated by cheap credit, went into reverse, while the commodity market, driven by the demand for minerals and food by the emerging economies, maintained its strong upward path. Investors with well-diversified portfolios have the reassurance of knowing that they can take the rough with the smooth.

Until recent years, it was considered that the basis of diversification was a judicious split between equities (for the most part UK equities) and gilt edged securities or corporate bonds.

Now, both equities and bonds are viewed globally, with increased emphasis on emerging markets, and property and commodities have become important ingredients in the investment mix.

There is also increasing evidence of the value of hedge fund techniques (particularly the 'short' selling of stocks which appear over-valued) in providing a degree of protection against market fluctuations. The managers of these funds are betting that some stocks will go up and others down, and the best managers have made some good calls for their investors.

There is, though, a school of thought that since a high proportion of fund managers under-perform their market average, certain investors could avoid the significant cost of fund management and rely on tracker-style funds to give them 'passive' exposure to the major asset classes: equity, bonds, property and commodities and the sectors within each of these asset classes.

Whether the investor favours an active or passive portfolio – or a blend of the two – the objective should be to achieve a sensible balance of holdings within the comfort zone of the individual investor and not be panicked by periodic fluctuations.

AGE ALLOWANCE

The increase of almost 20%, which is being introduced in the Age Allowance to compensate for the removal of the 10% tax band, makes this Allowance even more valuable for the over 65s. But both the Age Allowance and the Married Couples' Allowance, which is available to those aged over 73, are reduced when pension or other income exceeds a given figure.

The individual income limit for age-related Allowances in 2008/9 is £21,800 and the combined effect of tax and the reduction in the Allowance on any excess of income over this level is effectively to increase the marginal rate of income tax to 30%.

One way of avoiding this is to invest non-pension assets in an Investment Bond, which being a form of life policy produces no income as such, but permits up to 5% of the value invested to be withdrawn each year so as to provide what amounts to an income, without giving rise to any immediate tax consequences.



If the bond is encashed, the overall gain might well impact the age allowance/s, but this would affect a single year's allowance/s whereas the benefit would have been enjoyed every year that the bond had been held, and the risk of the gains from the bond crystallising by reason of the death of the investor could be avoided by writing the bond in the names of both the investor and selected family members.

PENSION BOOSTER

Many employees contribute to pension plans from their net salary, and they are happy that their contributions are eligible for income tax relief, in the form of top-up payments by the Revenue.

However, contributions made from salary will still have suffered both employers' and employees' National Insurance contributions (NIC's) at rates of 12.8% and 11% respectively.

One way to avoid this charge is through 'salary sacrifice'. That is to say, an agreement between employer and employee that the employee's contract of employment will be amended by reducing salary and paying an equivalent amount into pension on the employee's behalf. The considerate employer should also be willing to pay the value of the saving in employers' NIC's into the pension as a bonus contribution.

However, salary sacrifice is a long-term contractual commitment, and cannot be turned on and off to suit the employee.

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No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice. Please remember that past performance is not necessarily a guide to future returns.

The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

CLAIRVILLE YORK LIMITED, THE BELLBOURNE, 103 HIGH STREET, ESHER, SURREY, KT10 9QE

TEL: 01372 470477 – Fax: 01372 469777 – E-MAIL cyfsl@cyfsl.co.uk

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