

## Investment Markets

At a recent investment conference, four leading fund managers were asked to champion the sector in which they invest – respectively, UK equities; global equities; corporate and Government bonds; and emerging markets.

The conclusion was that the sector which seems currently to offer the greatest potential for growth is emerging markets, followed by bonds, with little enthusiasm being shown for other equities. However, all the managers agreed that the least attractive investment is cash.

Fund managers have been gradually unwinding the cash holdings in which they sought refuge in the market storms of Autumn 2008, and bonds have been the main beneficiary of this move.

Initially, UK Government bonds were favoured, not least because they offer the maximum security. However, the explosion in the Government's borrowing needs is likely to result in higher interest rates, which would undermine capital values. Hence the preference now for corporate bonds (and convertible and preference shares, which offer both income and the prospect of capital appreciation).

Economists' predictions are for continued deflation for another year or two, followed by inflation as the increase in the money supply feeds through into the economy. This suggests that conventional gilts will remain unattractive, but index-linked gilts could come into their own.

On the equity front, the preference for emerging markets needs to be put into perspective. Most investors would be advised to keep the bulk of their equity holdings in the developed markets, but there could be merit in increasing the proportion devoted to emerging markets.

Before the global economic crisis, emerging markets were assumed to be subject to different stimuli and therefore to be 'decoupled' from developed markets, thus offering a useful means of diversification. However, the crisis sucked all equity markets into its vortex, and the revised assumption was that the emerging markets would take even longer to recover.

What has actually happened, however, has been that emerging markets have led the recovery in share prices and the Financial Times now speaks of a "great decoupling", prompted partly by the fact that these markets fell more heavily initially, but also because of the importance among the emerging economies of China, whose government appears to have been successful in stimulating a recovery which is also benefiting other countries.

Hence the withdrawal of investment funds from Europe and the US in favour of emerging markets; and hence the success of the conference speaker whose fund had benefited from these trends.

## Pensions Complication

The Government drove another nail into the coffin of pension simplification with its Budget announcement that higher rate pensions tax relief was to be curtailed for those earning over £150,000 a year.

As from 6 April 2011, tax relief on pension contributions will be reduced to 20% for those with "relevant income" over £180,000 p.a. and relief will be tapered between 40% and 20% for those whose relevant income is between £150,000 and £180,000 p.a.. "Relevant income" for this purpose includes earnings, pension income, dividends, interest on most savings, rental and trust income.

"Anti-forestalling" rules apply in respect of the period between 22 April 2009 (Budget day) and 5 April 2011. These are designed to remove any advantage which might have been derived from increasing pension contributions before April 2011. For individuals whose relevant income exceeded £150,000 p.a. in 2009/10 or either of the two preceding tax years, 40% tax relief on contributions will be confined to the greater of their "protected pension input" and a "Special Annual Allowance" of £20,000.

Those with relevant income below £150,000 p.a. can continue to obtain higher rate relief on all contributions.

"Protected pension input" means an individual's established pattern of regular contributions which are made monthly or quarterly.



Where contributions exceed the Special Annual Allowance, tax relief will continue to be available as normal but there will be a 20% tax charge on the excess. Current regular contributions of over £20,000 p.a. will similarly be eligible for higher rate tax relief, but any single contribution or increase to a regular contribution which takes the total for the tax year to more than £20,000 will attract the 20% charge. However, those already contributing more than £20,000 p.a. on a monthly or quarterly basis are not affected.

The reduction in tax relief for people with incomes over £150,000 p.a. is a major disincentive to those affected, who as from 6 April 2010 (or a year earlier in the case of some professionals) will be paying income tax at 50% and may only be able to claim relief at 20%.

## Ways and Means

Another Budget announcement designed to penalise the "rich" was that with effect from 6 April 2010 the personal tax allowance for individuals with taxable income over £100,000 p.a. will reduce by £1 for every £2 of taxable income over £100,000.

However, if the same principles are applied as for age allowance, it should be possible to reduce taxable income to less than £100,000 by making a personal contribution to a registered pension scheme.

Employees in company schemes should be able to derive similar benefit by arranging to sacrifice part of their salary as a pension contribution (which also achieves a saving in National Insurance contributions).

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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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