

DEFENSIVE INVESTMENT

The traditional way of assessing fund performance has been benchmarking – that is to say, comparing the performance to that of other similar funds.

But in times when fund prices are falling it is of little consolation to investors to know that their fund has fallen less than others. The fact is that, if sold at that point, it might have lost them money. And, as John Chatfeild-Roberts of Jupiter has commented in his book "Fundology", *"for most private investors, the risk of losing money is a much more important risk than to lose money against a particular benchmark"*.

It is this thinking which has given rise to what are known as Absolute Return funds, whose objective is to make positive returns regardless of market conditions. A variant is the Target Return fund, whose objective is usually to beat the return available from cash.

Absolute Return funds began to appear in the period after the decline between 2000 to 2003 which followed the bursting of the dot-com bubble, when some investors were nervous of going back into the market. But it transpired that the market was set for a four-year period of sustained growth, and the new funds performed poorly compared with benchmarked competitors. Only during the summer of 2007 have they demonstrated the protection they can provide in adversity.

It is important, however, not to assume that all these funds are similar. They take many different forms. Some are equity-based, some are based on fixed-interest securities, and others adopt a multi-asset approach. Many use futures and options to smooth their returns, which places additional demands on the expertise of the fund managers.

It is early days in this new market and managers have to prove their

ability to make best use of the wider range of tools at their disposal. But Absolute Return funds have started to prove their value and there is little doubt that they will have a role to play in the portfolios of many investors.

IT PAYS TO BE MARRIED!

New laws are being drawn up to give cohabiting couples similar rights over financial assets to married couples; but these will only apply when the relationship breaks down. Until that point, marriage will continue to provide greater benefits.

Married couples enjoy advantages in relation to Income Tax, Capital Gains Tax and Inheritance Tax, but it is the Income Tax advantages which are the most straightforward and the least controversial.

The fact that assets can be transferred freely between spouses and civil partners means that income-producing investments can be placed in the name of the spouse who pays tax at the lower rate. This could also apply to the ownership of a second home, the rental income from which could be used to ensure that the personal allowance of a non-working wife was utilised and any income in excess of the allowance taxed at a lower rate than that applicable to the husband.

Equally, married couples can plan their Wills so as to ensure that each makes full use of the £300,000 "nil rate band" of Inheritance Tax. It has long been standard advice for married couples with taxable estates to execute back-to-back Wills creating "nil rate band" discretionary trusts, and if properly constructed this arrangement is still effective and can achieve substantial savings, despite an adverse ruling in the recent case of an academic, Dr Phizackerley, where the facts were very unusual.

Some couples have sought to take full advantage of their annual allowance for Capital Gains Tax by undertaking a "bed and breakfast" arrangement whereby the spouse who wishes to crystallise gains on an investment but not to relinquish the investment would sell enough to utilise the allowance and then arrange for it to be bought back in the name of the other spouse. However, the Revenue are thought now to be critical of such arrangements, and could call them into question.

A WELL-TRIED TAX SAVING SCHEME

A long-standing method of reducing liability to Inheritance Tax is the 'back-to-back' arrangement whereby money is invested in an annuity which produces an income (part of which is free of Income Tax) which is used to pay the premiums on a life policy which is held in trust for the investor's beneficiaries, thus taking the value outside the investor's estate.

The purchase of the annuity reduces the investor's taxable estate by the amount invested (thus potentially saving 40% tax) and it is the premiums on the life policy which are regarded as gifts for the purposes of Inheritance Tax. However, these will normally be exempt because of the annual £3,000 exemption and the exemption for gifts out of income. The overall scheme, therefore, is extremely tax-efficient.

The main condition imposed by the Revenue is that the two parts of the transaction – the purchase of the annuity and the purchase of the life policy – should not be directly connected. Each must be bought independently on the open market, and the arrangement could fall down if for example the two insurance companies were members of the same group or if one were insuring the other's risks. Taking expert advice is essential.

September 2007



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