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# Dare we feel hopeful yet?

After an appalling 2008 and early 2009, post-March has been a much-improved period for investment returns and equities regained pre-Lehmans levels in recent weeks. Markets are up around 60% from lows – despite the recent crisis in Dubai – with emerging markets leading the way, and areas including credit, oil and gold all improving.

But looking into next year, many believe this may be just a bounce back from previous levels of panic and could fall away, especially as there remain few signs of genuine macroeconomic improvement.

There are several macro questions that may determine investor fortunes in 2010, including withdrawal of quantitative easing (QE), ongoing bank health and inflation/deflation.

Alan Brown, group CIO at fund management group Schroders, says the financial system is not back to business-as-usual but the worst possible outcomes from the financial crisis appear to have been avoided. On QE, he believes timing will be key when the banks come to reverse this policy.

*“If the Bank of England were simply to go out there and sell what it has bought, it would be adding to already skyrocketing supply from the Debt Management Office, potentially precipitating a sharp rise in yields,”* he adds. *“Fortunately, we believe*



*it has other options. The Bank could simply hold the securities until maturity allowing for a natural run-off or turn surplus deposits into required deposits by changing the reserve requirement.”*

On the question of bank health, John Greenwood, chief economist at Invesco Perpetual, one of the biggest fund management houses in the country, believes we are through stage one of problems but have stages two and three still to come.

*“Stage one was essentially the losses banks made on their capital market transactions, against which we saw huge write-offs last year,”* he says. *“What we are seeing now is the losses coming through from the recession – small businesses going bankrupt, commercial property businesses failing and so on.”*

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# Where did all the income go?

## Boost for savers with ISA allowance increase

This year's Budget brought with it new limits for ISA contributors over and under 50 years old.

Those 50 or over on 5th April 2010 could, as of the 6th October, invest up to £10,200 in ISA amounts overall. These amounts can be split half and half into a cash or a stocks and shares ISA.

For those 49 or under as of that date, the current limit for this tax year remains at £7,200. However all investors have the increased limit of £10,200 available to use from the start of the next tax year in April.

If you have not used your entitlement this year or are unsure where to invest your ISA, talk to us. We can advise you on the best ISA to meet your needs so don't miss out on your tax-free investment opportunities.

## With many equity income funds expected to cut dividends next year, yield-hungry investors may have to rely on other sources to meet their needs.

On the banking side, there are several high interest accounts available and many firms also offer fixed-rate bonds for investors willing to tie up their cash. But with interest rates low and expected to remain so, income from this type of product has plummeted in recent times.

National Savings and Investments, for example, offer tax-free returns on its fixed interest and index-linked saving certificates. With a minimum investment of £100, the tax-free three and five-year bonds both give RPI plus 1%, which is equivalent to a gross yield of RPI plus 1.67% from other income products.

Also available for investors are guaranteed income bonds (GIB) from insurance companies, which pay a fixed income over a set term and return capital in full at maturity.

Where clients prefer to retain an investment bias, there are equity income funds although many are currently suffering from a yield drought in the UK market. Much of the current income problem is down to financials, with several banks forced to cut or suspend dividends as they attempt to repair badly damaged balance sheets. The

income hole left by these stocks means 50% of the FTSE yield now comes from six stocks and the top 15 companies account for 66% of dividends. One way to avoid this is by looking overseas, with various European, US and Asian income funds capitalising on the growing dividend culture in these countries.

Investment trusts are also an option, with many able to show enviable track records of increasing dividends year on year. Recent research from the Association of Investment Companies (AIC) revealed a fifth of 159 trusts with 10-year track records have grown payouts annually over the last decade.

Annabel Brodie-Smith, communications director at the AIC, says: *"Investment companies can retain some of the income they receive each year and transfer this to revenue reserves whereas open-ended funds are required to pay out all their income. These reserves can be built up in good years and used to boost shareholder dividends in more difficult periods. This is known as smoothing dividends and is a key advantage of the investment company structure."*

Elsewhere, assets such as bonds and property can offer decent yields, with the latter in particular moving back to its traditional income profile. Many investors are now beginning to look at property again after massive capital declines in 2008 and its income yield has moved to the highest premium relative to gilts since the 1930s.

Certain structured products also provide decent income, although several players in this space have gone under in recent months, so research is vital.

As ever, the best income option will depend on your particular needs and risk tolerance as a combination is often best. **Contact us** – we can help you determine your best options to achieve the desired outcome.



# The changing face of advice



**All independent financial advisers are being asked to change the way they charge for their services when advising on pensions and investments in a review, set out by the regulator, known as the Retail Distribution Review (RDR).**

They are also expected to increase their qualification levels to approximately double the average current level, with a deadline set to meet all these changes of December 2012.

Beyond this date, advisers may not be able to call themselves “independent financial advisers” (IFAs) though there is some debate suggesting some may be able to move to another more restricted category of advising. However under the current plans the Financial Services Authority (FSA) looks likely to decide that advisers who do not make the grade and pass the extra exams will simply have to stop advising.

If the Conservative party is elected in the meantime, some of the details may change. The party has said there may be some easing of the timetable if they are in government. Among others things, the Conservatives plan to replace the FSA with a new Consumer Protection Agency, but they say the fundamental shape of the reform will remain.

## **What does this mean for clients?**

The biggest change for clients is the move to something called adviser charging. This means an IFA will no longer be able

to charge for his or her services using commission from a provider i.e. a fund manager or an insurance company, to pay for his or her advice.

The other part of the equation will see fund managers and insurers banned from paying commission when it is attached to an investment or pension product.

IFAs may take a commission when it applies to protection insurance – effectively life insurance, critical illness cover or income protection, though once again the debate about this area continues. Advisers may also continue to take a procuration fee, paid by lenders on a mortgage referral, which is similar to commission.

The FSA believes that by stopping the use of commission it will stop an adviser biasing any recommendations they make either to a particular provider or to a particular type of product which pays more commission. The FSA says it will also remove any *suspicion of bias*.

Any charges for advice will have to be agreed upfront with clients. These may be taken out of initial premiums or investments or from investments made over time. This is known as the adviser charge.

## **More qualifications**

After the RDR, advisers should also be more highly qualified. The bodies which decide on the content of the exams are now considering exactly what that content should be. Many advisers are already moving in the right direction by taking further existing qualifications and some are already qualified to what is seen as an acceptable level – e.g. a Certified Financial Planner or a Chartered Financial Planner.

The debate is ongoing and widespread among the financial services industry, but no one will see the outcome until the end of 2012.

**“Do you have a lump sum to invest? We can help.**

Call us today or complete your Reply Card on page 7 of this newsletter”

### The first rung is the highest

The Financial Services Authority crackdown on self certification mortgages, announced in October this year, has provoked a great deal of debate about whether the self-employed and contract workers will be able to get mortgages.

In the wake of the paper, the last lender offering self certification pulled out of the market at the start of November. The move means that those seeking a mortgage are expected to have to provide lenders with at least three year's accounts to be eligible for a mortgage.

However since the paper, the FSA says it is lenders not the FSA, who are effectively slowing down the market. They argue their paper does not prevent lenders taking into account irregular income streams when considering a mortgage but they have to prove the existence of such income.

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# Looking after number one?



**Businesses often forget that the insurance of key people – including the owners – is an important element of business planning. Indeed, many people suggest it is so vital that it should be part of any business plan.**

The types of insurance, which may vary with the different types of business you may own or run include key person insurance, director protection, partnership protection, business loan protection and sole trade insurance.

**Key person insurance** – sometimes referred to as key man insurance – allows you to insure the business against a number of

named key individuals falling ill and against their death. Key man insurance should attract tax relief providing those insured are not significant shareholders in the business and any payout will seek to replace any profits specifically lost by the loss of that person from the firm. The policies are usually annual or five year terms.

**Partnership insurance**, or shareholder protection insurance, will allow the firm's other directors or partners to buy out another shareholder or partner – once again if they become seriously ill or from their estate if they die. This can be crucial if the remaining partners or shareholders do not have sufficient funds on their own.

**Insurance for sole traders** would tend to involve income protection and family income benefit designed to make sure the business could pay invoices arising if the sole trader could no longer work and so the sole trader's family can be supported.

Given that business protection insurance always involves individual sets of circumstances and that insurers' policies and attitudes to different types of risk vary widely taking qualified advice is recommended. **Contact us** if you are a business owner to review your business planning. For senior directors and those running small firms, it is arguably as important as other types of required insurance and indeed pension planning.

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## Is 55 the new all-important age?

**Pension savers looking to take tax-free cash and pension benefits before they are 55 need to make sure they take advice well before 5th April next year.**

The trend is for all dates surrounding retirement to increase and all political parties are committed to increasing the state retirement age. But for those aged 50 but under 55 who are invested in a personal pension, a stakeholder pension or a group personal pension, the age at which pension benefits can be accessed is changing, and is a deadline which should not be ignored.

### No need to get caught out if you plan ahead

The deadline may be of particular concern to people who are thinking of drawing on their pension fund who will reach age 50 before April 6th 2010. Anyone who wants to access their pension fund, e.g. to take tax-free cash or arrange an income in retirement, needs to take advice as soon as possible.

This change also applies to anyone who is thinking of taking tax-free cash but wants to continue working whilst continuing to pay into the pension. It is vital to take independent advice since taking tax-free cash reduces the amount of eventual pension income.

There are also limited opportunities to reinvest tax-free cash in a pension although there are rules about the recycling of this cash, so once again specialist advice should be sought.

# How to avoid the pensions hammer



**Chancellor Alistair Darling announced several measures to limit pension tax relief for higher earners in 2009's Budget and pre-Budget report – all coming in over the next few years.**

Starting in 2011-12, relief on contributions will be restricted to basic rate for individuals with an annual income of £150,000 or higher.

Another change involves the personal allowance (the first slice of tax-free income), which will decline on salaries above £100,000. From April 2010 this will reduce at a rate of 50p per £1 earned over the limit. Those earning above £112,950 will see it wiped out entirely, calculated by doubling the 2009/10 allowance of £6,475. Effectively, this means there is a band of income where the marginal tax rate is 60%, with the additional 20% created by each £1 that pushes another 50p into the 40% earnings bracket.

**As ever with complex pension legislation, there are ways to take advantage**

A £110,000 salary for example will wipe out £5,000 of the personal allowance from next year but it is possible to get this back by bringing your salary under the £100,000 threshold.

One way is to contribute £10,000 into a personal pension. By reducing salary, you can effectively regain the £5,000 personal allowance and will also benefit from the usual 40% tax relief on this additional pension contribution.

Another potential tax-efficient route is to consider reducing earnings to £100,000 via a "salary sacrifice" arrangement.

This means employees agree to a reduction in future remuneration in return for their employer contributing towards non-cash benefits such as pensions. The key advantage is that this money is removed from the National Insurance net, cutting the tax bill for both the employer and employee. This looks even more attractive after the recent pre-Budget report, in which the Chancellor announced a further 0.5% rise in National Insurance contributions from 2011.

Despite this, it is also important to note potential disadvantages, in that the reduced salary may affect the level of State benefits available, or the amount a lender might be able to offer for a mortgage. So it's important to take financial advice.

The pension arena is a complex one, so for specialist advice on your pension requirements [contact us](#).

Some may be phasing their pension income but may be caught out by the age change if the next phase is after April 5th and they are under 55. The deadline will also affect higher rate tax payers who might choose to invest in a stakeholder style pension with the aim of taking a lump sum immediately – say as part of redundancy planning.

Those who feel they have sufficient funds to take early retirement and all their pension entitlements as income now, could find themselves unable to do so unless they act quickly and contact an adviser.

Pension decisions are very important ones, which could significantly alter your circumstances now and your income in retirement. To make sure you don't get caught out [contact us](#) – we will be happy to help.



*"The first rung is the highest" continued*

In practical terms, the FSA will bring the measures in through next year and only then will it be possible to see what impact this has on the available supply of mortgages. It also depends on lenders being able to lend more in general too and they are unlikely to prioritise mortgages for the self-employed except for those with a large amount of equity in their house already or with large deposits.

For first time buyers (FTBs), they, at least, are seeing an easing off in prices for one and two-bedroom flats, though some price surveys show increases recently. However most face a difficult task in getting together a deposit.

In many cases, this now needs to be 25% of the asking price with the Council of Mortgage Lenders estimating that around 80% of FTBs are getting help from the parents with a deposit.

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*'The first rung is the highest' continued*

There are some 90% loan-to-value mortgages available and even a handful of 95% but they come at a high interest cost which can cost thousands annually in extra mortgage payments. There also remain a range of part-rent and part-buy schemes available through housing associations.

Our advice for FTBs and their parents is that they **contact us** for advice to make sure they find the most appropriate mortgage and understand the financial consequences.

**Your home may be repossessed if you do not keep up repayments on your mortgage.**

*There may be a fee for mortgage advice. The precise amount of the fee will depend on your circumstances and/or amount of borrowing. We will notify you of any costs before advice is provided.*



### **Families tend to cut spending on their children last.**

If they have also developed the habit of saving and investing for their children, this may well be one of the last things to be cut when times are hard. With Child Trust Funds (CTFs), politicians have offered a helping hand since 2002 but that help is now under threat.

The Conservative party has threatened to axe the CTF for middle class families and restrict it to those earning less than £16,000. However those funds which are already opened will not be affected.

Currently children born after 1 September 2002 receive a £250 voucher from the Government. Those from lower income families receive £500. This can be invested by the parents into a fund or, if parents fail to do so, will be invested by the Revenue 12 months later.

Children aged seven receive a further £250 from the Government. Relatives can invest a further £1,200 a year tax-free. The fund can be accessed by the children when they reach the age of 18 and they can expect to have a say in the investment decisions from 16.

CTF savings accounts are provided by most of the major banks and building societies.

Alternatively, parents may decide to place the money in a stakeholder account – with charges capped at 1.5% a year. The money is invested in equity funds with some in 'safer'

investments such as bonds. The proportion of safe investments is intended to increase as the child gets closer to 18 when they may seek access to the cash.

For those favouring a higher risk option, money could be placed in a shares account. These may have higher minimum investment levels, and a higher level of investment risk.

Funds include the Baby Bond or Baby Bond Choice account from specialist provider the Children's Mutual, which provides access to one or several fund managers running a range of funds. F&C also offers both stakeholder and share accounts. Both these firms are lobbying intensely to preserve the full CTF regime.

Parents who really wish to think ahead still have the option to place £3,600 annually into a stakeholder pension for their children. This will also receive tax relief, at 20% increasing the effective amount invested substantially and benefiting from a greater potential in terms of compound returns before they retire. Some pension providers actively market their stakeholder pensions to children such as Legal & General.

For those aiming to save additional money to create a substantial pot of money to enable them to pay school fees, seeking advice from us will help you to consider how you can adjust your planning to achieve your goals. We will be able to advise you on how best to manage the money to allow growth but also to prepare for the regular annual expenditure that such fees entail.

During political party conference season in October, Shadow Chancellor George Osborne gave a speech outlining the potential savings by scrapping the Child Trust Fund scheme for families earning more than £16,040.

He said: *"Handing out new baby bonds is a luxury that we can no longer afford".*

The Government has issued over 5 million vouchers since the scheme started, demonstrating its popularity. But the Tories said by issuing new CTFs just to disabled children and those from the poorest one third of families would save £300 million a year.

# Investing in the small acorns!

The Government continues to seek to encourage private investors to invest in start up and relatively immature companies in a bid to grow the economy, and offers generous tax advantages to help convince investors to do so.

However in recent years, rules have tended to change frequently as the Government fine-tuned what could be invested in, how much and for how long. This has frustrated investors, fund managers and companies alike. But Enterprise Investment Schemes (EISs) and Venture Capital Trusts (VCTs) still carry significant tax planning benefits worth considering.

## Venture Capital Trusts

VCTs offer tax relief of 30% for 2009 with an individual investment of £200,000 that can be set against income tax at either higher or lower rate. This brings tax to nil, although it is also reduced by pensions and gift aid contributions.

There is an exemption from income tax on dividends within the VCT and profits made from disposal of the investments are not subject to tax. Capital may be tied up for five years. Funds are closed – i.e. they have a traded price that may be less than the value of the assets.

There are a variety of investment strategies where the trust board will delegate management to an investment firm. AIM VCTs invest in companies that are listed on the Alternative Investments Market (AIM) stock market, generalist VCTs on smaller start-up firms commonly providing seed capital, while specialist VCTs can include healthcare, technology and those investing in wind power.

## Enterprise Investment Schemes

EISs offer 20% income tax relief on the purchase of shares up to £500,000 which must be held for three years.

Relief is against tax liability in the year the shares are issued but can be carried to the previous year. There is an exemption from capital gains tax made on any gain from the shares, and loss relief against income or capital gains after three years.

While the fees can be high and the types of investments variable, EISs are complicated and can bring a significant level of investment risk. But they can be highly lucrative with the right advice.

Contact us for specialist advice if these tax-efficient vehicles are something you may wish to consider.



## What's the difference between EIS and VCT investments?

An EIS comprises a single small company whereas a VCT invests in a number of companies with no more than 15 of its assets in any one. An EIS company could even be one of the underlying companies in a VCT as they have the same size restrictions as those which qualify for VCT investment.

Any capital growth is free of tax within an EIS but dividends payable by an EIS are potentially liable to higher rate tax unlike a VCT.



## Your Reply Card

Our aim is to provide clear, unbiased and well-informed advice. We also want you to have as much information and assistance as possible in helping to plan your financial future.

This Reply Card helps you to get in touch and tells us how we can help you. All you have to do is indicate your area(s) of interest and return this card to us – postage paid – or give us a call.

I would like to discuss the following with an adviser:

- A review of my investments / finances / portfolio
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- Children's Savings
- Pension Options
- Business Protection for financial security
- VCT / EIS investment opportunities
- Mortgage advice

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*'Dare we feel hopeful yet?' continued*

For Mr Greenwood, the third stage, which central banks have deliberately postponed so far, is the imposition of higher capital and liquidity requirements.

On the inflation/deflation question, Mr Brown says central bankers are currently worried about the latter as they think they know how to deal with the former.

*"Estimates of the output gap suggest inflation will remain very subdued for some time," he adds. "However, the Fed in particular, given its dual mandate of growth and inflation, is likely to want to be sure the green shoots of recovery have truly taken root before they move to tighten policy. There has to be a risk of leaving things too late and, with so much money on the table, inflation expectations could swing rapidly."*

Given the range of possible macro outcomes, Mr Brown says this is a time for putting a premium on diversification and maintaining flexibility to respond as developments unfold.

However, Mr Brown sees several reasons for the rally to continue. These include more good economic news for another quarter or two, near zero interest rates and reasonable earnings outcomes as the corporate share of profits grows and companies benefit from past cost cutting.

*"At the same time we are mindful of a potentially abrupt change to much harsher conditions if the inflation pendulum swings,"* he adds. *"We are preparing our action plan*

*should that happen and recommend you do too."*

As for other assets, property was later onto the recovery trail than most but the IPD Monthly index finally hit a turning point in July and rose for the first time in more than two years. Commercial property investment appears to be on the rise given the view the direct market may have seen a bottom and yield spreads relative to gilts have also hit record levels in recent months at 4%.

However, as with other markets, the rally is not based on material improvement in fundamentals and commentators warn investors to consider the tenant implications of the uncertain economic outlook.

Ann Breen, head of property research at Standard Life Investments, says the group's analysis predicts healthy single-digit returns for global commercial property markets over the medium term. She states *"In recent months, property capitalisation rates have seen some improvement for the first time since the onset of property's bear market in June 2007."*

Ms Breen feels an improving economic and monetary environment, plus a better balance of supply and demand, suggests investors could re-consider the position of commercial property within their portfolios.

Given this wide variety of factors that may impact upon investors make sure you [contact us](#) if you are considering your investment options for 2010.



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