

Pension transfer might increase its value

HIGH cost of some pensions is often not discovered until the accumulated fund is compared with others but a transfer can possibly be arranged which might then restore at least some of the damage.

By reducing how much of your savings goes to the pension provider you might see a significant improvement in your future benefits.

It follows that if you are setting up a new pension it is obviously important to try to keep costs to a minimum and if you have an outdated policy you should think about

transferring into a lower-cost scheme.

It is important that you have an idea from an early stage of the type of pension you wish to set up or transfer to, and which underlying funds you wish to invest in.

Once you have the transfer value from your existing provider and an idea of where you want to switch to, you can assess whether the move makes sense.

If you have long enough before you retire, it could still be worth switching to a lower cost pension even if you will have to pay large penalties to do so.

INVESTORS are frequently warned of the long-term effect of the annual charges levied on various investments and this has assumed even greater significance during the present uncertain situation.

We have occasionally quoted Fitzrovia, the fund research specialists, on this point but it is worth repeating that a £5,000 investment growing at 7pc after 20 years with no annual expenses, should grow to £19,348.

With annual expenses of just 1pc the growth will be reduced to £16,036.

Annual expenses of 3pc will cut the growth to £10,956 with around £8,400 taken in charges.

This theme is developed in the current outlook by Bill Gross, managing director of PIMCO, the world's biggest bond fund.

A recent Barron's article, says Gross, reported that stock funds extract an average of nearly 1pc in fees from an investor's portfolio.

Investing costs inhibit growth

Bonds and money market funds managed to subsist on about 0.75pc and 0.38pc respectively and, therefore, "much of the return winds up in the hands of investment managers."

"A mighty expensive potion indeed!" comments Gross.

Paying as much as 1pc during an era of asset appreciation with double digit returns may have been tolerable, says Gross, but if investment returns gravitate close to 6pc as envisaged in PIMCO's latest forecast then 15pc of your income will be extracted from your portfolio.

Annual charges of 1.5pc are commonly levied by UK managed funds and, to the average investor, this might seem to be reasonable enough or even on the low side.

In fact, 1.5pc of an annual growth of, say, 6pc is actually 25pc of that growth.

Hedge funds charging 20pc are routinely castigated for their greed but retail investors have only got themselves to blame for paying ever higher fees.

An alternative? Exchange traded funds (ETFs) which are growing in popularity (please see Investors' Notebook) routinely charge fees of less than 1.0pc (£1) annually.

Many of the ETFs provided by Barclays Global Investors, the world's biggest, charge as little as 0.20pc and the most expensive of Barclays ETFs, Islamic Emerging Markets, has a total expense ratio of 0.75pc.

Investors' Notebook

ASSETS invested globally in exchange traded funds (ETFs) have reached a record high at £514bn on the back of the stock market recovery and the strong demand for passive investment, according to Barclays Global Investors, the world's biggest provider which was recently acquired by BlackRock, the private equity giant.

The value of ETFs plunged at the end of last year as the global recession hit markets but now the total invested is expected to exceed £600bn by the end of this year.

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NATIONAL Savings & Investments (NS&I) has boosted a range of interest rates by up to 1.2pc to ward off competition from banks and building societies.

NS&I's Individual Savings Account (Isa) is now paying 2.5pc, up from 1.3pc previously.

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CHILDREN who turn seven years old in September will be among the first to receive a second instalment of £250 into their child trust fund (CTF). They were introduced in 2005 to encourage long-term saving and an initial payment of at least £250 is provided to parents of children born on or after September 1, 2002.

Clients will appreciate that life assurance and pension plans are generally long-term investments and there may be penalties for terminating such plans prematurely; that past investment performance is no indication of future prospects and values can fluctuate; that in relation to house purchase their home is at risk if they do not keep up the payments on a mortgage or other loan secured on it. Some of the products and services mentioned in Money Planner might not be among those regulated by the Financial Services and Markets Act 2000.

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Bulls rush in

INVESTORS who are unfamiliar with the arcane rituals of the equity market, and there are many of both, can be excused for being mystified by the gathering stampede of the bulls.

There were signs of bullish activity as early as last October just after the economic crisis became news but, as evidence of its depth has accumulated so have the number, variety and agitation of the bulls.

It is possible, of course, that many investors conditioned by the 50-year equity bull market, which came to its inevitable end last year, had forgotten that it is a real market just like the others.

As in all markets, when business is slack or seems threatened those with merchandise or prospects of wealth to sell raise their voices and use other means to attract buyers.

So it was no surprise to find that many of the bulls had a professional interest as sellers in the market: stockbrokers, fund managers and some print media commentators whose organs rely heavily on their funds advertising revenue for their survival.

The evidence concerning the gravity of the recession, some of which we report on this page, indicates that a UK equity bull market is not a realistic prospect.

Bonds for income

IN the present situation which is likely to remain for many years the rational course for non-professional investors is to concentrate on income-producing bond and equity stocks in companies with strong balance sheets and high dividend yields.

We feature some of these in this issue.

Recession indicates fixed income superior to UK equities for some years

AS the UK approaches the first anniversary of the biggest economic recession for 60 years its severity and likely duration are only now being realistically estimated.

The publication in July of a report by the Office for National Statistics (ONS) indicated a bigger than expected drop in GDP of 0.8pc in the second quarter after several weeks in which surveys had suggested that GDP had fallen only slightly and might even have stabilised.

Although a drop of 0.8pc was better than the poor first quarter which showed a fall of 2.4pc it confirmed the depth of the recession with the economy now having retracted in five successive quarters for a total drop of 5.7pc – much worse than the 2.5pc fall in the recession of the early 1990s and on a par with the slump of the early 1980s, when there was a peak-to-trough fall of 6.4pc.

The economic implications behind these gloomy figures, unfortunately, is being ignored by the performance of the stock markets.

UK equities at the end of August hit their highest levels since Lehman brothers' collapse

last September and seemed to add credence to the claims that the UK will soon return to the sunlit economic uplands.

A significant cause of the upswing in shares has been the injection of cash derived from institutional sales of gilts through the government's unprecedented multi-billion quantitative easing (QE) programme.

This temporary boost to the market will soon evaporate but the harsh economic facts will remain.

As the economy has stagnated the national accounts have generated still more red ink.

In July, usually a surplus month as tax revenues roll in, there was a record-breaking £8bn deficit and corporate tax receipts were 38pc down on the same month last year.

With a projected gilts issue of £200bn over each of the next three years in the pipeline one of the major uncertainties will be the response of overseas buyers.

If their view of the immediate prospects for the UK economy is unfavourable they will demand a more generous coupon on the gilts issues which will add to the nation's already huge debt burden and will inevitably postpone any genuine economic recovery.

Any realistic view on existing evidence must be that such a recovery is not likely until about 2020.

Savings accounts to be avoided

SAVERS searching the market for the most attractive interest rates could find they have discovered less competitive rates than are already available.

That is because some advisers are accepting a commission from building societies and others as a reward for recommending such accounts to their clients.

Savings experts say that there is a risk of such adviser

recommendations being driven by commissions, rather than best value for savers, especially as advice on deposits is not regulated.

Among the providers of the new accounts which pay commission on cash deposit products are Yorkshire, Skipton and Newcastle Building Societies and Scottish Widows Bank.

About 500 financial advisers and mortgage brokers have

signed up to a "savings club" recently launched by eMoneyfacts.

Current offers include a two-year bond from Newcastle Building Society with a fixed rate of 3.75pc and 0.35pc commission for advisers.

However, savers could take out a similar bond paying 4.2pc directly from the Society – or earn as much as 4.43pc from Aldermore Bank, the top payer over two years.

In this issue

- Lessons from the bull market
- Top tax and onshore bonds
- New rules for ASPs
- Pension transfers
- Boost for EISs and VCTs
- Investment costs
- Bond market turmoil

CONTRARY to widespread conviction, equity prices do not rise all the time.

Unfortunately, many thousands of retail investors remain unconvinced.

The Investment Management Association, representing funds valued at £3,400bn encourages the belief that equities will tend always to rise although "prices can go down as well as up".

This view is supported by the national print media through editorial comment and the display advertising paid for by the fund managements.

But the rational retail investor will acknowledge that even when the UK economy

Lessons from the 50-year bull market

recovers from the present recession the growth in GDP will remain sluggish which will be reflected in share prices whose course will be largely determined by their dividend record and earnings instead of the A&M (Acquisitions and Mergers) activity of the bull market.

This will effectively return the equity market outlook to a situation similar to that of the mid-1950s before the start of the 50-year bull market of which at least the final

decade is now acknowledged to have been a grotesque aberration.

A common feature of both, the gradual recovery of business activity, suggests that similar views of the equity markets are appropriate.

Retail investors of the 1950s were routinely advised to view equities with caution or avoid them completely.

Although equities at that period were always yielding significantly more than government bonds (the "yield

gap") it was felt that investors needed a reminder of the equity yield's vulnerability by the introduction of a further hurdle; the "equity risk premium" (ERP) which was usually perceived to be between 3pc and 5pc.

That yield gap was restored last October but the recent equity price surge has almost achieved parity again with the ten-year gilt yield at 3.68pc and the FT All Share yielding 3.71pc.

On this basis a more realistic valuation, applying a nominal ERP of 4pc, suggests that equities are again significantly over-priced and they carry a reminder that equities are always just equities.

"Scheme pension" alternative to ASP

PERSONAL pension holders who reach 75 are offered a choice, under the existing rules, of either buying an annuity or accepting an "alternatively secured pension" (ASP).

An ASP allows the pension to remain invested in the stock market but if the investor dies tax charges of up to 82pc are applied to the remainder before the funds are passed to the heirs.

There are already some "scheme pensions" which effectively by-pass those rules, drawn up by the pensions simplification legislation in 2006, which operate for the benefit of family members or business partners.

An extension of these has recently been launched by the Axa Winterthur, who have been among the leaders of pension provision for more than 20 years.

One key benefit of the Axa scheme is that it can provide a higher income than could

be achieved under the ASP rules.

In ASP, the maximum income is set according to government actuary tables which can be altered to be between 55 and 90pc of the rate.

This is a lower income than can be obtained under income drawdown which can be up to 120pc of the rate.

Under "scheme pension" there are no set limits but as the income can be matched more specifically to the beneficiary's age and health a higher income than under ASP will always be feasible.

For the first time "families" have access to a personalised scheme with all the main income options including the attractive scheme pension option.

There are also advantages if the strategy is to deliver the highest possible income to the member while protecting the beneficiaries and minimising the tax charge on any remaining fund.

VCTs and EISs break into EU

Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) will be allowed to invest in non-UK companies under new rules to become effective in 2010.

Currently, both VCTs and EISs can only invest in companies that operate primarily in the UK, but under the new rules they will be allowed to invest in companies operating mainly abroad, the only requirement being that they have a permanent base in the UK.

The changes, which are due to come into force as part of the Finance Bill 2010, come after VCTs and EISs gained "state aid approval" from the European Commission.

In order to gain approval for the schemes, the government has had to change the rules to align them with EU regulations and treaties.

The changes will also relax the listing requirements

imposed on VCTs.

Currently they are required to be listed in the UK, but under the new rules they will be allowed to list in any EU-regulated market.

Although these changes can be considered to be good news for investors there remain some uncertainties concerning the EU's exclusions of "enterprises in difficulty" which will not be eligible for investment under the EIS and VCT schemes.

An "enterprise in difficulty" is defined as being "unable to stem losses which would lead to it going out of business in the short or medium term".

Further details of this exclusion will be required before the investment implications can be fully appreciated.

DECISION by the Bank of England in August to increase its purchases of gilts by another £50bn to make a total of £175bn again took the bond market by surprise as well as Mervyn King, the governor, who voted for an increase of £75bn

No one knows whether or not the massive financial injection through the Bank of England's purchases of gilts and corporate assets is likely to feed through into bank lending, which is vital to breathe life into the economy.

So far, it is believed, some of the £133.5bn of bond purchases to date (£131bn in gilts and £2.5bn in corporate assets) has almost certainly found its way into the corporate bond market.

Sterling corporate bond issuance has surged to record levels as investors have sold their gilts to the bank and bought company debt to take

Corporate bonds will benefit from gilt issues

advantage of much higher yields.

This has succeeded in bringing down corporate bond yields and the yields on investment-grade sterling bonds have fallen about 2pc to about 6pc since the launch of QE on March 5.

The first part of the QE plan, therefore, is working as the Bank intended.

Lower corporate bond yields should encourage companies to borrow to grow their operations or, at the least, to pay debts and avoid bankruptcy, so aiding the wider economy.

With bank lending falling the corporate bond market is a vital source of capital.

But there is still no evidence yet that the second part of the QE plan, increasing bank lending, is working and the time limit for that assessment has almost been reached.

If the banks continue to hoard, then jitters about economic prospects might trigger a sell-off in gilts which would lead to a damaging rise in yields and interest rate costs for a government that has taken on record levels of debt with a huge issuance of new gilts (£220bn over the next three years) to finance it overhanging the market.

Investment bonds tax risk

HOLDERS of onshore investment bonds who are earning £150,000 or more should consider switching to alternative investments to avoid the new 50pc tax which will be introduced next April.

The new tax will be levied on gains from investments held within such bonds which include the popular with-profits bonds issued by insurance and investment companies, including Prudential, Scottish Widows and Standard Life.

As an alternative, the Capital Gains tax (CGT) on unit trusts and Oeics (open-ended investment companies) is only 18pc which is levied when funds are withdrawn.

Holders of investment bonds are already liable to CGT (at 20pc or 40pc) depending on their tax rating but some higher rate taxpayers have still favoured them if they expect to revert to paying basic rate tax on retirement.

Domestic bond market for LSE

PLANS to launch a new market for the trading of corporate bonds aimed at retail investors are being finalised by the London Stock Exchange (LSE).

An LSE executive explained: "There is a clear need, for a lot of companies to be able to tap the bond market, particularly for retail investors, and today there is no clear mechanism that is transparent with good technology."

Currently, private investors wishing to invest in the corporate bond market are required to call a broker but many do not have access to trading bonds in a market that is relatively illiquid.

An alternative for investors wishing to participate in corporate bond investing is through an exchange traded fund which will track the performance of a portfolio of the bonds at an annual charge of as little as £0.20.

Money Digest

RECENT personal finance pages have featured:

THERE is no investment option for this new environment other than steady income producing bond and equity investments in companies with strong balance sheets and high dividend yields, as well as selectively chosen emerging market commitments. – *William Gross, Managing Director, PIMCO*

★★★★★
DRIVING assets prices higher this year has been quantitative easing, whereby governments purchase assets, mainly bonds, from the private sector. (This) has put money into the hands of the investment institutions from which central banks have purchased bonds. This has been recycled into equities and commodities.

– *John Plender, Financial Times*

★★★★★
KEYNES' writings did anticipate one of the causes of the credit crunch. He would have been deeply sceptical about the computer-led stars of the investment banks who believed that skilful programming of information linked to mathematical formulas could produce risk-free capital gains. – *Dominic Lawson, Sunday Times*

★★★★★
THE sudden dovish move by Mr Mervyn King, the Bank's hawkish governor, suggests that he is prepared to risk prices racing higher to ensure that the economy does not sink like Japan's in the 1990s, was a shock. – *David Oakley, Financial Times*

★★★★★
RIGHTMOVE, the market leader with 80pc market share of the UK property website business, suggests that the housing market downturn is over with evidence of renewed interest among home hunters and its hard hit estate agent members. – *Financial Times*