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All

Start thinking about protecting your portfolio against inflation

Many influential figures are speaking out about the risks of inflation, and maybe it's time to listen to their voices. Last week Jens Weidmann, the Deutsche Bundesbank chief, warned of the dangers of complacency, comparing inflation to the Galapagos giant tortoise, which was classed as extinct for a century, only to be rediscovered. Andy Haldane - the Bank of England's chief economist - is even more concerned, issuing an alert about the threat of rising prices. He says: 'Inflation always starts looking temporary but can end up as the thin end of a very thick wedge.' A big bout of inflation has the potential to seriously damage your wealth. Yet other members of the Bank's rate-setting monetary policy committee say spikes in inflation will be 'transitory'. Not everyone is content with these reassurances, however, believing that record low interest rates and the money-printing quantitative easing programme will cause overheating of the UK economy – which is rapidly rebounding from its Covid doldrums. The $1.9trillion US stimulus package could add further pressure – in the US, and around the globe. Research from US fund manager Brown Advisory shows bonds and stocks do well if inflation remains below 5 per cent. But if inflation is above this level, performance flags. Duncan MacInnes, comanager of the Ruffer Investment Trust, says investors should heed the everyday evidence that the cost of living is going up. He says: 'Covid has propelled us into a new economy. Inflation is accelerating and has permanently shifted to a higher level. The damage to a conventional portfolio could be profound and painful. The effect of inflation on cash and bonds is like the melting of an ice cube that has been left out. If inflation runs at 3% a year, your money's purchasing power will have halved in 20 years.

Property Owner / Retired

The rise in popularity of Equity Release

Older homeowners are releasing an average of more than £100,000 from their properties, in what is being termed a 'middle-class stampede' towards equity release. Two separate studies found that homeowners were able to access triple-figure cash pots when taking out equity release deals- also known as 'lifetime' mortgages. This is when older homeowners take out a new mortgage on their home, allowing them to access some of the money tied up in it to spend in their later years. The loan is paid back from the sale of the property when the owner dies or goes into long-term care. Retirement lender Key Equity Release's Market Monitor suggests that, in the first three months of this year, the average homeowner who took out an equity release plan received £103,710: that's 25% more than the £83,000 released in the first quarter of 2020. The total value released increased 12.8% to £1.07billion. Key said homeowner's cash pots had been boosted by increases in house prices, which have risen by more than 10% in the year to March, according to the Office for National Statistics. An increase in the market value of your home means the equity you can release also goes up. The average loan-to-value of the mortgages taken out by equity release borrowers increased by just 2%, from 25% in the first three months of 2020 to 27% in the first three months of 2021 - and the number of plans sold actually reduced year on year. This suggests that increased house prices were largely responsible for the boost. The strength of the property market driven by the extension of the stamp duty holiday is helping to increase the property wealth that over-55s can use for retirement planning. The average amount released at more than £103,710 demonstrates how important property wealth is in meeting customers' wants and needs, while the rise in the average value of homes owned by customers' shows how wealthier customers are looking to use their homes. Data from later life mortgage broker ResponsibleLife indicates an even more dramatic increase in the sums that equity release borrowers were accessing. It says that the average amount released by its customers increased by 31% in the 12 months to April climbing from £86,000 to £112,700. Like Key, ResponsibleLife credited house price increases for the rise - but it also said that there had been a shift to a wealthier demographic who owned higher-value homes. In April, it said the average value of a home being used to secure a lifetime mortgages was 19.4% higher than a year ago, at £487,000 – nearly double the UK's average house price. Experts believe that there's no doubt there has been a middle-class stampede for lifetime mortgages over the past year, thanks to interest rates sinking to historic lows. Wealthier homeowners have cottoned on to how rates have come down and now see lifetime mortgages as an affordable way to improve their standard of living in retirement.

Equity release is a complex advice area and independent advice is always recommended to assess individual suitability.

Property Owner

House price dip

The price of an average home in the UK fell by 0.5% in June as the full stamp duty holiday came to an end, industry figures show. It was the first month-on-month drop since January and suggests peak buyer demand has likely passed, according to research by Halifax. However, the bank said typical property values were still more than £21,000 higher than a year ago, with an average home costing £260,358 last month. June’s price drop meant annual house price inflation eased slightly to 8.8%, from May's 14-year high of 9.6%. The stamp duty holiday in England and Northern Ireland is now being tapered and will be phased out entirely in autumn. The “nil rate” stamp duty band shrank from £500,000 to £250,000 from 1 July, prompting a rush of buyers trying to beat the deadline. It will revert to its normal level of £125,000 from 1 October. Commentators believe that with the stamp duty holiday now being phased out, the market might start to lose some steam entering the latter half of the year, and it is unlikely that those with mortgages approved in the early months of summer would expect to benefit from the maximum tax break, given the time needed to complete transactions. That said, with the tapered approach, those purchasing at the current average price of £260,358 would still only pay about £500 in stamp duty at today's rates, increasing to around £3,000 when things return to normal from the start of October. That power of home-movers to drive the market, as people look to find properties with more space, spurred on by increased time spent at home during the pandemic, won't fade entirely as the economy recovers. Coupled with buyers chasing the relatively small number of available properties, and continued low borrowing rates, it's a trend which can sustain high average prices for some time to come. While the reduction in stamp duty relief means less pressure on the demand side, supply is still constrained, construction is getting harder and more expensive, and a mass sell-off from property owners is unlikely in the absence of significant interest rate rises.

All

Income tax bills double

HMRC recently released statistics on income tax and analysis of the figures showed consumers are paying huge amounts through the levy. In light of this, guidance has been issued on how savers can reduce their income tax bills through effective use of ISAs and pensions. Hargreaves Lansdown examined these figures and highlighted the following:

- There were 31.6 million income taxpayers in 2018/19, and there will be 32.2 million in 2021/22, as a combination of employment and population increases alongside the freeze in the personal allowance.
- In 1999/2000 we paid £93 billion in income tax. This rose to £187 billion in 2018/19 and is expected to hit £199 billion by 2021/22.
- There will be 27 million basic rate taxpayers in 2021/2022, which is a 2.6% increase from 2018/2019. They will make up 83.2% of income taxpayers.
- There will be 4.13 million higher rate taxpayers in 2021/2022, which is down 2.4% from 2018/2019. They will make up 13.1% of income taxpayers.
- There will be 440,000 additional rate taxpayers in 2021/2022, up 10.3% from 2018/2019.

So the Government is going to take £199billion of our hard-earned money in income tax in 2021/22, more than twice the sum it took in 1999/2000. We have had a few years of more positive news for higher earners, because the personal allowance has been rising gradually, and we have seen a bump in the higher rate tax threshold too, so the proportion of people paying higher rate tax has dropped. Unfortunately, things are set to get far grimmer for the next few years. The freeze in the personal allowance and higher rate tax threshold means more people will pay more tax, and the number of higher rate taxpayers will grow again. By 2021/22 it will still be below its 2018/19 level, but it will soon be back over it again. And while we are happy to pay our fair share of tax, we cannot afford to pay over-the-odds. So it’s worth checking in with your adviser about simple steps to protect your income from tax.

Investor / Saver

FCA calls for stronger controls on funds post-Woodford

'Host' authorised fund managers (AFMs) have been told to tighten up control of their funds and better manage conflicts of interest following a review by the Financial Conduct Authority (FCA). All UK authorised funds are required to appoint an AFM, who is responsible for ensuring that the fund complies with FCA rules. Host AFMs, who could be authorised corporate directors or authorised unit trust managers, are those that delegate investment management to third party managers outside of their corporate group, although the FCA said that some of the findings of its review were also applicable to in-house AFMs. The FCA said that it would provide written feedback to all firms in the review, while a small number will be required to undertake section 166 'skilled person' reports to improve compliance or to hold additional capital against the risks that they are exposed to. It will review the progress each firm has made in 12-18 months and may propose changes to the regulatory framework, including rule changes, should this be necessary. These latest findings are the strongest indication yet that host AFMs must up their game and take strong regulatory control of their funds or the FCA will actively intervene – whether by rule change or disciplinary action. The reality is that in a hosting model, the investment manager usually holds the commercial and economic power in the relationship. This is at odds with where the regulatory obligations require the power to be. These findings show that that balance of power needs to shift. The FCA expects host AFMs to be well-capitalised and well-resourced, with senior management in place who recognise and control the conflicts of interest inherent in the business model. While some of the firms reviewed by the FCA were operating well, the regulator found weaknesses in governance structures, conflicts of interest controls and operational controls at others. Some of the firms reviewed were found by the FCA to be referring to funds as if they were solely operated by the third-party investment manager or fund sponsor; while others lacked sufficient focus on controlling the risk of harm to investors from being exposed to inappropriate or poor value products. The FCA was also concerned about the 'onboarding' process for investment managers, noting that in some cases there was no obvious link between questions asked and the outcomes to be tracked. While some host AFMs followed a set process, others relied on more informal conversations to assess and understand proposals and did not always gather the detailed knowledge required about the funds for which they would have responsibility.

Investor / Saver / Retired

Annuity or drawdown?

Pensions freedoms have given retirees more choices about their finances but this can leave many wondering which is the right path to choose. Transitioning from working life to retirement can be an emotionally tricky period. Often much of a person's identity is built around their career and the relationships they have built over many years in work. If that wasn't enough, those entering life after work also need to make some significant decisions about their retirement finances; just how will they afford the next stage in their life and what financial options do they even have at their disposal. Creating a financial plan for later life is not a simple task, with the Pension Freedoms act (introduced in 2015) meaning individuals gaining access to their pension savings now have a variety of financial products to choose from – instead of just deciding which provider to buy an annuity from. Knowing which of these options is best suited to their needs can take time to understand, as it comes down entirely to their individual circumstances; how much they have saved, the amount of retirement income they need, and how their requirements may shift as they progress through later life. In recent years, many people entering retirement have chosen to use an income drawdown plan rather than purchasing an annuity. These plans can provide flexible access to savings as retirees can withdraw their money in smaller amounts over time, benefiting from additional interest build up on the amount which remains saved. They are available to anyone aged 55 or over with a Defined Contribution (DC), or Self Investment Personal Pension (SIPP), pot. The major advantage of these plans relates to the increased flexibility that savers have. While they may still want to withdraw the 25% tax free sum that the government allows all savers reaching retirement age, they can still continue to grow the value of the remaining 75% of their savings. That is because the remaining portion will still be invested and continue attracting returns. Of course, drawdown plans are not risk free. That is because the part of the pot that continues to be invested could still decrease in value if the fund performs badly. This is an important consideration for people with a low-risk appetite. Annuities have long-been a cornerstone of the UK pension system and provide retirees with a guaranteed income for life. This ensures complete certainty over retirement income and can be a good option for people that are less confident about keeping their savings invested in a fund. Since the introduction of Pension Freedoms, the availability and price competitiveness of annuity plans has improved, however, many still feel they offer comparatively poor returns when compared with drawdown options. When it comes to choosing an annuity, retirees need to remember that they could potentially access better returns depending on their health. Providers are making an assumption about how long a person is likely to live for, so customers can access better rates if they have previous or ongoing medical issues. Smokers, for instance, are likely to benefit from an improved rate because their life expectancy is reduced. Health issues such as high blood pressure and obesity can also positively affect the rate a person receives. When speaking with a specialist later life financial adviser, always be sure to declare conditions like these are they will positively impact the income received. Fixed term annuities can also provide more flexibility to those wanting a secured income but that do not wish to cash in the whole value of their pot. With this, an annuity income is paid for a fixed period – usually around five to ten years. Annuities and drawdown plans need not be mutually exclusive. Many people entering retirement these days are likely to have several pension pots and they can aggregate or move their money as needed. This could mean using one pot to purchase an annuity, while leaving another invested in a fund to benefit from additional growth. Creating a hybrid plan, which capitalizes on the benefits of each product type, can be a good option for those wanting to diversify their retirement income streams.

Investor / Saver Retired / Estate Planner

EIS and VST opportunities

Venture capital trusts (VCTs) and enterprise investment schemes (EISs) are often cited as the next port of call after you have used up allowances for pensions and individual savings accounts (ISAs). But there are some key differences between VCTs’ and EISs’ tax reliefs and investment approaches, so it is important to use the right one for your financial and tax planning needs. VCTs are listed funds whose shares can be subject to volatility, and trade at premia or discounts to their net asset values (NAV). While this should mean that VCTs are more liquid than EISs, to benefit from the tax reliefs you need to hold VCT shares for five years after you have bought into an issue. Even then, there is very little secondary trading of VCT shares, so it may not be easy to sell them – and you may get a lower price than you paid for them. EISs are a wrapper within which you directly invest in unquoted companies and are harder to exit. Although you only need to hold EISs for three years to qualify for all their tax reliefs it is unlikely that you will be able to exit at that point. EIS exits are generally achieved when their managers sell a company, for example via a trade sale. So it could take eight years or longer before an EIS investment is realised. If you invest in EISs, it is particularly important to have a long-term investment horizon and not to invest money in them that you might need in the short term. VCTs are more diversified than EISs as they typically invest in 30 to 70 companies. Some EISs just hold a single investment and, although some managers offer portfolio EISs enabling you to invest in a number of unquoted companies, typically it is not more than about 10. VCTs are arguably less risky because the impact of one company failing has less of an effect on their overall returns. But if a holding does well it also contributes less than would be the case with a smaller number of investments. So EISs have the potential for both bigger losses and gains. VCTs' returns may be more regular, meanwhile, because they can pay a steady stream of dividends and can be considered as more of an income investment. EISs are very much about growth so, for example, you might receive nothing for years and then a big payout after a successful exit. However, following investment rule changes between 2015 and 2019, the new investments VCTs have been making are more growth-orientated. EIS investors can claim loss relief at their marginal rate of tax which, with the income tax break, provides some compensation for investment failures. This means that you are less likely to lose all of your initial investment. VCTs can be a tax-efficient way to save for retirement if you have used up your annual or lifetime pension allowances, and annual Isa allowance. They can be particularly useful for higher earners whose annual pension allowance has been tapered back to between £4,000 and £40,000. EISs are useful if you have a CGT liability because if you reinvest a gain in an EIS, the CGT is deferred. The tax might be incurred, for example, because you have sold a property that is not your primary home, a business, or investments such as shares held outside an Isa or pension.

VCT and EIS investments are considered a higher risk investment strategy and independent advice is always recommended to assess individual suitability.

Past performance is not a guarantee to future performance. You may get back less than invested.

Thresholds, percentage rates and tax legislation may change in subsequent Finance Acts and reliefs from taxation are subject to change. The FCA does not regulate tax advice.

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