

News & Views



WINTER/SPRING 2009

Rates reach a new low

In its latest attempt to revive the UK economy, the Bank of England (BoE) has cut UK interest rates to a new low of 1%. The half-percentage-point cut was widely expected, but it will inflict further pain on Britain's savers, who are already struggling with exceptionally low rates on their deposit accounts.

The UK is officially in recession. Consumer confidence has continued to evaporate, and inflation is falling fast, all amid speculation that the UK might hit an environment of deflation. Unemployment is rising, and the services sector is in decline. February's statement from the BoE's Monetary Policy Committee warned that "The global economy is in the throes of a severe and synchronised downturn", and the International Monetary Fund expects our economy to contract faster than any other industrialised country in 2009.

Some business groups believe that lower rates will not be sufficient to boost activity, and are urging the BoE to intensify pressure on banks to increase their lending activities. They believe lack of credit is ultimately more of a problem than the cost of borrowing. Many also believe the BoE will soon start to exercise its newly granted power to spend up to £50 billion buying high-quality assets in order to inject more money into the UK economy. In any case, with growing speculation that UK interest rates could actually hit zero, and sooner rather than later, the BoE will eventually be forced to look beyond monetary policy as a means of kick-starting the economy.

Welcome to the latest edition of News & Views, our update on developments in the world's stockmarkets.

In this issue, we bring you the latest on inflation and interest rates following a volatile period in markets.

Contact us:

Tips on surviving recession

NO 5: DON'T JUST HEAD FOR CASH

During a recession, it is very tempting to get out of the stock market and head for the safety of cash. However, this strategy can be risky. Stock markets are volatile so, just as they can fall quickly, they can also recover quickly, with no warning. If equities are the right asset class for you, moving out when you have already suffered a loss could mean missing out when they finally begin to recover. Moreover, inflation can impact the purchasing power of cash over time. You can be assured that you will not lose the capital value of money when invested in cash but it should not be considered entirely "risk-free"!

If you would like to discuss any of the information in this update, please do not hesitate to call us.



Reaching your investment goals

Investors can be divided into two very broad groups: those investing to generate an income, and those looking for growth. The former generally includes people about to embark on retirement who are looking to secure a regular income to help boost their pension provision. The latter will be investors who have longer-term investment horizons and who are simply looking to maximise the value of their assets.

Growth can mean many different things to different people, so it is important to set out your goal from the outset. This will help your financial adviser work out your position on the risk spectrum, which in turn will help them recommend the most appropriate investments to reach your goals.

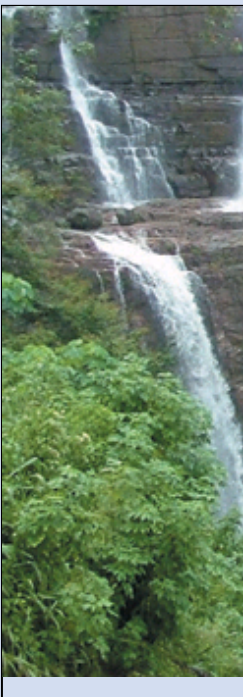
So what exactly is the risk spectrum? Basically, it is a term used to describe the scale of risk on which each investor can be placed according to their ability to tolerate market ups and downs. There is a relationship between risk and return - generally speaking, the greater the risk you take, the greater the potential return. To illustrate this, let's look at cash and equities.

You invest in cash because it provides security of capital, allowing you to withdraw your money at any time and get your investment back. However, over the long term, inflation eats away at the value of this capital and your income also fluctuates with interest rates.

Equities, on the other hand, move up and down in value every day - actually, every minute. Therefore, if you invest today, you may find that tomorrow, next week, next month, even next year, your capital is worth less than you invested. However, if you can sit back and ride out the ups and downs, over the long term, the general trend has been upwards - and much more positive than both cash and inflation.

So to meet your goals you need the right mix. At the core of your portfolio you might place a set of less volatile asset classes, such as UK bonds, cash and maybe some blue-chip equities. These form a base onto which you could then add the riskier options, should you decide they were appropriate.

Take some time to establish your goals before you make any decisions and decide your position on the risk spectrum. And, in all cases, it is always recommended you consult a professional adviser to ensure you get the choices right.



Drawing down the options

The latest interest rate cuts affect more than just savings rates. They also hit annuity rates, meaning the income from pension funds could also be hit. This is all very well - unless of course, you are about to retire, in which case, some ideas about how to maximise your income might be very welcome.

Income drawdown (also called an unsecured pension) is just one option to consider. What this offers is the chance to defer purchase of an annuity, leave your fund invested and in the meantime, draw an income direct from the fund. The rest stays invested until you perhaps consider it is a better environment to retire - or until age 75 when your needs must be reviewed, regardless. This allows you some flexibility in your planning. Subject to a maximum (which is defined by the Government's Actuary and reviewed every 5 years), any amount of income can be withdrawn. So, for example, if you continue working part time, you could draw just a small amount to start with, then increase it as your hours reduces. Or, you could take the tax free lump sum but leave the fund which will provide your income invested.

There are drawbacks. First, even given recent market disappointment, your fund could fall (further) in value leaving less than you have now. There are also charges for staying invested that would stop if you bought an annuity - and there are fees for carrying out reviews. Finally, there is no guarantee annuity rates will improve. However, you only get one chance to buy an annuity so you should ensure you check out all your options.

From Inflation to Deflation



Just a few months ago, inflation was the spectre that stalked us all. By September, inflation had soared to 5.2%, fuelled by high prices for food and energy. However, following sharp falls in commodity prices and declining demand for goods and services, inflation no longer appears to be a problem and deflation is the new threat.

Deflation is defined as a persistent and sustained decline in prices. A sustained deflationary spiral can help to exacerbate recession as, although some people might welcome an environment of falling prices – particularly after a period of high inflation – a sustained period of deflation could have very negative consequences for the struggling UK economy.

In a deflationary environment, consumers will delay making purchases, believing that prices for goods and services will continue to fall. This delay makes it harder for companies to sell their products, forcing them to slash prices and leading to lower profits, declining wages and job losses. In turn, the reduction in disposable income further impairs demand for goods and services, creating a sustained and damaging spiral.

The Bank of England (BoE) and Chancellor of the Exchequer have taken aggressive actions to try and avert a prolonged period of deflation by cutting rates and introducing a programme of fiscal stimulus. However, even with billions spent and the recent slashing of rates, a risk of below-target inflation still threatens and no one knows how long it will last.

Always shop around

When you retire, it can be tempting to succumb to the first fixed rate, level annuity quote you receive. However, with the average life expectancy now between 80 and 85, your annuity might have to pay out for more than 20 years - and inflation could really impact your spending power over that time.

It is therefore sensible to shop around - and there are various options to choose from if you want to make the most of your money. For example, there is an index-linked annuity, which is tied to the rate of inflation, and there is also an escalating annuity, which rises at a fixed rate each year, regardless of inflation (in other words, some years the rise may be greater, some years it may be less). For the more adventurous, you could even link your income to the ups and downs of investments (providing you are prepared to take the risk). All of these options are likely to offer a lower starting income than the equivalent level annuity, but over the long term, your ability to afford the same lifestyle could be better protected.

Of course, your circumstances may mean a mixture of annuities is appropriate. Or, depending on your appetite for risk, and size of your fund, you may be able to defer your annuity purchase and commence an unsecured pension (drawdown plan) instead. If you can leave the purchase until later in life, or if you suffer from poor health, the potential for higher income from a level annuity may outweigh other issues. Whatever you decide, make sure you shop around. You can't change your annuity once you've bought it, so pick the right one.



Tips on surviving recession

NO 8: PLAN WELL AND STAY CALM

Remember the saying 'If you can keep your head whilst all around you are losing theirs...'? Market downturns are a great example of when this applies. A fire drill is a good thing: the fire might never actually occur; however, even if the worst happens, at least you can be confident you have taken all the right precautions! The real secret is to make sure you plan your portfolio properly, with an expert, at the outset. Then, when a downturn strikes, you can stay calm and review with confidence - rather than be panicked into radical, unprofitable change.

"Stop the world, I want to get off"

2007 was the year in which the US sub-prime mortgage sector collapsed, triggering worldwide problems within the financial system. However, 2008 was the year in which governments, businesses and individuals finally became fully aware of the consequences of the debacle as the credit crunch finally hit the high street.

As the year progressed, investors and governments began to realise that the problems faced by financial institutions were much more extensive than had previously been thought, and would ultimately affect almost every business and household. During the year, confidence in the financial system collapsed and share prices plummeted. Eventually, governments and central banks had to step in to try and boost flagging economic activity and regenerate confidence - and billions of pounds of financial support was consequently poured into the troubled banking sector.

Financial markets themselves experienced wild swings during 2008, and movements of four per cent in a single day were not uncommon towards the end of the year. The MSCI World Index fell by over 40% in the year, and every major market experienced at least some heavy losses; indeed the American stock market sunk to levels not seen in over five years. Even now, corporate profits remain under pressure; companies are cutting or cancelling dividends and high levels of redundancies are swelling unemployment statistics as firms do whatever they can to cut costs and stay afloat. Higher unemployment is likely to compound pressure on economic growth as consumers tighten their belts and stop unnecessary spending.

In hindsight, interest rates probably also provided some of the most dramatic headlines during 2008. UK rates began the year at 5% and, as late as the summer, were expected to rise. These expectations changed dramatically after September, however, and ended the year at just 2% – their lowest level for over 50 years – amid fears of deflation and concerns about an extended economic downturn. Across the Atlantic, American rates reached an all-time low of 0.25% as the Fed tried the same tactic to kick-start economic growth and control price stability.

Although analysts still await official confirmation, the UK and US economies are widely considered to have fallen into recession, and this has already been discounted in share prices. Businesses, investors and analysts are now preoccupied by the possible length and severity of the recession, and are keeping a sharp lookout for evidence that the economy is either improving or deteriorating. As we say goodbye to 2008 and head into 2009, this uncertainty is likely to keep investors' nerves on edge, and ensure that share-price performance remains both volatile and headline grabbing.



The contents of this update are based on market conditions and opinion as at 12 February 2009 and are subject to change.

The contents do not constitute advice and should not be taken as a recommendation to purchase or invest in any of the products mentioned.

Before taking any decisions, we suggest you seek advice from a professional financial adviser.