AM&A | Investment & Pension Planning Limited

We have pleasure in issuing our newsletter for June 2018 that includes a detailed monthly commentary covering world equity markets in May together with other topical articles that we hope you find interesting.

The Bank of England did not raise interest rates in May, despite earlier suggestions that it would. Also in May, the Office of Tax Simplification (OTS) announced that it is looking at the way in which savings and investment income is taxed, which can be very complicated. The Chancellor has also asked the OTS to review the complexities of Inheritance Tax and outline ways in which it can be simplified and the OTS are carrying out research and consultation and will summarise the findings in a report with specific recommendations, to be published in Autumn 2018.

As always, please get in touch with us if you need help or advice on any of the topics covered in our newsletter.

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AM&A Model Portfolios, Indices & Benchmarks, Recommended Investment Funds Performance Data to 31 May 2018

The following tables show examples of percentage returns of AM&A risk rated model portfolios and market benchmarks and indices using prices at the end of the last calendar month over 1 month, 3 months, year to date, 6 months and over 1, 3 5 and 10 years. Please note that these examples are for illustrative purposes only and exclude the effect of fees on the actual returns. Please note that pension fund and life fund performance can differ from unit trust/OEIC performance due to the underlying taxation treatment that past performance is not a reliable indicator of future returns and the value of investments can go down as well as up. We endeavour to ensure that the data below is accurate to the best of our knowledge. However, we rely on information that is provided to us by third parties and this may therefore not always be correct and/or up to date. As such, we cannot accept liability for any reliance placed on this third party-produced information.

	1m	3m	ytd	6m	1yr	3yr	5yr	10yr
AM&A Model Portfolios								
AM&A Defensive Portfolios								
Cash Alternative Portfolio	0.0	0.8	-0.4	0.5	0.9	6.7	16.8	
Defensive Portfolio	0.8	1.3	0.2	1.5	2.4	13.2	26.6	
Benchmark IMA Mixed 0-35% Index (Defensive)	0.7	1.0	-0.4	0.4	0.9	10.0	18.4	
AM&A Cautious Portfolio								
Moderately Cautious Portfolio	1.7	2.3	1.2	2.7	4.7	21.9	39.4	81.3
Benchmark IMA Mixed 20-60% Index (Cautious)	0.9	1.3	-0.1	0.9	2.1	13.6	26.7	57.5
AM&A Balanced Portfolio								
Balanced Portfolio	2.5	3.2	1.8	3.5	6.2	27.9	50.1	108.2
Benchmark IMA Mixed 40-85% Index (Balanced)	3.2	-1.2	-1.2	-0.1	4.8	18.9	38.5	74.4
AM&A Moderately Adventurous Portfolio								
Moderately Adventurous Portfolio	3.1	3.8	2.4	4.2	7.2	32.7	58.7	128.3
Benchmark IMA Flexible Managed Index	1.7	1.5	0.6	1.7	4.8	20.7	39.2	69.0
AM&A Adventurous Portfolio								
Adventurous Portfolio	3.6	4.0	2.6	4.4	7.8	38.6	65.1	134.1
Benchmark AFI Aggressive	2.6	3.3	1.9	3.7	8.1	30.9	53.1	98.2
AM&A Aggressive Portfolio								
Aggressive Portfolio	4.4	4.2	3.9	4.4	9.8	43.3	55.8	123.0
Benchmark IMA Global	3.6	3.1	2.4	4.0	8.5	33.5	63.5	111.6

Source Financial Express 1 June 2018

10 Years of AM&A Model Portfolios

AM&A's first Risk Rated Model Portfolios, first launched in 2008, have recently celebrated their 10th anniversary and have delivered impressive performance against their respective benchmarks as illustrated by the table above.

Amongst the performance highlights over the 10 years to 31 December 2017, the AM&A Moderately Cautious Portfolio which aims to provide a balance between capital growth and capital preservation in real terms over the medium to long term outperformed its benchmark by 85%; the AM&A Balanced Portfolio which aims to provide capital growth and some capital preservation in real terms over the medium to long term outperformed its benchmark by 57% and the AM&A Moderately Adventurous Portfolio which aims to accumulate capital and increase future purchasing power over the medium to long term outperformed its benchmark by 84%.

The AM&A Defensive Portfolio launched in January 2009 which aims to provide some capital growth while focusing on capital preservation in real terms over the medium to long has outperformed its benchmark by 38% over the 9 years since its inception.

As always, please be aware that past performance is not a reliable indicator of future returns and the value of investments can go down as well as up.

Market Overview May 2018

Corporate news took a back seat during May as political developments directed investor sentiment. The possibility of an international trade war moved closer during the month as US President Donald Trump announced that he was ready to press ahead with tariffs on Chinese goods. China described itself as "surprised and unsurprised" by the decision. The US also announced tariffs of 25% on steel and 10% on aluminium imports from the EU, Canada and Mexico from 1 June. The tariffs affect EU exports worth €6.4 billion in 2017, and the news triggered fresh worries over the impact of trade wars. European Commission President Jean-Claude Juncker commented: "This is protectionism, pure and simple".

Europe was blighted by political instability in Italy during May. Attempts to form a coalition government continued to fail following a General Election in early March. At the end of May, however, the situation was finally resolved and Giuseppe Conte was announced as the new Prime Minister. The uncertainty took its toll, however: the benchmark FTSE MIB Index dropped by 9.2% over the month, France's CAC 40 Index fell by 2.2%, and Germany's Dax Index ended May 0.1% lower. Meanwhile, the eurozone's quarterly rate of economic growth slowed from 0.7% during the final quarter of 2017 to 0.4% in the first three months of 2018. The eurozone's annualised rate of inflation is expected to have risen from 1.2% in April to 1.9% in May.

A lack of progress on Brexit legislation continued to blight sentiment in the UK. Bank of England Governor Mark Carney warned that Brexit negotiations were entering "a critical phase". The central bank believes that Brexit has hurt the UK economy, calculating that household income is 4% lower than policymakers' pre-Brexit calculations. The FTSE 100 Index rose by 2.2% over May as a whole.

Japan's economy shrank at an annualised rate of 0.6% during the first three months of 2018, dampened in part by a slowdown in domestic consumption. The Nikkei 225 Index fell by 1.2% over the month. Elsewhere, Australia's annual Budget included tax reductions for those on low and middle incomes, and measures intended to return the economy to a surplus in 2019-20. Australia is one of only ten countries in the world to hold an "AAA" credit rating from all three credit agencies. The ASX All Ordinaries Index rose by 0.9% during May.

Interest rate rises prove hard to predict

The Bank of England did not raise interest rates in May, despite earlier suggestions that it would.

About four years ago a member of the Treasury Select Committee compared Mark Carney, the Governor of the Bank of England, to "an unreliable boyfriend". The remark was prompted by Mr Carney's record of talking about future interest rates increases that never became reality. The epithet came back to haunt the Governor last month.

The Bank had been hinting strongly that rates would rise in May, and by early April the money markets were effectively putting the odds on a May increase at 90%. However, a combination of surprisingly bad economic numbers – growth fell to just 0.1% in the first quarter – and downbeat business surveys prompted a rethink. By the time the Bank announced the rate would be held at 0.5% on 10 May, nobody was surprised.

The next opportunity for changes to the interest rate will come on 2 August 2018, when the Bank publishes its next Quarterly Inflation Report. The medium-term expectation is still that interest rates will rise unless something disastrous happens to the UK economy. For its part, in May the Bank repeated its familiar mantra that, "any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent".

Mainland Chinese stocks join the MSCI index

Important changes affecting Chinese market indices take effect in June 2018, which could affect emerging market funds.

On 1 June 2018, the index provider MSCI added 233 domestic Chinese stocks to its emerging market and global indices. MSCI has some of the most widely used indices for measuring the performance of emerging markets, with the MSCI Emerging Market index suite providing benchmarks for over $1,900 billion of assets. This popularity means that markets can move when any revisions are made to MSCI indexes.

Previously, MSCI's indices had only included Chinese companies with share listings outside the Chinese mainland, e.g. in Hong Kong. Although the Chinese mainland stock market is the second largest in the world, MSCI previously considered the market to have too many drawbacks to merit inclusion. The Chinese authorities have worked on the issues that concerned MSCI, such as ownership restrictions and limited liquidity, resulting in MSCI's change of heart.

The inclusion of the 233 Chinese shares will have little initial impact on the MSCI Emerging Market Index as their total weighting will be less than 1%. However, this is likely to grow as MSCI continues to monitor the market, include more Chinese companies and reweight its indices. In theory China could ultimately represent 40% of the Emerging Markets index.

However, before then it might be reclassified as a developed market. Such reclassifications do not happen often, but in September another index provider, FTSE Russell, will transfer Poland from the emerging to the developed category, the first such switch it has made in almost a decade.

These changes are a reminder that emerging markets funds are by no means static, even if they are merely index trackers. If you would like to learn more about the funds in this growth sector, do talk to us.

A savings tax review

The way savings are taxed is being reviewed by the Office of Tax Simplification (OTS). The OTS is looking at the way in which savings and investment income is taxed, which can be very complicated. According to its paper, published in May 2018, "the interactions between the [tax] rates and allowances is sufficiently complex at the margins that HMRC's self-assessment computer software has sometimes failed to get it right".

The complex marginal rules mean that, "many taxpayers continue to worry about the tax treatment of their savings income even when they do not in fact have anything further to pay, and there are also many specific complexities which taxpayers find difficult and confusing".

To make matters worse, the OTS also found that 95% of people do not pay tax on savings income, thanks to a combination of the personal savings allowance (£1,000 for basic rate taxpayers and £500 for higher rate taxpayers) and the dividend allowance (£2,000).

The OTS paper makes a range of recommendations, including:

- Changing the personal savings allowance and dividend allowance into genuine allowances. They are currently misunderstood nil tax rate bands.
- Increasing the flexibility of ISAs by removing some of the rules about in-year subscriptions and transfers.
- Reviewing the early withdrawal penalty on Lifetime ISAs which have experienced "slower than predicted" uptake.
- Reviewing the use of emergency tax codes for lump sum pension withdrawals. The system generally results in an overpayment of tax and the need for a subsequent reclaim. Around £37 million of overpayments have been returned to date.
- Ending the differential tax rates for dividends (7.5% at basic rate, 32.5% at higher rate and 38.1% at additional rate), to bring them in line with other tax rates on savings.

We can expect to hear more, probably including the announcement of a formal Treasury consultation document, in the Autumn Budget. In anticipation of this, the OTS has already made the plea that, "it is important not to make piecemeal changes, which risk adding further layers of complexity".

In the meantime, if the tax treatment of your own savings and investments is concerning you, do talk to us. Remember, even HMRC struggle to get it right.

Transfers out of private sector final salaries boomed in 2017.

There was a dramatic increase in the value of number of transfers out of defined benefit (usually final salary) pension schemes in 2017. A recent Freedom of Information (FoI) request to the Financial Conduct Authority (FCA) revealed that the £20,800 million was transferred last year, up from £7,900 million in 2016. There were 92,000 transfers, compared to 61,000 in 2016.

The increase in transfers stems from a variety of factors:

- A growing awareness of the planning opportunities introduced by pension flexibilities, which can make the traditional defined benefit scheme look outdated and rigid.
- The significant sums involved: the average transfer last year amounted to £226,000.

- Employers quietly welcoming transfers as a way of reducing their pension scheme liabilities, which have grown rapidly because of ultra-low interest rates and improving pensioner lifespans.
- The proportion of defined benefit schemes closing to existing employees steadily increasing, leaving more people with preserved pension benefits, even if they have not changed jobs.
- Since 2009, investment markets being generally benign or buoyant, helped by the same economic measures that have pushed, and held, down interest rates. The absence of any major market declines has reduced the visibility of one of the major transfer risks: exchanging a quasi-guaranteed benefit for one reliant on investment performance.

A transfer can be the right choice in certain circumstances, but there are sound reasons why the FCA continues to require advisers to start with the assumption that a defined benefit pension transfer will be unsuitable.

If you are considering transferring any of your existing pension arrangements, please make sure you talk to us before taking any action. A transfer out of a defined benefit scheme is nearly always a one-way ticket and you need to be sure you fully understand the pluses *and* minuses of the destination before the journey begins.

Can a revised tax system re-balance intergenerational fairness?
A new report has proposed taxing the baby boomers to help resolve major issues around intergenerational fairness. The report, published by the Intergenerational Commission in May, offers ten policy recommendations which would represent a radical overhaul of the UK tax system.

Examples include replacing inheritance tax with "a lifetime receipts tax that is levied on recipients with fewer exemptions, a lower tax-free allowance (£125,000) and lower tax rates (20% and 30%)" and replacing council tax with a "progressive property tax" levied on owners rather than occupants, with a marginal rate of 1.7% on property value over £600,000.

The Commission was set up by the Resolution Foundation to examine the issue of fairness between the generations and has been examining whether the baby boomer generation (1946-1965) has left generation X (1966-1980) and the millennials (1981-2000) to pick up the bill.

Their report found the post-war generation has the advantage, based on a range of measures including home ownership, earnings progression, personal debt and pension wealth.

As with most think tank reports, this grand plan is unlikely to be put in place. However, some of the proposals could see the light of day, as ministers look for solutions to the problem.

One such example was an idea to generate extra funding for the NHS by extending national insurance contributions (NICs) to people working beyond state pension age. This was reported the day before the Commission's report was published and Jeremy Hunt, the Health and Social Care Secretary, was quoted as favouring the idea. The Commission's report went further, proposing that NICs also be charged on private pensions, at a reduced rate.

One point the report makes, which is supported by many other research bodies, is that the ageing population will require more government expenditure on health and social care. The Commission wants that cost to be borne by those who receive the benefit, but politicians may not agree. Either way, the message is that if you are hoping for tax cuts, they are unlikely to come from the government. Taking control of your own planning for your later years is a more sensible option.

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