

Riding out the Storm

All investments carry a degree of risk, and as depositors in Northern Rock discovered, this even applies to cash deposits. But most people need to save – perhaps against a rainy day or to improve their retirement – and saving means investment. So there is no avoiding the need to take some risk. The important thing is that the risks individuals take should be consistent with their experience and their willingness to look beyond temporary setbacks.

Tracing the progress of stock markets over the past century, what is surprising is that the major setbacks barely register a blip in the otherwise steady upward progression. Even the dramatic decline of the early 1970s, when the market fell from 520 points to a low of 147 – the most devastating fall in recent memory – hardly registers on the chart.

So the first point to make is that investors need to take a long view. This makes it easier to remain reasonably relaxed while the lemmings are piling into ‘flavour of

the month’ stocks or rushing for the exits. When the sun is shining all news is good news, but when sentiment is negative, good news tends to be ignored.

Different economic conditions favour different sectors. In 2007, for example, the property market, which had become over-inflated by cheap credit, went into reverse, while the commodity market, driven by the demand for minerals and food by the emerging economies, maintained its strong upward path. Investors with well-diversified portfolios have the reassurance of knowing that they can take the rough with the smooth.

Until recent years, it was considered that the basis of diversification was a judicious split between equities (for the most part UK equities) and gilt edged securities or corporate bonds. Now, both equities and bonds are viewed globally, with increased emphasis on the emerging markets, and property and commodities have become important ingredients in the mix.

There is also increasing evidence of the value of hedge fund techniques (particularly the ‘short’ selling of stocks which appear over-valued) in providing a degree of protection against market fluctuations. The managers of these funds are betting that some stocks will go up and others down, and the best managers have made some good calls for their investors.

There is, though, a school of thought that since most fund managers inevitably under-perform their market, investors should avoid the significant cost of fund management and rely on tracker-style funds to give them ‘passive’ exposure to the major asset classes: equity, bonds, property and commodities and the sectors within each of these asset classes.

Whether the investor favours an active or passive portfolio – or a blend of the two – the objective should be to achieve a sensible balance of holdings within the comfort zone of the individual investor and not be panicked by periodic fluctuations.

Age Allowance

The increase of almost 20% which is being introduced in the Age Allowance to compensate for the removal of the 10% tax band makes this Allowance even more valuable for the over 65s. But both the Age Allowance and the Married Couples’ Allowance which is available to those aged over 73 are reduced when pension or other income exceeds a given figure.

The income limit for age-related Allowances is £21,800 in 2008/9 and the combined effect of tax and the reduction in the Allowance on any excess of income over this level is effectively to increase the marginal rate of tax to 30%.

Pension Booster

Many employees have pension plans to which they contribute from their net salary, and they are happy that their contributions are eligible for income tax relief, in the form of top-up payments by the Revenue. However, contributions made from salary will still have suffered both employers’ and employees’ National Insurance contributions at rates of 12.8% and 1% respectively.

The way to avoid this charge is ‘salary sacrifice’. That is to say, an agreement between employer and employee that

the employee’s contract of employment will be amended by reducing salary and paying an equivalent amount into pension on the employee’s behalf. The considerate employer should also be willing to pay the value of the saving in NI into the pension as a bonus contribution.

However, salary sacrifice is a long-term contractual commitment, and cannot be turned on and off to suit the employee.

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