

### Your independent window on financial issues

## A Budget for making things ...



A focus on growing the private sector

The aim of this Budget was to help the UK recover its position as a manufacturing country.

To achieve this, we need to make it easier for businesses to start up and thrive, as well as to reduce the proportion of GDP represented by the state. According to the Budget Statement, GDP growth forecasts have been cut from 2.1% to 1.7% due to weaker than expected 4Q10, higher inflation and increased commodity costs. However, the future looks stronger with the economy set to grow by 2.5% next year, rising to 2.9% in 2014.

Additionally, borrowing for the year is forecast at £146bn, falling to £29bn by 2015/16 and CPI

inflation is likely to remain between 4% and 5% for 2011, before reducing to 2.5% next year and to 2% in two years' time.

### Personal taxation

The personal allowance - already set to rise by £1,000 to £7,475 - will be increased for 2012/13 by a further £630 to £8,105, for under-65s. The government will consult on merging the tax and National Insurance systems, in order to simplify their operation for businesses. This will not affect pensions or other forms of income.

The 50% income tax rate is not seen as permanent, but future tax indexation will be in line with the CPI rather than the (generally) higher RPI. This means that thresholds will not keep pace with the higher measure of inflation in future. This also applies to ISA limits from April 2012.

The tax relief available on Enterprise Investment Schemes increases from 20% to 30% and the capital gains tax entrepreneurs' lifetime relief is doubled to £10 million.

The fuel duty escalator announced in 2009 Budget is abolished and replaced by a 'fair fuel stabiliser', paid for by a levy on oil companies. The main fuel duty rate was cut by 1p per litre from Budget day.

### Business taxation

The main rate of corporation tax is cut by 2% rather than the 1% previously announced, producing a rate of 26% from April 2011. It will be cut by a further 1% each year, until it reaches 23%, making it lower than in France and the US.

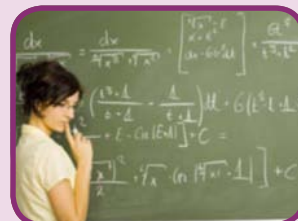
The tax system is being simplified with the removal of more than 100 pages of code. To help small businesses in particular, £350 million worth of specific regulations are being removed and 21 new Enterprise Zones are being created, offering businesses up to 100% discount on rates, new super-fast broadband and the potential to use enhanced capital allowances in zones where there is a strong focus on manufacturing. The small business rate relief holiday has also been extended by one year from 1 October 2011.

Overall, it is to be hoped that, while there is little short-term joy for families, there is real potential for an economic recovery that can make us all better off over the longer term.

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## The impact of inflation on savings

Even if interest rates rise throughout 2011, it is unlikely that they will rise high enough for savers to achieve a positive return, in real terms, any time soon.



**A mismatch between interest rates and inflation**

On the basis of Consumer Prices Index inflation at 4% a year, a basic rate taxpayer needs to earn 5% before tax, if the impact of inflation at this level is not to erode the purchasing power of their non-ISA cash savings. Matching the Retail Prices Index figure, which is usually higher, makes achieving real growth even more difficult.

This situation may encourage investors to adopt higher risk strategies, to secure a better return.

### Is risk a bad thing?

Risk is an integral part of investment; generally, the greater the risk, the higher the potential reward. However, the value of investments really can go down as well as up – if you accept greater risk in return for the prospect of larger profits, you could lose part or all of your money.

On the other hand, leaving your cash on deposit can simply mean that its value withers over the years, in any event.

### Unacceptable risk

What is unacceptable, in terms of risk, is leaving yourself open to potential losses that you are not aware of. This can happen with some forms of derivative-backed investments that look as if they are guaranteed; but the protection evaporates under certain circumstances, such as default by the guarantor.

### Acceptable risk

'Nothing ventured, nothing gained', they say. You cannot afford to go through life in cotton wool, but must accept some degree of risk if you are to achieve any growth. To do this successfully you must understand what risks you are exposed to with various types of investment, and consider an asset allocation strategy that gives you the best chances of success.

Asset allocation strategies involve ensuring that you do not have all your eggs in one basket. Of course, if you knew in advance which horse would win the Grand National, you could

put all your money on it to win. But in reality, the future is a closed book. If we cannot put all our money on a 'sure winner', spreading our investments avoids putting everything on a 'loser'. Selecting different shares to invest in, for example, means that you have a greater chance that, if one sector performs less strongly, another might shine.

Not everyone will require the same strategy, but looking at separate business sectors, company sizes and geographical locations could be a good start. For those with larger sums to invest, it may also be worth considering inclusion of a wider range of assets such as commodities and property. These, however, have different risk profiles compared with more traditional assets such as shares and most collective investments, so individual advice is essential.

It is important always to seek independent financial advice before making any decision regarding your finances. The value of investments is not guaranteed; you may get back less than you put in.

## Families lacking protection

**According to Professor Stephen Hawking, adding one equation to his book would halve sales.** It is therefore with some trepidation that we include some statistics in this article. On the other hand, few people reading financial articles are likely to share the 'popular' fear (even ignorance) of statistics, and their use can make things much clearer.



**Not always the best way to communicate**

So here we go. According to research undertaken by Aviva for its Family Finances Report (19th January 2011):

- 93% of families do not feel they have adequate financial protection;
- 89% are without income protection insurance;
- 87% do not have critical illness insurance; and
- 61% do not even have basic life insurance.

Perhaps even more worryingly, two-thirds of all divorced parents with two or more children said they have no, or inadequate, financial protection.

### Why do people 'not bother' with insurance?

According to the research, one in five people believe that life insurance will be too expensive, while one in twenty think it "never pays out", so is not worthwhile. In fact, Aviva's own figures show that cover can cost as little as £5 a month and it says it pays out on 99% of all life insurance claims. The average claim, it says, is for more than £50,000.

Critical illness insurance can be more expensive and the older you are when you start your critical illness or life cover, the higher the premiums will be. There are clearly very good reasons for taking out cover as early as possible, while you are young and healthy.

### Perhaps they don't know how important it is?

According to Aviva, a quarter of the families questioned said that they had already experienced what it is like to have the main breadwinner out of commission and unable to work due to illness, so they know how important that can be. Furthermore should the breadwinner die, there is no chance of getting better and going back to work.

### A plan of action

The importance of adequate protection cannot be overstated. Of course you cannot do everything at once, especially if money is tight, so addressing the most important issues first is a good idea. With careful planning, you can ensure that costs are not too high. For example, using family income protection (which provides an income rather than a lump sum, on death) rather than level term insurance, can be less expensive.

Selecting a longer 'waiting period' - the time after the onset of illness before a claim starts to be paid - can also reduce the cost of income protection insurance. In some cases, critical illness insurance may be an alternative, although this will not pay out in every instance, whereas income protection tends to be more comprehensive in its scope.

You should take individual professional advice before making any decision relating to your personal finances.

### Living to 100 and beyond ...

According to a report in the Telegraph (29th December 2010), 10 million people who are alive in the UK today will live to more than 100 years old. That is both good and bad news. Of course, nobody wants to die, so the prospect of living to more than a hundred years of age sounds appealing.

There are, however, a number of issues that, while not necessarily detracting from what is really good news, should at least give us pause for thought. All it takes is a little planning to ensure that increased longevity is the bonus that it should be.

### Making your savings last longer

The key issue for most of us, especially those who are already



Will eighty be the new sixty?

over 50 (and therefore have less time to build up additional pension funds) is that our money is going to have to last much longer for us.

Purchasing an annuity with your pension fund when you retire may sound a good idea, as this gives you a guaranteed income for the rest of your life. Unfortunately, because insurance companies know that we are living longer, and as interest rates are currently very low, annuity rates are nothing like as high as they once were. This means that we will receive a smaller annual pension, for a given pension fund, than a decade or so ago.

The solution to this comes in several stages. The first is to maximise the amount we put into our pension provision so that we have more money available to live off later on in life.

The second is to consider gradually 'phasing in' retirement, rather than giving up work on one day, using the changeover period to enhance our retirement pots. This is made easier by a rule change that means we can now manage the way we take income from our pension plans without having to buy an annuity. In fact many of us will not even have to buy an annuity when we reach the age of 75 as once was the case.

### Health is an issue

As we get older our health may deteriorate and we could start to need more assistance in coping with activities of daily living. There are forms of investment designed to assist with what is called 'long term care' and these can be funded in a number of ways, including lump sum investments and funding by releasing equity from the family home.

Hopefully, improvements in health care will ensure that many of us remain far fitter for longer than was once the case, so the average time for which long term care is required is not much longer than at present.

It is important always to seek independent financial advice before making any decision regarding your finances. The value of investments is not guaranteed; you may get back less than you put in.

## News in brief (data compiled by The Insurance Marketing Department Ltd. except where otherwise stated)

Despite a difficult March, driven largely by events in Libya and Japan, the FTSE100 ended the first quarter of 2011 0.15% higher than at the end of last year. The Dow Jones, however, actually rose by 6.41% over the same period.

The mid-cap FTSE250 similarly performed positively during the first quarter growing by 0.29% but AIM, which had been performing more strongly, suffered more during March and therefore ended the quarter 3.46% down.

Sterling, which had fallen against the US dollar during the last quarter of 2010, bounced back by 2.86% in the first three months of this year, ending at \$1.61. However, compared with the euro, it lost 2.75% of its value to finish at €1.13.

House prices rose by 0.5% in March, according to Nationwide, making the annual increase just 0.1% and the average house price across the UK £164,751. Average prices are now about 1.5% higher than at the end of last year.

## Is now the time to re-mortgage?

**Interest rates have been low for a long time now. In fact the Bank of England's base rate has been at historically low levels since March 2009.**

Low interest rates are great for borrowers - although most do not have 'trackers' that directly follow the Bank of England's base rate, so they are likely to be paying much more than 0.5% at the moment.

When interest rates are so low, repayments are less than might originally have been budgeted for and many people will therefore be taking the opportunity to 'over-pay' each month, in order to reduce the outstanding balance faster than planned, as this can save a lot of interest later on.

### Is this the only consideration?

Good as it is to cut down your mortgage as quickly as possible, there are other issues to consider such as what is likely to happen to interest rates over the next few years.

Base rate is likely to rise during the course of 2011, largely because inflation refuses to calm down and this is one of the few weapons available to the Monetary Policy Committee (MPC). One member, Dr Andrew Sentance, has been arguing in favour of this strategy for months.

Of course, lenders are not tied to what the Bank of England does (except for base rate tracker mortgages) but as a general rule if base rate rises, home loan rates tend to follow suit. So mortgage rates are likely to rise during the year.

### Fixed rates

It is, however, possible to arrange a 'fixed rate' mortgage although rates are generally only fixed for a limited period - seldom much longer than 60 months, or so - and are often initially higher than for standard variable rate mortgages or trackers. This is because lenders also expect rates to rise and

are already factoring-in an allowance for this.

Lenders' arrangement fees can also be higher than for some other loans and this needs to be taken into account when considering whether the costs involved (and a possibly higher interest rate than you are currently paying) justify moving from your present mortgage.

You may also be tied-in to a higher standard variable rate than would apply under your current deal, at the end of the fixed period, and may then have to accept additional costs in order to make alternative arrangements.

This is not a simple matter and consulting an independent mortgage or financial adviser before making any decision, is essential.

Your home may be repossessed if you do not keep up the repayments on your mortgage. A fee may apply for mortgage advice and you must ask for details before making any decision relating to a new mortgage as the actual amount will depend on your personal circumstances, but in most cases is unlikely to exceed 0.5% of the loan value (on a typical £100,000 mortgage, this would be £500).



**The Bank of England influences mortgage interest rates**

It is important to take professional advice before making any decision relating to your personal finances. This publication represents our understanding of law and HM Revenue and Customs practice as at the date of publication. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK, please ask for details. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from taxation are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.

The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get back the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency. Your home may be repossessed if you do not keep up the repayments on your mortgage. A fee may apply for mortgage advice and, if applicable, you must ask your adviser for details before making any decision relating to a new mortgage as the actual amount will depend on your personal circumstances, but in most cases is unlikely to exceed 0.5% of the loan value (on a typical £100,000 mortgage, this would be £500).