review

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Crystal Wealth Management

2012 markets: a look back

2012 was not a vintage year for our economy. The full picture has not yet been revealed, but it seems likely that while consumer prices rose at a comfortable rate close to 2.5%, gross domestic product (GDP) failed to gain any ground.

In the light of such little growth it is surprising that the level of unemployment is lower rather than higher than it was at the beginning of 2012.

For the financial markets, 2012 proved volatile but broadly positive. The FTSE 100 Index gained 10%, though gains made in the first quarter were wiped out in what proved to be a difficult second quarter – from peak to subsequent trough, the FTSE 100 lost 11%.

Both domestically and internationally, smaller companies outperformed their larger peers and while value stocks outperformed growth stocks on a global basis, that trend was reversed in the UK with those stocks in the growth category providing almost double the return of those in the value category.

UK investors with exposure to Asia Pacific equities saw terrific returns in this section of their portfolio, with strong gains too from a remarkably volatile Europe.

Bond investors were rewarded with relatively solid returns too. UK conventional government bonds gained nearly 3%, with inflation-linked bonds returning a little under 1%. Investment-grade corporate bond holders saw capital values rise by around 13%, while lower-quality, higher-yielding bonds rose by a whopping 19%.

Property investors endured further disappointing returns from bricks and mortar (1.2% for the ABI sector average), while property securities such as REITs motored ahead closer to 20%. Those investors seeking greater diversity saw 'absolute returns' averaging 3.4%. Please talk to us about how you can make the most out of your investments this year.

The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

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Tax saving in the run-up to the tax year-end

As the Government's austerity programme drags on, with an end date now pushed out to 2018, year-end tax planning for individuals and businesses has become more important than ever.

Tax changes in the last couple of years have meant that there are many tax saving opportunities on which you might want to consider action well in time for the end of the tax year on Friday, 5 April 2013. You might consider acting before the Spring Budget on 20 March, just in case there are some surprise announcements.

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Pensions The Autumn Statement included some important pension announcements that take effect from April 2014, but they cannot be ignored in 2012/13.

For example, the lifetime allowance – the maximum tax-efficient worth of all your pension benefits – will fall from £1.5 million to £1.25 million. At the same time, a new transitional protection will be introduced, which will allow you to retain the £1.5 million, provided you make no further contributions or accrue no further pension benefits. There is therefore an opportunity to maximise your pension fund now – perhaps with 50% tax relief before that disappears in 2013/14.

Individual savings accounts (ISAs) The 2012/13 ISA contribution limit is £11,280, rising to £11,520 from 6 April 2013. There are four good reasons for making the most of your ISA allowances.

- Income from fixed interest securities held in a stocks and shares ISA is free of personal UK tax.
- Interest earned on deposits in a cash ISA is also UK tax-free.
- Gains made within ISAs are free of capital gains tax (CGT).
- There is nothing to report about your ISA on your tax return.

Inheritance tax (IHT) The IHT nil rate band of £325,000 was frozen on 6 April 2009 and will not change next year.

That freeze makes it all the more vital you use your annual IHT exemptions. The main £3,000 annual exemption can be carried forward, but only to next tax year (2013/14), and then can only be claimed once the 2013/14 exemption has itself been used up. If you and your partner have not made any gifts since 6 April 2011, you could now jointly give away £12,000 free of IHT.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice. The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

State pension reform changes unveiled

The much-delayed White Paper on the future of state pensions has been published.

The United Kingdom has one of the most complex state pension systems in the world. To quote the White Paper, 'many people do not have a clear starting point from which to plan and save for their retirement'. The solution proposed is:

- Introduce a single tier pension of £144 a week in today's terms, marginally above the level at which any Pension Credit is payable.
- End accrual to the additional pension (the state second pension) and contracting out.
- Base entitlement on the individual, ending the right to inherit or take credit for the pension of a spouse/civil partner.
- Scrap the Savings Credit for new pensioners.
- Review (and probably increase) the state pension age (SPA) every five years.

To gain the full £144 a week pension you would need a 35-year record of national insurance contributions and/or credits, compared with the 30 years currently required for the basic state pension. A minimum period to receive any pension will be set – probably at ten years.

The proposed starting date for the new pension regime is April 2017, 'at the earliest', and if you reach your SPA before then, you will be unaffected. It is not surprising that there are complex transitional rules to deal with state pension benefits accrued before the start date.

The White Paper admits that 'single-tier reforms have been designed to cost no more overall compared to the existing pension system' and the Department for Work and Pensions' own projections suggest that in the long-term the cost will be less.

While there will be many people, particularly those who are low paid, who will gain from a single-tier pension, the lower overall expenditure means there may be more losers than winners.

So while the proposals are a simplification, they are no substitute for private provision.

In early November 2012, National Savings and Investments (NS&I) announced an immediate cut in the interest rate on their Direct ISA from 2.5% to 2.25%. The move was in line with other short-term ISA rates, which have been falling since the summer. There is no sign that interest rates will be rising soon – the money markets imply virtually no change before 2015. If you started a cash ISA in March or April 2012, you should check what interest rate you will be earning after the first year's anniversary. You may find that last year's 3% becomes 0.5%. The FSA does not regulate National Savings products.

Inflation – making difficult times harder

2013 is going to be another tough year as inflation is likely to remain stubbornly above target, according to the Bank of England's chief economist Spencer Dale.

Mr Dale was stating the obvious when he said many households and families were 'much worse off'.

Rising food prices, the fact all the 'big six' energy firms have hiked bills, rail fare rises and higher tuition fees are all having an impact.

Many accounts pay interest below the rate of inflation. A glimmer of better news is that the amount that can be invested into an ISA is to rise by £240 from £11,280 to £11,520 from April 2013. Further, the amount of annual gains you can bank before paying tax is rising by 1% in 2014 and 2015 to £11,100.

However, if you are saving for a pension there was some bad news in the Chancellor's Autumn Statement, with the annual allowance for tax-incentivised pension saving cut from £50,000 to £40,000 and the lifetime allowance reduced from £1.5 million to £1.25 million, both in 2014/15.

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The basic state pension will rise by 2.5%, but when inflation is taken into account, pensioners are likely to be worse off. However, those funding retirement through pension drawdown will be able to take 20% more of their fund each year under rules that will take effect from 26 March 2013.

The Government has also announced that rises to tax credits and child benefit will be pegged back to 1%, rather than inflation. The change to tax credits comes into effect in April 2013 and will last three years; the change to child benefit comes into force in 2014 and will last two years.

However, the amount that can put into a child's junior ISA or child trust fund will increase from £3,600 to £3,720 from April 2013.

The news is not all bleak – unemployment is lower than anticipated and the Bank of England has predicted modest growth for 2013. But, given that inflation will be sticking around, taking expert guidance remains crucial.

Time to go east?

China is the world's most populous nation and its second largest economy, so after a rocky 2012, is it now a good time to look at investing there or in other Far East countries?

While it offers unique opportunities in terms of its scale and manufacturing capabilities, China's fortunes have been intertwined with the global economy – if wages rise, it becomes less competitive and if export demand falls, then so do its earnings.

China's performance has disappointed of late, with weaker exports and imports and signs of a property bubble. And, in March 2012, the Chinese Government revised its annual growth target for 2012 down to 7.5%, creating some anxiety.

Despite the slowdown, the HSBC purchasing managers' index for December rose to 51.5 from 50.5 a month earlier, resulting from increased government spending on infrastructure. Meanwhile, predictions vary about what growth China will see in 2013. The official view is 7.5%.

China may suit you if you have predominantly UK and European holdings and favour diversification. What's more, valuations are roughly a third of the peak level reached in 2007. However, China is far from being the only Eastern player, and although Japan has been a disappointment for investors over the last couple of decades, it is suddenly looking a little more promising.

New Japanese prime minister Shinzo Abe has implemented a programme of fiscal stimulus, and although there have been false dawns before, some commentators believe that Japanese equities are looking good value. There are many funds on offer, so seeking guidance on those likely to outperform could make sense.

There is also a wide range of funds focused on the Asia Pacific sector. Some may be heavily influenced by China, but others may be investing in less promoted countries such as Malaysia, Thailand and Indonesia.

The region has also been bolstered by improved relationships with the United States – US President Obama described the region as a 'top priority' in terms of its importance as a leading trading partner and in having a pivotal role in the United States recovery. With many western countries being in the doldrums, it is no wonder eastern markets are receiving increasing attention.

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State pensions – still not enough

State pensions are still not an adequate retirement income, despite April's increases.

To date, the current Government has protected the benefits of pensioners more than those of other members of society. Universal pensioner benefits, such as the winter fuel payments, have been untouched and state pensions have at least kept pace with inflation, even though it is measured on the consumer prices index (CPI), which tends to rise more slowly than the retail prices index (RPI).

State pensions have been growing faster than average earnings which, according to National Statistics, increased by only 5.5% over the last three years to October 2012, less than half the rate of CPI inflation.

However, state pensions are still not enough to provide an adequate retirement income, despite their recent outpacing of earnings. Recent research published by National Statistics showed that in 2010/11 state pensions and related benefits accounted for less than a third of the income of pensioner couples, where the head of the household was under age 75.

There is another salutary warning from this set of statistics: for the same couples, earnings accounted for a greater proportion of their total income than did state benefits. If you do not want to be caught in that trap, make sure you review your private pension provision now.

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Bonus time?

It is here again – the time of year when with profits insurers declare bonuses.

About two years ago, the Financial Services Authority (FSA) issued a consultation paper, 'Protecting with profits policyholders'. The title reflected the FSA's concerns about the operation of with profits business.

Thirteen months later, in March 2012, the FSA published new rules and guidance. The current bonus season is therefore the first where the FSA's revised regime takes effect.

While investment conditions in 2012 were generally better than in 2011, this year's bonus rates are unlikely to be much better than last year's. All with profits insurers are facing the issue of historically low yields on the government bonds and other fixed interest securities, which form a large part (or sometimes all) of their with profits funds.

Low income returns generally mean low regular bonuses, but you should not automatically assume that it is not worth holding onto any with profits policies you have. There is no substitute for a policy by policy assessment, given the huge variations between both contracts and providers.

We can undertake such a review and supply an analysis of your options. Only then can you decide whether the low bonus rates are not as bad news as they appear.

Let's get personal

Higher personal allowances could be an opportunity.

Next tax year's personal allowance will jump by £1,335 to £9,440. Will you make the most of this increase? If you are employed or you receive State and other pensions the answer is probably yes, because your earnings and pension count as the first slice of income for tax purposes.

However, if you or your partner largely rely on investment income or have total income below £9,440, then part or all of the personal allowance could be going to waste.

Sometimes the solution is to rearrange who holds which investment, so that you each have enough income to cover your own personal allowance. Often there will also be a need to change investments, because what is suitable for a taxpayer may be inappropriate for a non-taxpayer.

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We can advise you on your options and warn you of the inevitable tax traps. The sooner you start making the changes, the sooner you will be in a position to benefit from April's increase.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Services Authority does not regulate tax advice.