Wealth Management Update

Message From Anita

I would like to start on a very personal level and say sadly my father lost his battle with cancer at the end of the year. I would just like to say thank you very much for all the very kind messages and cards I received. It really makes me appreciate the relationship I have with my clients, so thank you very much for that.

Looking forward, I am now able to really focus on how to make sound decisions and how to help you through these unsettled economic times.

Interestingly I was talking to a close friend last week who happened to have a brief chat with the Prime Minister. On asking how he was proposing to get us out of this current situation, the answer came, 'Well that's what everyone wants to know.' He then proceeded to walk off to talk to other delegates. If ever a Churchillian response was needed.

It is clear that these are unchartered waters and even the top economists are unsure of the best way forward. It is time for cool heads, careful planning and diversification. It goes without saying that if you have any concerns about the best way forward we are always at the other end of the phone.

So who is this Milton Keynes guy?

This was a very real question from a client who had been listening to the radio and had heard talk about the government going back to some "old economist's" view of how to get us out of the economic mess we are in.
Alas, Milton Keynes is not named after probably the world's second most well- known economist after Adam Smith, John Maynard Keynes.
John Maynard Keynes was born on 5 June 1883 in Cambridge. With an economist-philosopher father, and mother who progressed to being Cambridge's first female mayor, it was inevitable that against such an academic background he would excel academically at Eton, and then to Cambridge University where he studied mathematics.

His background also made him a welcome friend to members of the Bloomsbury group of intellectuals and artists.

After graduation, Keynes went to work in the India Office. His work there did not preclude, or get in the way of, further studying, and during this period he completed a dissertation that earned him a fellowship at King's College, taking him back to Cambridge in 1908.

The Treasury beckoned him next, after the outbreak of the First World War. Not afraid of stating his mind, he felt very strongly about what he considered to be exorbitant reparations exacted from Germany in defeat, and following the Versailles Peace Treaty, he published his thoughts in what was to become a best-selling book, "The Economic Consequences of the Peace", which made him world famous. It can have been of little comfort to see his prophesy of

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German revenge realized.

He used his knowledge and understanding of how economics works to great personal and academic effect, building a sizeable fortune for himself, and in his capacity as bursar, adding to the wealth of King's College. He was on the board of a number of companies, and still found time to patronize the arts.

In 1926, he married Lydia Lopokova, a Russian ballerina.

The classic work, "The General Theory of Employment, Interest and Money", was published in 1936, and not only made Keynes's theories a benchmark for future economic thought, but also strengthened his position as Britain's most influential economist.

Conflict returned Keynes to the Treasury, upon the outbreak of the Second World War. In 1942, he was elevated to the House of Lords.

During these war years Keynes was less controversial, and was prominent in the negotiations that were to stabilise international economies in the aftermath of the war. In 1944, he led the British delegation to the Bretton Woods conference in America, playing a significant part in the formation of the organisations that would emerge in the shape of the World Bank and the International Monetary Fund.

Keynes died on 21 April 1946.

Keynes was effectively a founder of the modern financial world, and it was his economic theories and policies that helped lift the world out of the depths that were the Depression, and the damaged world after the Second World War. Anyone who has seen the stage musical Annie, will have seen how little Annie, when meeting President Roosevelt, explains Keynes's theories in perfect simplicity, and helps save the US nation, economically speaking.

In the 70's, Keynesian economics fell out of favour following mass unemployment, high rates of inflation and growing interest rates. The fiscal policy that he so admired became overtaken by the more popular monetary policy.

What are monetary policy and fiscal policy?

In its most simple terms, monetary policy is the control and manipulation of the economy through the control of interest rates. Fiscal policy is the control and manipulation of the economy through government spending and taxation.

If you want to generate increased growth in the economy, you need people to spend more. To do this with monetary policy, you reduce interest rates. As interest rates fall, people have more money in their pocket, because mortgages are cheaper, and so they can spend more. More spending results in growth. Also, as interest rates fall, there is less incentive to save, and so people tend to spend more and save less, also increasing growth. To slow an economy you increase rates to restrict spending, so that the opposite happens. This is how monetary policies work.

With fiscal policies, you control spending through government spending and taxation. Rather than relying on the population to spend more or less, the government does it for you. It does this by increasing its spending, and increases disposable money by reducing taxation. This has the effect of growing the economy.

What makes Keynes so different?

Where Keynes differed from every other economist was in his understanding of two points. Firstly, that the government is more powerful than the populace and, secondly, that there is a "multiplier effect".

The problem with using interest rates to control the economy is twofold. Firstly, it is very slow (typically a change in rate affects GDP 9 to18 months after implementation) and, secondly, people do not always act rationally. Take the present situation, for example. If interest rates fall, people should spend more. This is because they have more money in their pocket and loans are cheaper. But think about those people who you know and what their psychological position is now. Do they feel confident? Do they feel that now is a good time to spend? Probably not. What can happen, and probably will right now, is that reduced interest rates may simply lead people to save more. This is because they feel uncertain about the economy and their jobs, and so they will put money aside. The impact of the media has had a dramatic effect on this. Negative reporting can almost cancel out any interest rate cuts!

Keynes realized this, and so favoured fiscal policy. But he also understood the "multiplier". When the government spends £100 it does not generate just that amount in the economy, it generates considerably more. When it spends £100, around two-thirds of that money will come back to the government. Partly in income tax, partly in corporation tax and partly in VAT. This means that it would actually cost the government only about £30 to boost the economy by £100. Taking this further, the £70 that the government gets back can be spent again, and returning that £70 into the economy will generate about £50 back. This can go on and on, generating significant levels of additional GDP growth.

While reductions in taxes can bring about an increase in money for people to spend, they can have the reverse effect as they reduce the amount that the government gets back, with reliance being placed on people spending more, rather than saving as would probably happen now.

So what does it all mean?

There are two problems facing the world. The first is the rupture in the global economic system, and the second is global recession.

The governments of the world have shown their intent to do whatever needs to be done to shore up the world's financial systems. Banks can not be treated like other businesses and allowed to fail. The US government let Lehman Brothers fail, and that exacerbated the current inter-bank crisis. If they had protect Lehman's, I believe we would not have had the banking problems that we have had of late. Everyone's wealth is dependent upon being able to get to their money and move it around. If banks fail, then the whole world comes to a halt – a very different situation when compared to a car manufacturer failing. I believe that the banking crisis is near to an end, and we will see a return to normal by the end of the year.

The second issue is the global recession. All economies go through the economic cycle; they always do and always will. It is impossible to continually grow an economy all the time. This is because when economies grow, so do businesses and government. Businesses exist that really shouldn't, but are carried by the tide. Government departments grow and become heavy and slow. Over time, businesses and governments need to be shaken and the dead wood taken out – this is what the economic cycle does. It hurts, but, like cutting out a cancer, must be done.

Most economists believe that Keynes was right, but experience has shown that, as a general rule, in recessionary times fiscal spending policies tend to produce the best results; in growth times, monetary policy and fiscal policy focusing on tax control tend to work best. The big problem is that it is tough to look ahead more than three months with any certainty, because controlling the economy is like driving a car by looking in the rear view mirror. Also, governments hate doing things that will stop them getting elected. To really control an economy well you must do uncomfortable things when they do not seem to be needed. For example, restricting spending in the later stages of growth. However, a government that decides to close schools and hospitals, or spend less on policing, is always criticised. For this reason, it will almost always be impossible to avoid boom and bust.

But, as Keynes himself said: "In the long run, we are dead!"

We never do what we should

How do you lose weight? There is only one way, consume less than your body needs. It is very simple, everyone knows it, yet we spend thousands on products and services, books and magazines each year in the hope that we can find another, less uncomfortable answer.

How do you invest? You buy low and sell high. Everyone knows this, it is as simple as simple can be, but no one ever does it, and never can.

We never buy low, because when investments fall we are scared to buy them precisely because they are falling. We never sell them when they are high, because we hold on to things that are doing well.

Add to this the uncertainty that we never really know when we are at “the bottom” or at “the top”, meaning that it is impossible to do what you know you should. The only thing you can do is to get as close as possible to this by using an asset allocation strategy.

In a falling market you can never not lose money, but what you need to do is to lose less than everyone else, and when the market grows you need to make more than anyone else.

Now really could be the time to invest. Markets across the world are down, and if you are holding cash, now maybe the time to take advantage of this. Interest rates are falling and returns on cash will fall.

A different perspective

“Dear Dad

Please don’t worry but I have to let you know that the digs where I am staying caught fire last night and were burned to the ground. I narrowly escaped, but all of my belongings, including the £2,000 computer and printer that you bought me, are destroyed, as is all of my dissertation work that was on the computer. Unfortunately, I never sent off the insurance form that you gave me so nothing is insured.

I was lucky to escape because my boyfriend was staying with me. I know I have not told you about him before, but I have always been afraid to because he is so different from you. He works in a tattoo parlour in town, because he was made bankrupt last year when he failed to make the maintenance payments to his ex-wife and four children. Because he is such a light sleeper following all of his problems, he smelt the smoke and we got out in time. I am so pleased that we did because he has asked me to marry him now that I’m expecting his child, and it looks like triplets. I may have to suspend my last year at university now, but I would hope to start again once the children are old enough.

Dad, before you explode, the digs have not burnt down, and I am not pregnant by a tattooist , but I have failed my 2nd year exams – I just wanted to put it into perspective for you.”

There is so much negativity in the press at the moment, with so many terrible and horrible things happening in the world. Not a day goes by without some other terrorist atrocity; not a day goes by without some new economic or business problem being shouted from the TV; but no matter how terrible things may seem, we must ask ourselves – how much does this really affect our lives?

It does feel really worrying that your investments have fallen. It may be true that you could be paying a little more tax. It may be true that your holiday might cost you more because of the weakening of the pound, but all of this must be put into perspective.

We live in a comparatively safe country. We live in a comparatively wealthy country. Every one of us is wealthy in terms of what we have when compared to 90% of the world’s population. With that in mind we must be grateful for what we have, and how truly lucky we are.

If you woke up this morning, then that is better than the alternative. If you have a home to live in, a family to love and health to be thankful for, then you are wealthy beyond compare.

These economic difficulties will pass in time. We are all affected by them but the last thing we need is to allow things beyond our control to knock time off our lives with worry. Believe me when I say this is easier said than done but we all need to keep some perspective.

Plans for high earners

With the new 45% tax rate planned for 2011 and a reduction in personal allowances when earnings are over £100,000, there is a great deal of work that needs to be done for high earners to limit exposure to the new higher rates.

All higher earners should be aiming before the end of the 2010 tax year to put plans in place. That said, high earners need to understand that to benefit from the tax increases (yes, it is possible to benefit!), then income now must be deferred for income in the future.

The most obvious way to benefit is to make additional contributions to pensions. With the higher rate at 45%, even more tax relief will be possible.

For example: if you earned, say, £105,000, the £5,000 would reduce your personal allowance by £1 for every £2 earned and would also cause you to pay £2,000 in tax. In addition to that, your employer would pay National Insurance on your earnings.

However, if you reduced your income to £100,000, you could have your employer put your £5,000 into a pension pot. This would immediately save you £2,000 in tax, but, in addition, you would not only avoid the £2,500 reduction in your personal allowance, but also the further £1,000 tax you would have paid at 40% on that amount. You may even be able to have your employer pay into your pension the NI that they would have paid!

So, if you took the £5,000 earnings, you would end up with around £2,000 after tax and allowance amendments. However, if the money went into your pension you would keep the £5,000, or even £5,665 if the employer added the NI contribution.

You can take this further by perhaps paying the salary into a VCT scheme instead of a pension, to receive tax relief. Then, after the qualifying period, transferring the money into your pension to get a second set of tax relief!

It goes without saying that if you want to talk this through in more detail you need only to call me.

Basic pension rules change

Currently, to receive a full state pension a man needs to have worked for 44 years and a woman for 39. However, following the recent change, if you retire after 6th April 2010, then this has been reduced to 30 years for both men and women.

Under the present rules it is possible to buy back lost years by making additional Class 3 National Insurance contributions. The payments have to be made within six years of the end of the missed year.

Now, following an amendment to the Pensions Bill, people will be able to purchase up to another six years over and above the existing limits. All in all, this is very good news.

Remember, you must claim

Last October, the Inheritance Tax rules were changed so that you can carry forward a spouse's unused Nil Rate Band, which means that a married couple or those in a civil partnership could effectively receive the benefits of two Nil Rate Bands.

However, this carry forward must be claimed. It is not an automatic right. As reported previously, on the second death the claim must be made via form IHT 216. However, HMRC are complaining that less than 30% of claims are being accepted, because of insufficient documentation.

This goes to show the importance of collecting the correct documentation on first death, to allow the claim to be made on second death. If you do not have somewhere secure to keep these documents, or more importantly, if your children or executors do not know where they are kept, then you need to remedy this now or the tax will be payable.

Don't forget, you can claim tax relief on inheritance tax (IHT)

Most people completing probate forms are aware that inheritance tax is paid based upon valuation of the assets. The IHT must be paid **before** the assets are sold. However, in the present circumstances, the assets, usually a house, may take many months or years to sell. With property prices falling, this may mean that the property is sold for less than the probate valuation.

If this is the case, a tax refund can be claimed on the difference between the sale and the purchase prices. To do this, all assets must then use the new valuation date and period.

But where does the money come from?

It can't have escaped your attention that a bank or two has failed in the last three months. You know that your deposits are now guaranteed up to £50,000. But who guarantees them? And where does the money come from?

Unlike as most people think, it is not the government that digs deep into its pocket to protect you when a bank fails. It is the Financial Services Compensation Scheme (FSCS). The scheme is run by the FSA, which collects contributions to the scheme from all those who are registered with the authority each year, to meet the claims on failed banks. This includes cre8.

If only we could keep all of the fees we charge! But, alas, a proportion of all fees is paid into the FSCS to protect your money – little wonder I rant and rave over the way that banks have been operating—I will be picking up part of the bill!

And finally

Below is an article I found on the American perspective of things presently going on. While I am not sure about how healthy our relationship really is with our Atlantic friends, I always think it is interesting to take in their thoughts on the economy as a whole.

Whoa there America- take a deep breath. As impressed as we all are with the significance of this moment we are about to inaugurate the first African American President of the United States -- it is possible that our collective giddiness will lead to the worst kind of disappointment. President-elect Barack Obama is being breathlessly compared to FDR, JFK, Abraham Lincoln and George Washington. So far - he has won an election. And that is it.

Even Obama is hyperventilating. In Sunday's speech, he said "I stand here today as hopeful as ever that the United States will endure." Endure? Did he think the country might actually go out of business? Merge with France? Sell out to Wal-Mart? That we might decide that Citigroup was too frail, Iraq too complex and our waistlines too bulging to carry on? What did he mean?

For sure, we are in a nasty recession. It is not unprecedented. The downturn in the 1970s, complete with soaring inflation and sky-high interest rates, makes this one seem benign. The media, though, has portrayed today's slide in the harshest possible light, scaring Americans to death and most definitely making matters worse. That's what sells newspapers, and attracts viewers.

Take the reports on unemployment. The press emphasizes the 11.1 million Americans out of work, which is indeed higher than it has ever been (and lamentable). At the same time, the number of Americans - that is, the population - is also at an all-time high. The percentage of workers unemployed, which has traditionally been the way we looked at the jobs picture, is nowhere near a record level.

At the height of the Great Depression, unemployment was 25% of the workforce. Today it is 7.2%, compared to 10.8% in 1982, for instance.
Unemployment will doubtless increase, but it is not at crisis levels.

This is not the Great Depression. Moreover, there is no reason that this recession should approach that terrible time in our history. It is hardly ever mentioned that during the 1930s the nation, still an agrarian country by and large, suffered a terrible drought, causing massive failures of farms across the land. That act of nature, combined with wrong-headed tax, monetary and tariff decisions, caused the economy to wither.

Today, we have boosted the money supply and placed government backstops behind the financial *system, avoiding systemic meltdown. Other nations around the world have done the same, providing liquidity and mutually beneficial supports to demand. At the same time, the price of oil has plummeted, comforting consumers.*

We are certainly not out of the woods. However, we must not use this economic downturn as an excuse to usher in an era of enduring Big Government. The current malaise is the strongest argument possible against allowing politicians to steer the economy. This recession began with a collapse in the subprime mortgage market, which had been inflated by Congress' insistence that low-income Americans be welcomed into the ranks of happy homeowners. That well-intentioned but uneconomic notion brought down Fannie Mae and Freddie Mac - institutions caught trying to serve shareholders and social engineers. And yes, greedy Wall Streeters compounded the problem.

My message is not that we are without challenges, Mr. Obama. It is that this country has overcome much, much harsher times than these. Go take a look at the videos of the Kent State shootings, or the race riots in Watts, or the assassination of JFK. Consider the Vietnam war - a conflict that in terms of alienation, anger and, sadly, body count, dwarfs our incursion into Iraq. We have been in darker times than these. You are, possibly, too young to remember.

The United States is energetic, ambitious, open-hearted, fair-minded and resourceful. It is bigger than me and, with all due respect, bigger than you, Mr. Obama. This country will not only endure, I am sure it will prosper, by allowing individuals like you to pursue their dreams. Oh, and good luck, Mr. President. We are all rooting for you.

Book of the Month

This month's book looks at the world and what would happen if we were not here. *The World without Us* (ISBN 978-0753513576), by Alan Weisman, is a fascinating thought experiment about what would happen if humans simply disappeared overnight. When you see films such as *I Am Legend* or TV series such as *Survivors*, we can sometimes have a rose-coloured view of the world and how we have affected it. The truth, however, is rather interesting. This book not only considers a world without us, but also looks at evolution and how we may, or may not, be affecting the world.

This book is a genuinely interesting read, and is written in an easy-to-read format. If you are looking for some interesting, but light, reading, you would not go wrong with this.