

Pension Funds and Asset Allocation

We have written a number of articles on investing which are aimed at encouraging debate. There has been a long standing argument over the additional value of an active manager over a passive option. The latter aims to access and benefit from the embedded market return without making any active management decisions over whether one particular company in a sector is better than any other.

Various studies suggest that in the region of 80% of a portfolio, returns can be explained by underlying market performance and asset allocation rather than the decisions taken by an active manager. Active managers disagree, however, there is growing evidence that passive funds have an increasing role to play.

The total expense ratio (a measure of the cost of a fund) is important, the lower the cost of a tracker the closer the fund performance can be to the index and the lower the tracking error should be. As well as cost, the underlying assets being tracked are also important, for example many portfolios would hold perhaps 4 asset classes, property, cash, fixed interest securities and equities. In addition to these commonly held asset classes, thought can be given to commodities, managed futures (the right to purchase underlying assets in the future at given prices) and hedge funds to broaden diversification and potentially reduce investment volatility or provide the opportunity for enhanced returns above cash. Access to these areas can be provided via passively managed funds.

A typical pension provider's managed fund falls into the balanced sector, this normally has in the region of 80% invested in global equities, very little in commercial property and the remainder in fixed interest securities. The level of asset diversification is low and the volatility is often quite high. The annual management fees are normally in the region of 1% per annum which often includes no ongoing advice costs, normally the entire fee goes to the pension provider.

An alternative which is available for the same charge is to access a broad portfolio of assets which are more in line with a given risk profile, very few of our portfolios hold 80% equities as this is deemed volatile. A Self Invested Personal Pension can be available for little annual cost and a portfolio of index tracking funds (excluding managed futures and hedge funds) may cost in the region of 0.61%. Adviser fees can then be included with the total management fees being in the region of 1% per annum. Unlike many passive funds in the market you will then have broad geographical exposure, asset diversification and the risk weighting will be maintained over time.

If you would like to review your existing pension(s) to see whether this type of management would add value then do call, as a special offer we will review an existing pension for £250 plus VAT and outline the options for you. This does not include the implementation of advice.

Choice of Annuity

When you retire, it can be tempting to succumb to the first fixed rate, level annuity quote you receive. However, with the average life expectancy now between 85 and 90, if you decide to take an annuity straight away, it might have to pay out for more than 20 years - and, over such an extended period, inflation can seriously impact on your spending power.

It is therefore sensible to shop around and there are various options to choose from if you want to make the most of your money. For example, you could choose an index-linked annuity, which is tied to the rate of inflation, and there is also an escalating annuity, which rises at a fixed rate each year, regardless of inflation (in other words, some years the rise may be greater, some years it may be less). For the more adventurous, you could even link your income to the ups and downs of investments (with or without an annuity - providing you are prepared for the risks). All of these options are likely to offer a lower starting income than a level annuity, but over the long term, your ability to afford a consistent lifestyle could be better protected.

Of course, your circumstances may mean a mixture of annuities is appropriate. Depending on your appetite for risk and the size of your fund, you might even defer your annuity purchase - or perhaps not even buy one at all. If you can leave the purchase until later, or if you suffer from poor health, the potential for higher income from a level annuity may outweigh other issues. Whatever you decide, make sure you shop around. You can't change your annuity once you've bought it, so pick the right one.



**WAVENEY
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Issue 10

October 2011

Waveney Newsletter



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Waveney Update

There are a number of legislative changes which are being implemented over the coming years. From 2012 the Financial Services Authority is introducing new standards for advisers which will result in an estimated 30% of advisers leaving the industry. At Waveney we are prepared for this and are ahead in terms of the qualifications required under the new standards.

We have been in contact on numerous occasions with updates relating to the new National Employment Savings Trust pension rules and have also provided an update in this Newsletter on amendments to pensions which may affect certain clients in retirement.

We continue to provide relevant updates and an ongoing service to our clients but always look at ways to improve on this—your feedback is welcome and always sought.

We welcome two new members to the team, Charlotte Montague and Annabelle Grimsey have joined as administrators. We are keen for them to progress and we will encourage them to study towards the initial financial planning exams.

We now have 11 staff with 2 external consultants who help to manage, plan and improve the business.

In our previous Newsletters we discussed the new software which has been introduced to help us improve the valuations processes and financial cash flow statements. Hopefully these are being well received and if you have any queries do let us know.

We still intend to introduce online valuations although this is some way off. Currently we are speaking to our software provider, we will keep you informed of progress!

Market Comment

Our March Newsletter made reference to whether interest rate rises would come sooner or later to try and reduce inflationary pressures.

The answer seems to be later and probably not for some considerable time. The economic recovery has proven to be somewhat elusive and unless this turns around quickly (and there are little signs of this) then an interest rate rise now would be very difficult for industry and consumers alike.

Predictions are impossible; we remain convinced that a diverse investment process accessing all asset classes is advisable. Market timing is difficult if not impossible to predict and time in the markets is the most important factor.

Special points of interest:

Retirement Ages

State provision will be reduced in the future.

NEST

The ban on transfers out of NEST will be reviewed.

Pension Funds

Asset allocations should be reviewed.

Annuities

Investigate all options, don't go with the first offer from your provider.

Interesting Statistics

The cost of living continues to rise, however, the effects of tax increases will work their way through the system and commodity prices seem to be easing.

	June 2011	July 2011
RPI	5%	5%
CPI	4.2%	4.4%
AWE Index: March to May and April to June	2.3%	2.6%

The state retirement age increase to 66 is to be accelerated; by April 2020 this should be completed. In addition the increase to 67 will be brought forward and be implemented from 2024 to 2026. By 2046 the state pension age will have increased to 68.



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Investment Update

August proved a tumultuous month for world markets, with many major share indices experiencing wild swings. Markets started on an unsteady footing amid escalating concerns the US was in imminent danger of defaulting on its loan payments and, while its debt ceiling was eventually raised – narrowly averting a disastrous default – the deal so tortuously thrashed out by the country's politicians did not boost investor sentiment. Morale was further undermined by the news that ratings agency Standard & Poor's had cut the US's long-term credit rating from AAA to AA+.

Investors remained preoccupied by concerns global economic growth might be decelerating and leading economies might be in danger of slipping back into recession. The Organisation for Economic Co-operation & Development (OECD) announced growth in the world's leading industrialised economies had slowed for a fourth consecutive quarter during the second quarter of 2011 and warned "Short-term emergency actions that are not perceived to be part of a medium-term strategy will only bring short-term relief". Elsewhere, head of the International Monetary Fund Christine Lagarde highlighted the risks to the global economic recovery, warning "We

are in a dangerous new phase" in which economic recovery could be derailed. She urged governments and policymakers to ensure their macroeconomic policies support growth.

The Dow Jones Industrial Average index fell by 4.4% over the month as a whole, while the S&P 500 index dropped 5.7%. The US market experienced considerable volatility during August, falling by as much as 6.7% in a single day. In the UK, the FTSE 100 index dropped 7.2% during August, while in Japan the Nikkei 225 index dropped 8.9%.

In Germany, the DAX index plunged by 19.2%, while French stocks, as measured by the CAC 40 index, fell by 11.3%. However, share prices rallied towards the end of August, particularly in Europe, where the FTSE 100, the CAC 40 and the DAX all rose by more than 2% during their final day of trading.



Looking ahead, investors are searching anxiously for evidence the recent slowdown is a temporary blip rather than the beginning of a more extended downward trend.

Exceptional factors – including the Great East Japan Earthquake, the escalation of unrest in the Middle East and North Africa and Europe's debt crisis – have dominated sentiment for much of the year. Nevertheless, as we move towards the final quarter of 2011, many investors will be looking for signs the effects of such factors might be diminishing, allowing economies and markets to move onto a firmer footing.

Self Invested Personal Pensions

The popularity of the Self Invested Personal Pension (SIPP) has increased dramatically in recent years. Costs have come down, many investment providers have launched SIPP-friendly products, and the UK government has ensured many different types of investments qualify for inclusion within a SIPP wrapper.

A SIPP is a tax-efficient wrapper - a particular type of pension - which sits around your retirement fund, allowing you to select from a wide range of investment choices. It gives you great control and flexibility over the investment decisions you make,

allowing you to tailor your SIPP portfolio to precisely match your requirements and readily move those investments around as markets and your circumstances dictate. If you are employed, your employer can also pay into the plan to help boost its value. Contributions, subject to some annual and lifetime limits, receive income tax relief at your highest rate, and all investments are free of income or capital gains tax (CGT) whilst they remain within the plan.

A SIPP also allows flexibility once you reach retirement, whether you buy an annuity immediately or opt for phased or deferred

retirement. However, while there are benefits for those interested in the flexibility, SIPPs are not for everyone. There are set-up charges and annual management charges which need to be weighed up against the benefits. You will also need to consider whether you need the full investment flexibility provided or whether the increasing range of fund links offered by more conventional plans would actually be sufficient.



Retirement Options

We have provided information on changes to pensions legislation in past Newsletters, however, the pace of change has accelerated and it is worthwhile summarising the current position.

The lifetime allowance is the maximum an individual can have within their pension during their lifetime. As assessment is carried out when benefits are taken and on death. The current maximum is £1.8m which is set to reduce to £1.5m from April 2012. Any individual with funds in excess of the £1.5m or who may well exceed this limit in the future should review whether to make additional contributions and possibly seek to protect the fund by carrying the existing £1.8m allowance forward into the future.

Another change is to reduce the annual allowance from £255,000 to £50,000. In practice this has actually increased the amount people can pay as those who could pay the higher amount were restricted to c.£20,000 or face a tax charge. There is also the ability to carry forward unused annual allowance from previous tax years to the current year but you cannot pay more than your income!

The biggest factor for those taking benefits is the reduction in the maximum income which can be paid under income drawdown accounts. These work by leaving your fund invested and making withdrawals from the pension pot. Unfortunately investment returns have been poor for many and the value of the fund has decreased at the same

time that the Government has reduced the maximum allowable withdrawal from 120% of a single life annuity to 100% - using their own reference tables. The income reviews have changed from 5 yearly to every 3 years to age 75 and annually thereafter.

The good news is that you can remain in drawdown post age 75 and the maximum income will take into account your actual age. Under old rules post age 75 you were frozen at age 75 for income reference purposes! This means that a 90 year old will at least benefit from being allowed to make higher withdrawals.

The taxation of the fund on death is also important, if the death benefits exceed the lifetime allowance (which can include any death in service lump sums) then the excess is charged at 55%. In addition, once in drawdown the fund is taxed on the death of the last dependant at 55% - for those aged over 75 this is an improvement on the old 82% rate!

The new rules create some interesting estate planning opportunities, especially if you have alternative qualifying income of £20,000 per annum and can benefit from uncapped withdrawals.



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NEST Update

UK individuals who do not belong to a pension scheme could face an uncomfortable retirement. At present, not every employer provides a workplace pension scheme for workers and, even if such a scheme were available, employees are not obliged to join it. According to consumer group Which?, only 50% of UK employees were enrolled in an employer-sponsored pension scheme during 2009, and membership of pension schemes varies widely from one industry to the next. Membership of pension schemes is relatively high in sectors such as energy, financial services, manufacturing and the public sector, but is lower in areas such as construction, retail and administration.

However, from 2012, firms have to provide a qualifying pension scheme. Employees aged between 22 and state pension age and earning more than £7,475 per year will be automatically enrolled in a scheme from October 2012 if they work for a large company and by 2016 if they work for a smaller company. Companies can set up a qualifying pension scheme of their own, or they can enrol their employees in the National Employment Savings Trust (NEST).

NEST is a major component in the government's reform of occupational pensions. Aimed at employees with low-to-moderate salaries, it is intended to provide a simple, inexpensive, accessible pension scheme that will increase individuals' savings for their retirement. NEST members will use their accumulated pension pot to buy an annuity that will provide their retirement income. NEST has selected a panel of five providers – Canada Life, Just Retirement, Legal & General, Partnership and Reliance Mutual – but members are also able to look elsewhere, although they will need to seek professional advice. A Which? pensions expert commented, "The NEST panel... offers less choice than a whole-of-market search but should deliver good outcomes to most members."

Looking ahead, a House of Commons Work & Pensions Committee has been set up to examine how automatic enrolment into NEST will work, and how it will affect smaller firms. It will also review the current ban on transfers in and out of NEST, and examine the possible effect on NEST of lower-than-expected membership. Approximately four million individuals are expected to join NEST, although they will be able to opt out after enrolment.