

Kudos . pension newsletter



December 2010

Investment Update

Market volatility, fears of a double dip recession and worries about sovereign debt have all led to 2010 being a less than relaxing year for investors.

However, the third quarter of the year brought some respite with all the major asset classes having generated positive returns.

Impressive headline returns were masked by a huge degree of volatility, with investors very uncertain as to the size of the inevitable quantitative easing package (buying back government bonds to increase the money supply) from the United States, now confirmed at \$600bn. Sentiment continues to fluctuate wildly with each new item of economic news, most recently on the news that the EU and Ireland had agreed a rescue package to help tackle a huge hole in the government's finances. In a move aimed at bringing financial stability to peripheral Europe, Ireland has agreed a bailout package of €85bn over the course of the next three years, although they have had to increase taxes and further their austerity measures as a result.

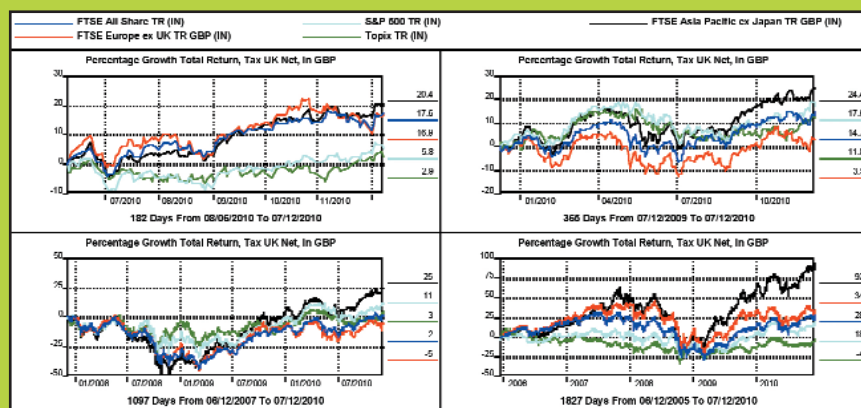
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Having risen 2.5% in October, UK equity markets enjoyed another positive month in November, with the FTSE All Share rising 0.5%. With metals prices soaring, thanks in part to a weakening dollar, mining stocks have driven the markets with a 13.2% gain since the end of September 2010.

Economic news was headed by a 0.8% increase in third-quarter GDP, which was somewhat stronger than most market commentators had expected. George Osborne, the chancellor, also announced the results of his public-spending review with up to half a million public-sector jobs likely to go over the next five years. The breakdown of the plans was broadly in line with expectations and should provide reassurance to financial markets regarding the UK's commitment to bringing its spending to heel. On the corporate front, there were impressive trading updates from the likes of Marks & Spencer, Royal Dutch Shell and Tesco; and British Airways reported its first half-year profit in two years as it prepared for its merger with Spain's Iberia. Deal activity included a £1 billion approach from Royal Bank of Canada for Bluebay Asset Management, and BHP Billiton abandoned its takeover bid for Canada's Potash Corp.

Since the end of September, we have most certainly seen a sell off in Fixed Interest markets, with gilts largely underperforming the corporate debt market, reiterating our stance to be overweight credit over sovereign debt. While Kudos continue to believe that gilt investors are likely to lose money once interest rates start to rise, those invested in corporate bonds can expect reasonable returns with yields well above those available from sovereign debt, and far healthier balance sheets and lower default risk from many borrowers than that seen even a year ago.

Commercial Property still offers an attractive longer term play despite the short term prospects for the asset class being less than optimistic in terms of capital growth. It still provides a stable and secure income, currently running at about 6%, with the potential for capital growth over the longer term. Prices are still way below their July 2007 peak and there is value to be found in select properties in key locations. While the returns of last year will not be repeatable, we still expect returns of 5-6% to be achievable over the next year, which is quite attractive when compared to Cash rates.



We believe that interest rates are likely to remain very low for most of 2011, with returns from Cash being affected by stubbornly high inflation. While the economy is recovering albeit slowly, the coalition government's plans to deal with the deficit has been reasonably well accepted by the market. The second round of quantitative easing in the US means there will be significant sums of Cash needing to find a home, and while this has been priced in to equity, fixed interest and commodities to an extent, it does provide some support. Good corporate results, valuations not unreasonable, and many shares unusually yielding more than their respective corporate bonds could be seen as an excellent opportunity to buy into markets given a medium term view.

Source of Graphs: Lipper

The value of investments can fall as well as rise. Past performance is no guarantee of future performance. The above reflects the views of Kudos, but no responsibility can be accepted by Kudos for an individual acting upon the above unless they have taken advice personally from Kudos.



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Comment

Given increases to life expectancy, increasing the State Pension Age by one year is no great surprise. Raising the bar to age 66 will make the state pension more affordable for our children, but delaying retirement by a year is also sensible for private pension savers. A 45 year-old man saving £200 a month and delaying his retirement age by just one year could see his pension rise by almost 10%.

Notes

1. £200 per month invested from ages 25, 35, 45 and 55, growth rate 3.5% real net of charges.

2. Annuity shown is a level annuity with no spouse's pension or guarantees, from FSA annuity tables 20 Oct 2010.

Increase in State Pension Age could result in higher private pensions

As part of the comprehensive spending review, the Government has announced that the State Pension Age (SPA) will rise to age 66 by 2020. Women's SPA is currently scheduled to increase from 60 to 65 between 2010 and 2020. This timetable will be accelerated from 2016 onwards, so that women's SPA reaches 65 in November 2018. The SPA will then gradually increase to 66 for both men and women between December 2018 and April 2020.

If people also choose to delay taking their private pension by one year, as many will do, they may see their private pension rise considerably. By delaying retirement by just one year, a 45-year-old man saving £200 a month could increase their private pension by nearly 10%. The following table sets out the income that could be received by men starting to save £200 a month at ages 25, 35, 45 and 55 and delaying their retirement from age 65 to age 66.

Age when saving starts	Pension at age 65	Pension at age 66	Percentage increase
25	£13,356	£14,364	+ 7.5%
35	£8,196	£8,880	+ 8.3%
45	£4,548	£4,992	+ 9.8%
55	£1,956	£2,244	+ 14.7%



Example - how does it work?

Alison has earned £50,000 for the last 4 years and pays 5% (gross) of her salary to her group personal pension. This means she pays a net contribution of £2,000, which is automatically grossed up to £2,500.

Alison finds out that she has been missing out on higher-rate tax relief for four years. She is entitled to a tax rebate of £500 each year.

She makes a backdated claim to HMRC for the three previous tax years and the current tax year, re-couping 4 x £500 = £2,000.

If you haven't reclaimed your higher-rate tax relief Kudos can provide you with the appropriate draft documentation to correspond with HMRC.

Claiming higher-rate tax relief

While the Government has recently taken a swipe at pension tax relief for very high earners, around 85% of higher-rate taxpayers continue to be eligible for 40% tax relief on their contributions. It's no secret that this is an exceptionally valuable benefit but, despite that, it is estimated a quarter of a million people do not claim this relief - either through apathy, or because they don't appreciate that it isn't given automatically.

All personal, stakeholder and group personal pensions, as well as some occupational schemes use the 'relief-at-source' payment method. This means basic-rate tax relief is automatically added to the pension pot by the provider who, in turn, re-claims the amount from HM Revenue & Customs (HMRC). So, in simple terms, for every £80 someone pays, £100 ends up in the pension scheme. The exception from this method is any arrangement set up using Salary Exchange (also known as Salary Sacrifice) where the employee is deemed not to be making an employee contribution.

People earning above £43,875 in this tax year may be able to claim a further 20% relief (depending how much income is liable to higher-rate tax). By not claiming this additional tax relief, someone earning £100,000 and paying a 6% contribution could be missing out on £1,200 per year - money that goes into their pocket, which they can spend as they wish.

For the majority of taxpayers in the UK the income tax system requires little or no thought as many people pay tax through the Pay As You Earn system, which automatically deducts tax from the wage packet. If this is the case, claiming additional relief requires workers to take some action, although those who already complete a self-assessment return, such as self-employed and those with various sources of income, should already be receiving it.

To obtain the additional tax, people either need to complete a self-assessment return or ask the local tax office to change their tax coding. The good news if you haven't claimed higher-rate relief is that they can make a backdated claim. The time limit for claiming repayments is currently four years.

Claiming additional tax is straightforward, so taking action now could save you money. For those who haven't, a refund cheque from HMRC will come as a welcome bonus.



From April 2012, the lifetime allowance – the maximum level of benefits a member can draw from all registered pension schemes without incurring a tax charge - will be £1.5 million (reduced from £1.8 million in 2010-11 and 11-12).

The higher than expected reduced Annual Allowance, coupled with being able to utilise unused relief from the past three years, should help to minimise potential tax charges and therefore is welcome.

The anti-forestalling regulations introduced with effect April 2009 still apply for the remainder of the current tax year 2010-11.

Changes to Restricting Pension Tax Relief and Personal Allowance

Restricting Pension Tax Relief from 6th April 2011

As expected, the Government's recently announced proposals for restricting pension tax relief from April 2011 scrapped the previous Labour Government's complex proposals. These proposals linked the level of tax year earnings (greater than £130,000) with restriction on tax relief available on pension contributions – this has now been removed. However, while we know all the "core" elements of the new regime, the complete picture is as yet unclear.

Key points include:

- The Annual Allowance is the maximum level of contributions that can be paid by or on behalf of an individual in any tax year and receive full tax relief. If an individual pays contributions they will only receive tax relief up to 100% of their earnings. From April 2011, the Annual Allowance will be £50,000 (reduced from £255,000 in 2010-11), remaining at this level until at least 2015-16.
- Tax Relief on contributions within the limits referred to above will be available at an individual's marginal tax rate, which means up to 50% tax relief for those with earnings over £150,000 pa.
- The Annual Allowance tax charge applying on pension contributions in excess of the Annual Allowance limit will be structured to recoup the full marginal rate relief from which an individual has benefited, instead of the current 40% flat charge.
- Carry-forward from the tax years 2008-09, 09-10 and 10-11 will be available against an assumed Annual Allowance of £50,000. Anyone who has not made any contributions in these years will be able to pay up to £200,000 and receive tax relief at their marginal tax rate assuming they had a registered pension in force during these years.
- Deemed contributions to defined benefit schemes will be calculated via a flat factor as is the case now, but this factor will be 16, instead of 10. Deemed contributions are calculated by taking the difference in the benefit accrual at the start and end of the scheme year (less indexation) and multiplying the pension increase by the factor of 16.

Withdrawal of Personal Allowance for Incomes over £100,000

From 6 April 2010, for individuals with a taxable income above £100,000, the personal allowance will be reduced by £1 for every £2 of income in excess of £100,000 until there is no personal allowance available. This will mean that anyone with an income above £112,950 (based on 2010/11 tax allowances) will effectively have no personal allowance.

What does this mean in practice?

If you have income of £112,950 or more you will pay an extra £2,590 in tax each year if you are a 40% tax payer or £3,237.50 if you are a 50% tax payer.

Is there anything that you can do?

It is possible to reduce your income for the purposes of calculating your personal allowance by effective pension planning resulting in even more tax efficient pension contributions.

Help protect your investments from the taxman with an ISA

An Investment Individual Savings Account (ISA) is a potentially tax-efficient way to invest in stocks and shares through professionally managed funds. Payments into an ISA are subject to upper limits set out by the Government (HM Revenue & Customs) each tax year.

Since April 2010, you have been able to invest £10,200 in total. You can invest up to £5,100 of that in a cash ISA and the remainder in a stocks and shares ISA, or the whole amount in a stocks and shares ISA.

The benefits of the tax advantages depend on your personal circumstances. Tax rules can change.



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