Michael Barr & Co. Ltd

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The market has gone up

The end of this week[1] marked the six month anniversary since the stock market hit bottom and began its spectacular rise. This has happened with all the major global stock market indexes.

It is good to see smiling faces again, and why not? The market upswing has been very big by historical standards. According to the FT, the only other period to have actually seen a rally of this size during a similar timeframe was in 1932-33.

A more typical recovery occurred after the early 1990s recession.

[1] As at 11th September 2009

The stock market traded sideways until 1995 when the market jumped nearly 17%. After the Dotcom bust reached its low point in 2003 the market jumped over 30% in six months

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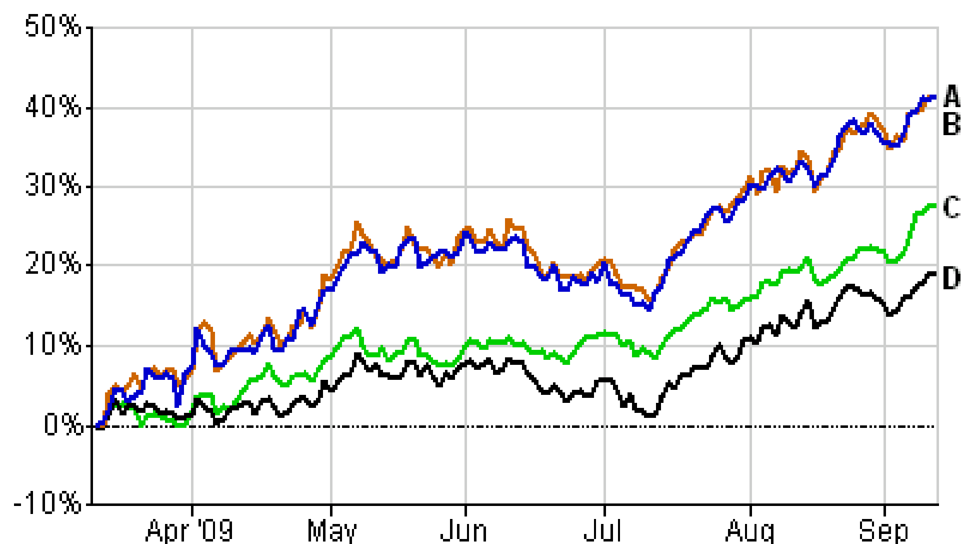
The UK FTSE All share index, at the time of writing, was up 41.5% over the past 6 months - breaking even over the last twelve months.

When planning for the longer term it is important to avoid disasters. The chart below shows the performance of three popular funds that have not done so well compared to the index.

The name of an investment fund is clearly no guide to the expertise of its fund manager.



The new 60% income tax rate

The new tax in brief

- The new taxes will affect many lower earners who will pay more than basic rate tax.
- Pension contributions will be restricted.
- Investment Bond holders need to exercise care.
- CGT planning should be reviewed.
- Plan action well before the 2010/11 tax year starts

Economists seem to be in general agreement that a very high income tax rate reduces the tax revenue for a government. It also encourages tax evasion and removes the incentive for business owners to help to grow the economy.

However, in a desire to increase its revenue and to help to address the huge national debt, the Government is increasing income tax next year. A new 50% higher rate of tax applies to those earning £150,000 or more from 2010/11, but the devil is in the detail.

£100,000 is the new tax hot spot

Those with incomes above £100,000 will start to lose their personal income tax allowance, and the rates of tax that will apply will be the highest since the "investment income surcharge" which applied a generation ago.

The personal allowance will be reduced by £1 for every £2 of income above the £100,000 limit until the personal allowance reduces to nil. Based on the present personal allowance this will create a 60% marginal rate of tax for those with an income falling between £100,000 and £112,950.

A tax trap for investment bonds

Billions of pounds are held in Investment Bonds. These are often labelled as 'with profit' funds, distribution bonds, and various types of managed fund and structured stock market products. As a measure of the popularity of these investments, every prospective new client we have seen in the past year has owned an investment bond. They do have a place, for example for trustees of trusts, but they are over-sold.

They are recommended on the basis that you can have a 5% a year income without paying any tax. There is an element of truth here, but the fundamental point is that insurance bonds are subject to income tax. A 5% a year 'income' can be taken on a bond, but the bond itself is subject to income tax and there is a full assessment of the income tax when a bond is surrendered.

When an Investment Bond is cashed in, from tax year 2010/11, there is going to

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be a test to see if you lose your personal allowance. It is similar to that used for 'age allowance' calculations

How could it work out? For example, an investor earning £12,950, who after investing in an investment bond for a ten year period, receives a surrender payment with a gain of £100,000.

A table showing the marginal rate of tax

*Income will include the entire gain of a surrendered investment bond, and for the purposes of this calculation 'top slicing' does not apply. The 'Chargeable Event' is deemed to occur at the policy year end.

Income*	Marginal rate
£112,950	60.00%
£120,000	52.95%
£130,000	48.63%
£140,000	46.67%

The top slicing rules ensure that they remain a basic rate tax payer (£100,000 divided by the 10 years= £10,000 Top slice income). Unfortunately, for the purposes of calculating the personal allowance, the entire gain of £100,000 is added to your income. In this example, the total income would be £112,950 for determining the personal allowance and therefore the whole allowance will be lost, creating an extra tax charge of £1,295.

This translates to a marginal rate of tax of 30% for an offshore bond and an additional 10% for an onshore bond (having already suffered tax at source).

A higher rate tax payer, earning say £45,000, will face a similar problem even though the income is well below the £100,000 limit.

A large policy gain in one year will wipe out the personal allowance, creating an additional tax charge of £2,590, which is a marginal tax rate of 60% for an offshore bond and 40% for an onshore bond (having already suffered tax at source).
There is a window of opportunity to review insurance bonds.

From a tax planning perspective, it could be favourable to surrender a bond in the current tax year, before the new rules come into force, rather than waiting until later.

Personal pensions

The Government introduced 'pension simplification' but there is now a great complexity when planning pension contributions.

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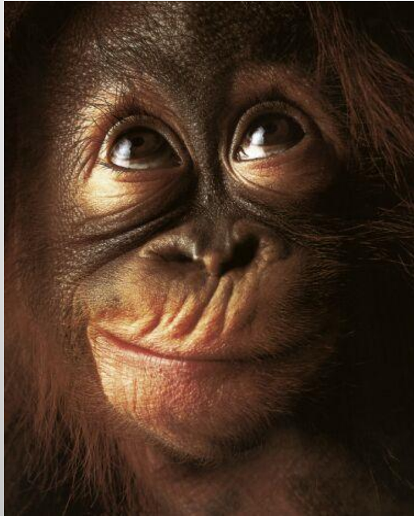

There Is a Window of opportunity

With tax at 'only' 40%, there is a compelling argument for making a pension contribution, if your aim is to build up capital. On this measure, the tax relief will look wonderful when weighed against a higher 50% tax rate and a marginal 60% tax rate.

Pension contributions are to be restricted to £20,000, but for those who have been committed to making a significant contribution, the level can be raised to £30,000.

To qualify for this higher allowance, a pension review is recommended before the tax year end.

Company reserves

Many of our clients who are business owners hold high reserves in their companies.

There is an argument for accelerating the withdrawal of these funds, so income tax is paid at 'only' 40% or 42.5%, depending on the method of extraction. The owners can use the next year or two to restore the company reserves.

With fortune on their side, they could avoid these very high rates of tax if a future government has a change of heart.

Capital gains tax planning

Not many of us make good use of their capital gains tax (CGT) allowance.

Once the capital gains tax allowance has been used, the CGT is only 18%, and this does look out of line with the other higher rates of tax, which will apply from 20011/12.

Unfortunately, many of the people I meet have investments which have lost value, and they are waiting for the price to recover. Depending on the amounts and the sums involved, when they do eventually sell they expect to pay capital gains tax at the rate of 18% - or could it be higher in the future?

One approach is to sell investments that have lost capital to create a capital loss. This can be carried forward to offset future capital gains. Realising a loss will allow you to offset future gains, and these may be taxed at a higher rate than today's 18% rate. ⬭

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The say;

- Guard your PINs and passwords
- Never throw away papers - shred them
- Be plastic smart
- Be password smart
- Be postal smart
- Only access sensitive data at home

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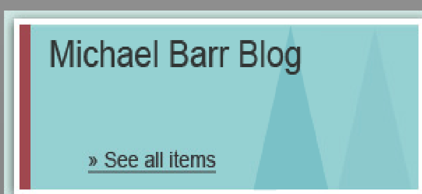


Financial crime & the FSA

In a speech made by the Financial Services Authority last year, it clearly shares our view about avoiding financial crime. It gives financial crime a great deal of publicity, and like us it is trying to get the message across to the public, to help us to be better protected against financial crime. An FSA spokesman recently said,

"…we are all consumers;
We all share the same frustration;
Our identities exploited.
Our funds lost.
Our accounts violated."

The message is that our key defence against financial crime is GOOD DATA SECURITY. Our help does not end with our five top tips; we are constantly researching to find the current scams and the easiest ways to prevent becoming a victim.

It is interesting that since the introduction of Chip & PIN credit card fraud is at its lowest levels in 10 years. Good news? Not really because statistics show that ONLINE credit card fraud is increasing at a rate of around 20% per year.

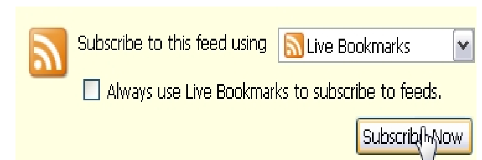
We cannot sit back and relax, as the statistics prove that the criminals are not relaxing; they are constantly looking at innovative new ways to exploit you and steal your money.

We are constantly researching in this field and keeping our knowledge current so that we can be as much help to you as we possibly can in this area.

online credit card fraud is rising dramatically

My blog

It is quick and simple to subscribe to my blog. Simply click on the Michael Barr Blog box on the far left and choose the RSS feed (live bookmarks) –



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I try to get a newsletter out to you every 2 months; I intend to write on my blog more frequently than this. My blog will contain my views of the stories featuring in the news and any other subjects which catch my eye and I think would be interesting or useful and it will be interactive as you can post your comments. Subscribe and have a quick read over your coffee!

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Missing the boat

Reading between the lines, and looking at the performance of investment funds, it is clear that a lot of investors have missed this big rally, or a significant part of it. Market timing, which is selling in anticipation of a fall, and buying in anticipation of a future rise is fraught with difficulties.

When the market hit rock bottom in March a lot of investors were frightened.

They had already experienced large losses and feared more to come. Those who sold would have found it very difficult to jump back on board because, to quote an old phrase, the market "climbs a wall of worry".

There are still great difficulties in the economy; there is high unemployment, and huge government debt. There is no doubt the markets will turn queasy again at some stage, but I cannot say if this will happen before or after another upward surge in the markets.

All the evidence shows it is better to stay invested, keep the trading costs down, and make sure the portfolio is matched to your financial planning needs. ⬭

Corporate bonds become popular

Companies with good credit ratings are using the banks for finance a lot less than they used to. This year European corporate bonds have been issued in greater numbers than ever before, exceeding $2,000 billion this year.

As a consequence, bank lending has slowed down, presumably because issuing corporate bonds is more efficient for the companies and perhaps less expensive.

Our portfolios hold only short dated and high grade corporate bonds.

There is no expectation, in the immediate future of interest rates going up, but when the mood changes this must have an effect on the values of long-dated issues.

If expectations change to one that interest rates are going up, which is probably the only option with the base rate standing at 0.5%, long dated bonds are likely to lose value.

We use corporate bonds as a component of the defensive side of a portfolio. They provide a reasonable yield, with low volatility, and reduce the overall short term volatility of a portfolio. We only ever use short term bonds. ⬭

Don't keep us a Secret

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