ASSET

THE NEWSLETTER OF MURDOCH ASSET MANAGEMENT

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Pension revolution: time to splash out?

Market perspective

What really drives the market? After five years of a coalition government, the Conservative Party has emerged with a fairly centrist agenda. The surprise election outcome had little or no effect on the stock market: the trading range in the run up to the election with the expectation of a socialist-led minority coalition was very similar to that of the weeks immediately afterwards, which demonstrates how little impact the government of the day has on the stock market, and the same is true for the economy in general.

Chancellors may claim that they make a difference – such as Gordon Brown's classic assertion that he had abolished boom and bust – but it's economic cycles and business that hold the real power, less so politicians. The turnover and profitability of London-listed global businesses such as Royal Dutch Shell, HSBC, BT and GSK are not remotely affected by who the Downing Street incumbent is, and it's important to remember this when making investment decisions. Likewise, whether we stay in Europe or leave will be of little or no detriment to business as we will still continue to have very strong trading links with the continent and our companies will simply adjust to any new regulatory relationship – not better or worse, just different. (Continued on page 3)

THE PENSION ISSUE

With the new pension rules now in force, this issue focuses on what they mean for you: how they could affect you, the choices you have and where you should tread carefully. We also look at the relationship between the UK's political landscape and the market, and bring you a round up of sector news.

Market update

The economic story of the year so far has been falling inflation in the UK, with the Consumer Price Index deflating for the first time since its records began in 1996 – though data does suggest that deflation had previously occurred in 1960. Equity markets have continued to strengthen, with the FTSE 100 Index quite steady between the 6800 to 7200 level.

In the US, the S&P 500 now trades at its highest level, despite disappointing retail sales and weaker sentiment from house builders. China, now the world's second largest economy, has seen new house prices fall for the eighth consecutive month, steadily deflating their property bubble, and its annual growth rate slowed to 7% in the first quarter. Europe is still wrangling with Greece and continues its quantitative easing programme.

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The pension revolution

Anyone over the age of 55 can now take advantage of the Government's new pension rules, which apply to the majority of schemes. As part of the pension revolution, three new concepts have been introduced for people with defined contribution pensions – those that are based on a monetary value rather than a percentage of final salary. These are:

- Flexi-access drawdown

You will be able to designate all or part of your defined contribution pension to drawdown without any restriction. You can draw 25% of the amount you designate as a tax-free lump sum and the remainder can be drawn as income, which will be subject to income tax at your highest marginal rate. Previous flexible drawdown funds will automatically be converted to flexi-access drawdown but capped drawdown will stay as it is.

- Uncrystallised funds pension lump sum (UFPLS)

As an alternative to flexi-access drawdown, UFPLS allows you to draw income directly from any defined contribution pension without designating it to drawdown or purchasing an annuity. Lump sums or regular income drawn in this way will be paid part tax-free (25% of the payment), with the remainder taxed as income. The whole fund can be taken out in one go or drawn as a series of smaller regular or ad hoc payments.

- Flexible annuities

Traditional pension annuities were either fixed or increasing, plus you could add a spouse's benefit and a guaranteed minimum payment term of five or ten years. Under the new rules, an annuity can start at a high level ending after a fixed period or be one that decreases over time, and a guarantee can be secured for any length of time. The former offer the choice of a known higher income in early retirement and the latter enables a minimum return on your capital for your heirs if you die earlier than expected. Pension annuity payments will continue to be taxed as income.

Key points

The traditional method of taking 25% of your pension as a tax-free lump sum on retirement and buying an annuity is still available. If you are already in capped drawdown, you can continue with it and add new pension benefits to the existing scheme and remain under the old rules.

Whenever you crystallise pension money, the amount could be subject to the new rules and tested against the lifetime allowance (currently £1.25m) to ensure that you haven't exceeded your limit. A 55% charge is still levied on the excess.

If you have flexi-access drawdown or UFPLS, your future pension contributions will be restricted to paying in £10,000 a year, whereas if you only have capped drawdown, the limit is £40,000 as before. Income tax relief is still available on contributions at your highest marginal rate, though the Chancellor has indicated that this may be scrapped for the wealthiest earners.

Your existing pension arrangement may not facilitate the new flexibilities, so you may need to transfer to one that does. Many defined benefit schemes can be transferred but they are normally incredibly valuable and you should take advice before ceding their benefits. Public sector unfunded schemes are not transferrable and there are moves towards stopping the transfer of other defined benefit schemes too.

There are changes in the pipeline aimed at giving those who have already retired and bought annuities more options, however the details are yet to be announced.

Company update

New qualifications
Top qualifications are a hallmark of our hard-working staff and we are always proud of their commitment to continual learning and their achievements. With final exams now successfully passed, Marie Dinsdale and Margaret Andrew have both been awarded the Certificate in Financial Services; Lisa Flynn has been awarded the Certificate in Life & Pensions; and Sarah Thomas has gained the Diploma in Regulated Financial Planning, the benchmark QCF Level 4 qualification – the key to the door.

New appointments
Phil Hunt has been appointed Director of Operations, and Lisa Flynn and Samantha Cross have both been promoted to Senior Client Administrator.

More under management
We now have £270,000,000 under our management and we'd like to say a big thank you to all of our clients for the trust that you put in us.

MURDOCH
ASSET MANAGEMENT

6 Oriel Court, Omega Park, Alton,
Hampshire GU34 2YT
T: 01420 83517 F: 01420 86180
E: info@murdochasset.co.uk
W: www.murdochasset.co.uk

design: www.prhdesign.co.uk

Passing on your pension

If you die before you reach age 75, any residual pension fund can now be passed to your chosen beneficiary as a tax-free lump sum. If you are over 75 when you die, lump sum distributions will be taxed at 45% instead of the recent 55% and 82.5% before that. However under the new rules, your residual pension and lifetime allowance can now be passed on as a pension to your children, grandchildren or anyone you choose – not just your spouse – avoiding the 45% immediate tax charge. The money in those pensions can then be drawn out by the beneficiaries at their rate of income tax: 0% for low earners, 20%, 40% or 45%. It can be taken out at any time, even before the age of 55, and there will be no impact on their own annual or lifetime pension limits.

As a spouse is usually named as the primary beneficiary and scheme administrators can only distribute pension money to named non-dependants, we suggest having your Expression of Wish form reviewed so that you can take advantage of more tax-efficient distribution.

We recommend that the primary beneficiary continues to have the majority of the benefits assigned to them, with a split between potential non-dependant beneficiaries of a nominal 1% each.

After death, any beneficiary can ask for their split to be altered in favour of others listed if their needs are already more than adequately met elsewhere. For example, if a wife names her husband as recipient of 95%, with 1% each going to her son, daughter and three grandchildren, after her death, her then widower could instruct the scheme administrator to give his share to his grandchildren.

> After death, residual pension and lifetime allowance can now be passed on to anyone...

Fund manager news

Since our last newsletter, we have changed our US equity exposure from Threadneedle American to Artemis US Select, and have followed Cormac Weldon, Threadneedle's former fund manager, to his new firm. It is still early days but Weldon has continued outperforming the North America sector average, whereas his successor at Threadneedle, Diane Sobin, has underperformed the peer group.

We are in the process of changing our fixed interest line-up, replacing the Investec Emerging Markets Local Currency Debt fund with the M&G Emerging Markets Bond fund. We became dissatisfied with management of the Investec fund plus the M&G mandate gives fund manager Claudia Calich extra flexibility.

Threadneedle has rebranded its business after combining its operations with sister firm Columbia, with its new name, Columbia Threadneedle, now reflected on clients' valuations. There are no changes to the way in which any of the funds are managed or to our advice on holding their Credit Opportunities or High Yield Bond funds at present.

Pension fund withdrawbacks

It may be tempting to raid your pension fund to purchase a buy-to-let property or a Lamborghini but be careful as you may face a hefty tax bill. Under the new rules, only 25% of the fund can be taken tax free, with the remainder subject to income tax at your highest marginal rate.

If the sum you withdraw plus your annual income exceeds the higher rate threshold, you will be charged 40% tax on the excess. There will also be 20% tax to pay on income above your personal allowance and up to the higher rate threshold. Adding to the burden, you will lose your personal allowance if your income total for the year exceeds £100,000, with 45% tax payable on amounts above £150,000.

As an example, John is considering withdrawing the full £125,000 from his pension fund and has an annual income from other sources of £31,000. He can take 25% of his pension tax free, with the remaining £93,750 taking his income for the year up to £124,750. The table shows what John's tax bill would be in this scenario compared to what he currently pays.

	CURRENT SITUATION
Other income	£31,000
Personal allowance	£10,600
Taxable income at basic rate – 20%	£20,400
Total tax payable	**£4,080**
	FULL PENSION WITHDRAWAL
Other income	£31,000
Pension income	£93,750
Total	**£124,750**
Personal allowance	£0
Income tax at 20% on £31,785	£6,357
Income tax at 40% on £92,965	£37,186
Total tax payable	**£43,543**

If John withdrew regular smaller amounts each year, keeping his annual income below the higher rate threshold and therefore retaining his personal allowance, he could draw out his entire fund and pay only 20% income tax – £18,750 in total.

In other words, a liberated pension may look seductive but think twice before you succumb as you may end up giving the taxman a very large bonus.

Think twice before you raid your pension fund as you may end up benefiting the taxman...

(Market perspective continued) The three key considerations for investment are: have I got enough cash to see me through the short term; have I got a long enough investment horizon and tolerance for short-term losses; and can I get my money invested with the better-performing companies rather than the poorer ones? As always, the critical factor is the long-term prospects of the underlying businesses in which our money is invested, and our chosen fund managers have proven their ability to pick well through all economic cycles and political uncertainty. There will be good times and bad times, and capital values in non-cash investments will rise and fall, but it is the long-term underlying value within those businesses that will deliver decent returns for you.