ASSET

THE NEWSLETTER OF MURDOCH ASSET MANAGEMENT

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Heading for the cliff?

Once Barack Obama had been re-elected with a surprisingly large majority, there was only a brief respite, before the dreaded "Fiscal Cliff" reared its ugly head. The markets worried about financial meltdown and a potential 4% drop in GDP, despite the inevitability of some form of agreement to tide the US over the first deadline. A tentative agreement was signed a few days later, the "crisis" was averted and investors have drawn a collective sigh of relief. Since New Year the S&P 500 Index has risen to an all-time high, the FTSE 100 is up 10.64% and the Nikkei more than 15.5%.

The resolution is welcome, but only in the interim and a cross party agreement needs to agree the debt ceiling; they have only "kicked the can down the street", as they say that side of the pond. Despite the political bickering that besets the solution, everyone stands to lose if none is forthcoming and we believe the risk of a US collapse has lessened considerably.

Mario Monti's shock resignation in December, triggered by the withdrawal of support of Silvio Berlusconi's People of Freedom Party, left the latter ready to fight for office once again. This is not something Angela Merkel will be happy with, but it did not stop European equities making a strong start to 2013, up just shy of 4.06%, reflecting the good work she has done reconciling the economic differences across the union. The consequences of the deadlock are yet to play out.

We anticipate regular on-going and often conflicting economic data to buffet the stock markets over the coming twelve months, but even at current levels, there is much in the way of good value stocks and profits to be earned by discerning investors.

IN THIS ISSUE

We look at the Pension Simplification rule – hardly simple in our view. We also try to explain the Care Funding reform, which is another area needing careful consideration when planning. Plus frequently asked questions on Trusts and an update on fund manager Neil Woodford.

Troublesome Trusts – FAQs

Q. Are all gifts into trust exempt from inheritance tax if you live seven years?

A. Not when it's a Loan Trust. As the name says, with a Loan Trust, the capital lent is repayable to you upon demand and will be included within your estate for inheritance tax purposes when you die. It is only the investment profit on the borrowed amount which escapes and the effectiveness of this arrangement is very limited. Unfortunately, we encounter many of them as part of our initial consultations and trust review service. People have often followed this route under advice, as they have expressed the desire to have access to capital or to receive a "tax-free income" for up to twenty years.

I say "tax-free income", because it is neither tax-free, nor income. There is no tax at the point of withdrawal, because all the profit is stored up for final surrender and the amount drawn down comes from capital.

There are more suitable trusts to remove the whole value from your estate and retain access to some of the capital should you need it.

One solution to this problem is to wind up the trust. The profit can go to your beneficiaries now (they will probably find a good use for it), the repaid loan can be gifted outright if you don't need it, or to a trust where the settlor can have a degree of access if you do. The seven-year clock will finally start ticking on the gift.

(Continued on page 3)

Making Pension Simplification more complex – rule update.

More changes have been announced on the retirement front; all of which underline the need to actively manage your pension's investments and ensure you are contributing enough to live off when you stop working. Even then, you cannot afford to take your eye off the ball, as post-retirement rules have changed too.

Income Drawdown: some welcome news.

Two years ago the maximum income allowed from a Drawdown Pension was reduced from 120% to 100% of the GAD rate (Government Actuaries Department). The GAD rate is broadly equivalent to a single person's level payment annuity. The move created a perfect storm. The confluence of a period of poor investment returns, interest rate decimation and increased life expectancy saw retirees' income levels plunge and hardship for those who relied on this money for their day-to-day living.

After much campaigning, the Chancellor confirmed that the 120% maximum income level is to be reinstated, with effect from 26th March 2013. At the next Drawdown anniversary date, you can apply for a review of the income levels to see if a higher level of income is allowable.

We will assess this for you at your annual review and discuss the implications as usual, but let us know if you would like to discuss this now.

State Pension changes

The White Paper detailing how the new flat-rate, single tier state pension is to be implemented was released on 14th January, doing away with the State Second Pension (S2P) and Contracting Out. The highlights include:

- £144 per week in today's terms.
- Annual increases in line with the 'triple lock'; the greater of earnings, prices or 2.5%.
- Implementation anticipated by 2017 at the earliest.
- State Pension Age will be 66 by 2020, increasing to 67 by 2028.

If you retire before 2017, you will not be affected by the changes.

Standard Lifetime Allowance

The maximum pension fund size, before punitive tax charges (Standard Lifetime Allowance), will be reduced to £1.25m from 6th April 2014. Additional protection measures will be implemented for those already in excess of that level or who make no further contributions. As if Primary, Enhanced and Fixed protection were not complicated enough already!

Annual Allowance

The pension contribution limit will reduce from £50,000 to £40,000 with effect from 6th April 2014. You can Carry Forward your unused allowance for the last three years, giving a maximum possible pension contribution of £200,000 in the current tax year, if your salary is large enough.

Pensions still offer highly attractive tax benefits, if you know how. Please ask us if you can gain further benefit from them.

Care funding reform: no relief for the wealthy and a further blow on inheritance tax.

This month's announcements do not really herald the end of estate attrition by the high cost of personal care and are the final nails in the coffin of George Osborne's 2007 promise to let all but the very wealthy off inheritance tax.

From 2017, a lifetime cap of £75,000 will apply to everyone, but it will not be based on the actual cost of your care, rather the difference between the local authority's benchmark (typically £500 per week) and your notional living cost contribution (circa £240 per week). At this rate, there would be no help for 288 weeks, or five and a half years. So if you are paying fees at £700 per week, you would have spent £201,600 before the cap had any impact.

Once the cap kicks in, you will still need to make up any difference between the actual cost of care and the benchmark rate, as well as paying your notional living cost.

The upper capital limit has been increased to £123,000, compared to the current level of £23,250. Once your capital is reduced to this level, there will be a complex interaction with the cap and after four hours of trying to explain this in less than 1000 words, I have concluded that it is unlikely to help the majority of Murdoch Asset Management clients, who will continue to have to fend for themselves.

Unfortunately, the real impact to our clients is no increase in the personal inheritance tax exemption (the "nil rate band") until at least 2019 to fund the cost of this care promise and the threshold will remain at £325,000.

What should you do now? First of all make yourself a cup of tea. Then plan. Plan to avoid inheritance tax through on-going gifting, either into trust or directly to your children. Couples' wills should set up trusts on first death to ring-fence the deceased's capital from the survivor's future care needs.

What if you, or one of your relatives, are paying for care now? Consider an immediate care annuity which guarantees a fixed, tax-free income for life in return for a cash sum. Invest the residue for income to preserve your wealth for as long as possible, or a combination of the two.

If low interest rates, tax and inflation are eroding your capital...

The tax year end is the 5th April 2013 and Individual Savings Accounts are free of income and capital gains tax. The Stocks & Shares ISA limit this year is £11,280, less any amount paid to a Cash ISA.

Cash ISA interest is almost negligible and lower than inflation, so there is a reasonable argument for taking some extra risk to pursue income through carefully selected investments. (Continued on next page)

(Troublesome Trusts continued)

Q. When is a trust not a trust?

A. When it has not been correctly drafted, signed, witnessed or registered. There is an argument for all life assurance policies to be written under trust, allowing one to nominate the beneficiaries that will receive the death benefit. The payout would avoid probate and the value is excluded from the deceased's estate for inheritance tax.

The monies can be released immediately, retained in the trust until needed or used to provide income and capital for the beneficiaries, without them ever forming part of their estate. This can be very useful in the event of their divorce, financial incompetence or complex personal needs.

We regularly encounter clients whose trusts will fail due to error, so we will review any non-Murdoch trusts you, or any of your friends have, to verify their accuracy.

Consider an immediate care annuity which guarantees a fixed, tax-free income for life...

Fund Manager News:

It has also been a busy start to the year for big investors; Invesco Perpetual's Neil Woodford completely sold out of Vodafone shares across all of his funds in just over a week, demonstrating that despite having the largest remit in the UK, he is still able to act decisively and with great conviction.

Neil Woodford

He held Vodafone for ten years, accounting for 5.79% of the two portfolios at its peak. This follows his decision to sell his Tesco holding last year to Warren Buffet, a firm he had invested with for over 20 years. As a defensive, high conviction investor, there will always be times when his short-term performance looks poor compared to others, but his long-term track record gives us confidence to stay with him.

The rapidly changing economic environment, coupled with highly volatile markets, can make it hard to keep the faith, but we remain convinced that consistent, rational investment processes applied by fundamental investment managers (rather than algorithms) will deliver above average returns.

We have been pleased with the performance of our funds and model portfolios, but we have made some changes. We switched out of the SVM Global Opportunities fund following a change of manager and long-term poor performance, with the proceeds allocated to Terry Smith's Fundsmith Equity fund. Since we made this recommendation, Fundsmith has out-performed both the SVM fund and its peer group.

Allianz BRIC Stars fund was next to go, but instead of choosing a single fund to replace it, we have gone through all holders' portfolios and made a recommendation on a case-by-case basis. Generally, we prefer to remain invested in emerging markets equities, but we are conscious not to allocate too heavily towards one fund.

We regularly review those clients' funds that we have inherited, rather than recommended ourselves, identifying which funds we believe should be replaced and will contact you individually where relevant. As usual, please contact us if you wish to discuss an individual holding, any new opportunities you encounter or for a chat.

(Capital erosion continued) Our Prudent, Balanced and Active income portfolios currently yield 4.47%, 4.27% and 3.89% respectively, with the option to tailor a higher level of income if required.

The income can be paid to you free of income tax or re-invested within the ISA for growth. Over the long term a significant proportion of all growth comes from the re-invested profits on shares held, meaning this strategy can work for growth and income investors alike. You can use your spare savings or "slide over" your current non-ISA investments.

Cash ISAs can be transferred to Stocks & Shares ISAs without affecting your annual allowance, which is ideal if you are fed up seeking out ever-diminishing interest rates and can tolerate a fluctuating capital value. Be warned though; once you have transferred a Cash ISA to a Stocks & Shares one, you cannot send it back the other way.

It would help us if you did not leave it until the last minute, so do please contact us now if you are thinking about it.

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