



FINANCIAL VIEWPOINT

COLLECTIVE FINANCIAL PLANNING LTD
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From straightforward solutions to more complex
planning talk to us about your investment choices.



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Thanks to pension freedoms introduced in 2015, savers over 55 have a wide range of options when it comes to drawing from your savings, and this brings opportunities although it's also easier to make a mistake.

There are now essentially four main ways for you to access your pension savings:

- 1. Buy an annuity** which guarantees an income, typically for the rest of your life but in some cases for a fixed period
- 2. Flexi-Access Drawdown** allows you to withdraw from your savings when you need to, while the balance remains invested
- 3. Take it all out as cash** with the first 25% tax free and you pay income tax at your marginal rate on the rest, although you may face a hefty tax bill the following year
- 4. Take part of it out as cash** with the first 25% tax free with the rest taxed at your marginal income tax rate. You can do this as many times as you like until you no longer have any pension savings.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

Information contained in this article concerning taxation and related matters are based on Openwork's understanding of the present law and current legislation.

Your pension savings, your future options

Why you should consider modernising your pension

As well as giving you greater freedom over how you access your savings, there are several other benefits when modernising your pension:

- Take full control of your pension savings
- Choose when and how to draw an income to suit your retirement planning
- Keep your options open for drawing an income in the future
- Optimise your tax efficiency - both on any money you might leave invested, and Inheritance Tax.

If your pension plan does not offer all four of these options, then you should think about switching it.

What else do you need to think about?

There are other factors to take into account when switching to a modern pension.

Firstly, the chances are the costs will increase. You may end up paying as much as an extra 1% of the value of your savings annually. So, if you have saved £200,000, your provider could charge up to £2,000 more per year. And if you seek financial advice, your adviser may also levy a fee, either upfront or as an ongoing service charge. These additional fees eat into your pot, but you could equally benefit from the flexible access as well as greater visibility and control.

Another consideration is tax. Regardless of whether you stick with your current pension or switch to a modern one, your income - other than the first 25% of a partial or whole lump sum - is subject to your highest rate of tax. Seeking professional advice can help you access your savings in a tax-efficient manner.

There is certainly plenty to consider and it is wise to regularly explore your current and potential retirement routes.



How inflation eats into your returns

Food price comparison

	1989	2019
White sliced loaf	49p	£1.09
Chicken (fresh / per kg)	£1.89	£2.77
Milk (per pint)	28p	44p
Oranges (each)	17p	38p
Draught lager (per pint)	£1.06	£3.69

The value of your investments can fall as well as rise, and you could get back less than you invest.

Understanding inflation and its impact on your portfolio is important because rising prices can reduce the value of the money you get back from your investments.

What is inflation?

Inflation is a term used to describe a rise in prices. In the UK, it is measured by the Consumer Prices Index including owner-occupiers' housing costs (CPIH), the Retail Prices Index (RPI) and the Consumer

Price Index (CPI). CPI the most commonly quoted measurement tracks the changes in prices of several hundred household goods and services including food, clothing and recreation. The Office for National Statistics publishes CPI figures on a monthly, quarterly and annual basis.

Prices increase for a variety of reasons, such as a rise in the cost of the raw materials used to manufacture goods, or tax cuts which encourage consumers to spend.

In the UK, inflation has drifted above the Bank of England's (BoE) target of 2% since the Brexit referendum as political uncertainty has caused sterling to weaken against other major currencies. Weaker sterling means goods imported from outside the UK become more expensive.

Most other major central banks set a similar target because a healthy level of price rises reflects a strong economy. If inflation races ahead for any reason, the banks can use interest rates to get it back under control.

Why does inflation matter to investors?

Inflation reduces what is known as your purchasing power. In short, when prices rise, you can buy less with your money. This effect does not just impact your day-to-day spending though, it also eats into the returns generated by your investments.

Say your portfolio increased in value by 5% in a year. This is your nominal rate of return. However, prices rose by 2% during that time, consistent with the BoE's target. To determine your real rate of return, you need to subtract the inflation rate (2%) from your nominal return (5%). In this case, the value of your portfolio increased in real terms by 3%.

Inflation proofing your portfolio

An investment portfolio should ideally be designed to deliver returns that beat inflation over the long term (five to ten years), even if it does not achieve this aim consistently throughout the whole investment period.

Bonds play an important role in the diversification of risk in your portfolio, but they may underperform when prices rise because payments become worth less. Fixed interest payments received by bond investors stay the same regardless of inflation, while equity investors earn a variable return which they expect, to some degree, to reflect changes in inflation. Alternative asset classes such as commercial property and commodities might also benefit from rising prices. Conversely, with interest rates at record lows since the 2008 financial crisis, holding cash will generate negative returns.

Investing for the next generation

In the early years this might translate into a surplus of toys or days out, but this stage eventually passes and thoughts turn towards the future transition from child to adulthood and beyond.

This longer-term perspective raises the question of how best to provide financial support through, what could be an expensive transition and inevitably this leads to a variety of issues:

- Are there particular needs which should be targeted or is it more important to have money available as and when your child needs it?
- Which investments would be appropriate?
- Is it possible to put some parental or other controls in place for when children can access the investment?
- Which are the most tax-efficient investments?

Investing for life's key events

For today's children, the path through the early years of adulthood might cost rather more than that of their parents - and grandparents:

Higher education may be seen to be more important for gaining a reasonable job, but it also comes at a much higher cost. Taking into account tuition fees, accommodation and living expenses, a three-year degree is likely to cost the poorest students more than £50,000 according to a 2017 Institute of Fiscal Studies report. Before 1998, there were only grants and loans for tuition fees did not begin until 2006. Your generation may have left university with a bank overdraft, but the sum owing probably pales into insignificance compared to the five figure debts faced by today's graduates.

Marriage is an increasingly costly staging post for those who choose it. According to the annual wedding survey by Bridebook.co.uk the average cost of a wedding in 2018 was just over £30,000! Despite the cost, two thirds of couples questioned in the survey admitted to either going over budget or having no budget at all.

Getting on the first rung of the **property ladder** is another growing cost for the next generation. According to research by Halifax, first time buyers are having to find record deposits, with the national average exceeding £33,000. It's no surprise people are having to leave it until later to buy their first home.

Once they have the degree, the job and the home (and the mountain of debt), there's another long-term financing requirement which today's children will encounter: **retirement provision**.

Take expert advice

Two principles that apply to many aspects of financial planning are particularly relevant when thinking about children:

1. The sooner you start the better, and the more scope there is for investments to grow (although there's still no guarantee that they will).
2. Take expert advice before making any decisions. The right investment set up in the wrong way can be worse than the wrong investment set up in the right way. DIY planning is not to be recommended, given the potential pitfalls.

If you want to help your child progress through this financial landscape, please get in touch.

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