



Welcome to the latest edition of e-Update, our update on developments in the world of financial services.

We hope you find the contents of interest. If you have any questions, or would like to discuss any of the points raised, please give us a call on 01323 721721

## The benefit of hindsight

What is the most useful tool a successful investor could have? Strong research? Access to company management? A prodigious memory? These are all useful – perhaps even vital – attributes. However, the most useful tool is the one thing nobody can have: the benefit of hindsight.

As long experience shows us, different asset classes and industry sectors will provide strong or weak performance at different times. For example, equities are widely acknowledged to have provided the best long-term performance of the four main asset classes. However, most investors who have lived through the meltdown of the "dot-com" sector - or the pain of the last 12 months - know only too well that, in the short term, things can be quite different. Bonds on the other hand, are viewed as medium to lower-risk investments, particularly when economic growth is on the wane - but the recent credit crunch has left some with burnt fingers. Meanwhile, in times of uncertainty, investors make tracks for the safe haven of cash – but leave your money there too long and the value can fall prey to the corrosive effects of inflation.

The theory runs like this: during periods of strong economic growth, equities are likely to perform well, whereas when economic growth is in decline, bonds and cash should prove more beneficial. In addition, there are "specialist" asset classes – such as commodities and property – available which can perform differently from all of the above, although these, and alternative investments, need expert advice and should be approached with a degree of caution.

What can be tempting for investors is to chase the best returns by jumping from one asset class to the next when the returns look promising. However, in reality this rarely works. If judging the right time to switch and where to switch to were easy, we would all be rich. Even some of the full-time, so-called professionals consistently get these decisions wrong. Therefore, instead of trying to choose which asset class to be in and when, perhaps it would be better to have a bit in all the asset classes, all of the time.

This is called diversification – the act of spreading your investment across more than one asset class. In doing so, you not only make sure you are invested in the asset class that is performing better, you also ensure you are not 100% invested in the asset class that is doing worst. Instead you get a bit of everything – and as a result, your investment returns should be smoothed out as performance rotates through the asset classes and each compensates for another as time goes by.

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## Selecting a tax wrapper

The 2008 budget introduced a simplification of the capital gains tax (CGT) regime. However, as with many tax simplification measures, it also introduced some complications. Notably, it has muddied the tax position of insurance bonds when compared with mutual funds such as unit trusts and OEICs.

CGT used to be payable at a taxpayer's marginal rate (40% for a higher rate taxpayer and what would now be 20% for a basic rate taxpayer). As of April 2008, however, it is now being charged at a flat rate of 18% regardless.

The CGT advantages of different products have therefore changed; specifically, the advantages of holding investment bonds over collective investments have diminished. The fine detail is complicated and your own circumstances will always impact on any rule of thumb. However, there are some general guidelines emerging that might help.

For high growth, low income investments – such as UK growth funds, international equities and commodity funds - the situation seems quite clear. Growth in an investment bond is effectively charged as income tax and it will therefore attract more tax than if it were charged as CGT.

In a unit trust or OEIC, on the other hand, growth is charged to CGT, leaving a growth investor with 2% (for a basic rate) or 22% (for a higher rate taxpayer) more of any profits. For investors who do not use up their full CGT allowance (and according to FundsNetwork, a UK investment fund platform, less than 1% of individual investors do) the difference will be 20% and 40% respectively.

For income-producing assets – for example, corporate bonds and high dividend, low growth equities – the situation is less clear. The tax rates on dividends in each of the two products are effectively the same – 20% and 40% respectively.

However, there are some tax deferral and switching advantages the investment bond might offer that could make it more attractive to an income investor, particularly if you are currently a higher rate taxpayer but expect to be a basic rate taxpayer when you cash in. On the other hand, there are charges - and it can take only a small additional charge to outweigh the tax considerations, particularly for an income investor.

Having said all that, tax should never be the guiding reason for making an investment decision. What you must decide first is your risk profile, what investment mix would suit you and where those investments are actually available. Only then should you make the tax decision. Consulting a professional financial adviser will ensure none of these issues are missed.



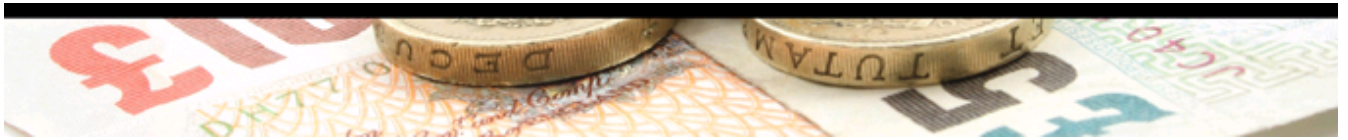
## What is the...

...difference between a unit trust and an OEIC?

Both are collective investments that invest in a wide range of asset classes depending on their specific objective.

However, a unit trust is unitised - that is, new units are created for new investors and cancelled when sold. An OEIC (open-ended investment company) is set up as a limited company and investors buy shares rather than units. Most OEICs operate as umbrella funds, allowing the creation of different sub-funds, each with different aims, charges and investment requirements within the one structure. When all are run by the same group, this can make switching between those funds easier.





## The UK market

As a UK investor, you'll probably be most familiar with your national stockmarket. It is full of household names, which can offer a certain reassurance that you know the businesses in which you are investing.

Shares here are traded on the London Stock Exchange, and are split across two primary markets – the Main Market and AIM – with indices tracking the performance of different elements. The FTSE 100 Index tracks the largest 100 companies (which make up around 80% of the stockmarket by value), followed by the FTSE 250 Index. Combine the two and you get the FTSE 350 Index. Smaller companies make up the remainder, and bring the total market capitalisation of the UK market to around £3,500bn. AIM (Alternative Investment Market) is composed mainly of smaller, high-growth companies and now boasts more than 1,000 participants (Source: ftse.com as at 31 December 08).

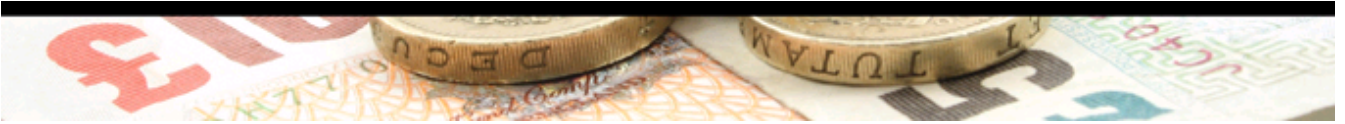
Average company profits have grown in recent years, buoyed by strong economic growth, merger and acquisition activity and efficient management. Some of the largest FTSE 100 companies are global leaders in their fields, which means future progress is increasingly influenced by events in other parts of the world, and many UK companies are now as dependent, if not more so, on international business than on the UK. The UK is traditionally seen as a 'defensive' market because it is dominated by banks, pharmaceuticals and oils, which are less vulnerable to the economic cycle.



## A new flat rate

The 2008/09 tax year brought in a new Capital Gains Tax regime, aimed at simplifying things for everyone. Out went indexation, taper relief and marginal tax rates and in came a flat rate of 18%. Most investors, particularly higher rate tax payers, probably now pay less, although some business owners have experienced a rise in liability from their previous 10% rate. 'Entrepreneur's relief' helps a little by allowing people with a 'material stake' (5% or more) in a new business to dispose of assets at a rate of only 10% on gains (subject to a lifetime limit of £1m). In this way, the positive environment for new business growth remains whilst closing the perceived loop holes of the old regime.





## What if my bank goes bust?

The Financial Services Compensation Scheme (FSCS) is an independent body that was founded in the UK in 2001 by the Financial Services Authority (FSA). It covers all companies regulated by the FSA, and is funded by levies on companies authorised by the FSA

Under the FSCS, customers' deposit account savings are guaranteed up to a maximum of £50,000 per customer per institution, or £100,000 for a joint account. If a customer has more than £50,000 with a bank that collapses, they will only receive the maximum amount of £50,000 per person per institution. However, they might eventually receive additional funds following the distribution of any assets as part of the insolvency process. Interest owed to customers up to the date that the bank is found to be "in default" will be treated as part of the compensation.

The FSCS does not always cover 100% of a customer's losses. If the customer owes money to the failed firm (such as mortgages or loans), these will be taken into account when compensation is being calculated.

The FSCS aims to pay out within six months, but has never actually had to pay out for the failure of a major UK bank. However, it is likely that the UK government would do everything within its power to avoid the collapse of a British retail bank.



## Little and often

In the world of investment, timing is everything. But, despite claims to the contrary, no one can second-guess the market. However, by saving regularly, investors can benefit from what is called 'pound cost averaging'. Regular savings mitigates the risk of buying all your investment at a single price. Instead, smaller sums are invested at a variety of prices. In a rising market, regular savings would underperform a lump sum as the later investments would miss out on the early growth. However, in a variable or falling market, later investments would buy in at lower or alternating prices and thereby offer more growth as the market returns to higher levels.

## Guide to the future?

Past performance continues to be a key feature of investment advertising and, with over 2,000 UK-domiciled funds available, it is easy to be influenced by it. But how much guidance does it offer? Past performance figures can help you identify which funds have done well to date – but it does not say why or indicate how performance was affected by market conditions. On their own, they also cannot indicate how the returns were generated. Did they all come from one lucky stock idea or were they more evenly spread? It is much more important to match a fund's objectives to your own needs. However, as part of a wider research process, the figures can be a useful filter.

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