NLPFM news

News and views from NLP Financial Management

The end of pension tax relief?

The government launched a major review into the effectiveness and distribution of the billions in tax relief granted to pension savers each year. The objective, it would seem, is to reduce the net amount the Treasury 'loses' and stimulate the lower paid into engaging with the long term savings bug. But at what cost?

Having floated a number of ideas, including a pension-ISA concept, rumblings from the Treasury seem to suggest that they favour a 'flat rate incentive scheme'. All will become clear – we are promised – in the 16th March Budget.

The present system which has been in place for decades, provides tax relief on personal pension contributions at the marginal rates at which your income is taxed. Income taxed at 40% is granted relief at 40% when personally paid into a pension; income taxed at 45% gets relief at 45% and so on. This now appears to be economically – and possibly politically – inexpedient.

Salary sacrifice arrangements also look to be in the firing line.

So what might replace the current system and how could you benefit?

Talk of a radical shake up, where tax relief is abolished altogether and replaced with a 'top-up' system has some traction. Clearly, the lower the 'top-up' rate the greater the impact on 40% and 45% taxpayers, conversely, the higher the top-up rate, the greater the incentive to save will be for nil and basic rate taxpayers and the less the Treasury will save.

Higher and additional rate taxpayers may be best advised to consider bringing forward their pension contribution planning to before 16 March – basic rate payers may be best to wait.

If you want to maximise the efficiency of your pension planning, reduce your tax burden and discover your available scope for tax-efficient pension contributions, please speak to us as soon as possible – the 16th March may just prove a day too late!

For further information, please contact:

Graham Mendoza-Wolfson
T 020 7472 5551
E graham.mendoza@nlpfm.co.uk

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This newsletter is for general information only and should not be construed as a personal recommendation of any investment or service. We suggest that you contact us for independent financial advice so that we can determine the suitability of investments and services on an individual basis. We are not responsible for any action or inaction based purely on this document.

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Financial planning surgeries

As part of our corporate services package, we offer companies the opportunity to host financial planning surgeries for their employees.

To date, feedback from these surgeries has been very positive. These usually begin with one of our consultants hosting a presentation on a topical matter (often retirement planning) at the company's offices. Following on from the presentation, we offer one-to-one consultations with interested employees to run through their individual circumstances and see if there are any areas where they would benefit from advice.

Depending on the company size, we can divide the workforce and offer tailored presentations to separate groups. Often this is the first time employees have encountered a financial planner, so the take up for the "no obligation free consultations" is usually very high and well received. A typical meeting will see an employee leave with a greater understanding of their financial position, and importantly where there may be gaps in their planning that might be addressed. These planning gaps could be filled immediately with our help, or could be put to one side while a more pressing financial matter is addressed (such as buying a property). Importantly, we can set out a guideline plan for the individual so that they know what they need to be aware of, the opportunities available to them and how to access help in the future.

Ultimately these sessions reflect well on the employer as not only has the company provided an additional employee benefit (the sessions), but existing employee benefits can be explained in more detail, enhancing the value of the company's overall benefits package.

For further information, please contact:

Lee Pittal
T 020 7472 5544
E lee.pittal@nlpfm.co.uk

Retirement planning – at your service

Many of us look forward to retirement where we can spend our days doing whatever we wish, take up new pastimes and travel the world. As life expectancy is increasing, our retirement can now represent more than a third of our lifetime, so it is becoming more important to ensure we have a robust financial plan to meet our income and capital needs when we retire.

We can help you plan the financial aspects of your retirement, whether you are many years from, or approaching retirement, with our 'Retirement Service.' We focus on six separate areas summarised as follows:

Establish what you Need – Help you understand what your expenditure may be in retirement and factor in the impact of other variables such as inflation. A retirement budget planner is used to aid this process.

Establish what you Have – Estimate what potential income you may have at retirement taking into account your savings, investments, state and private pensions.

Bridge the Gap – Our cash-flow planner will illustrate any shortfall / surplus between what income you may need and your current savings. It can also illustrate whether you may run out of capital in later life, the impact of higher than anticipated levels of expenditure, inflation and investment growth levels so you can consider a range of variables. We can then advise on what changes you can make to both your savings and investment strategy to achieve your required goals.

Discuss your Pension Income Options – Once you reach retirement, you may either opt to secure pension income through purchasing an annuity and/or select a more flexible pension income option such as drawdown. We will advise on a range of strategies according to your circumstances, incorporating your objectives and risk profile as well as considering inflation, tax, investment approach, access to capital and death benefits.

Consider Non-Pension Savings – Advise on how other investments held such as ISAs and share portfolios can be used to supplement your income needs in retirement.

Inheritance Tax and Estate Planning – Advise you on how to structure your affairs to potentially mitigate inheritance tax through considering a variety of solutions which will prioritise your own financial needs whilst seeking to protect assets for the next generation.

Our service does not stop there. It is important to provide an ongoing service "In Retirement" in order to ensure that your goals are on track and any income is sustainable. We will regularly appraise your investments, your pension income options, legislation and changes to your lifestyle.

For further information, please contact:

Chad Atwal
T 020 7472 5555
E chad.atwal@nlpfm.co.uk

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Structured products – is now a good time to invest?

A structured product is a fixed-term investment, the return on which typically depends on an Index level, e.g. the FTSE-100 Index. The main attractions of investing in structured products are that the potential returns can be quantifiable albeit they are not guaranteed, and they provide useful diversification from other more traditional investments such as equities. Although capital invested can be tied up for a number of years, most plans offer the potential for early maturity, often on an investment anniversary, subject to the performance of the referenced index. However, these can be sophisticated investments, in which complex financial instruments are used to provide the returns.

We undertake extensive research into available structured products and maintain a panel of approved plans. We prefer offers that are linked to a single index, such as the FTSE-100, rather than being linked to multiple indices or individual stocks, which may offer higher returns but carry greater risk. We favour defensive plans which can pay out even if the FTSE-100 Index falls by some margin during the term. Some plans offer a "step-down", where on each anniversary the required level of the index is lower than the year before, meaning that the plan can mature early even if the index has fallen.

"The returns offered from these products are usually higher during periods of increased market volatility, which is why now may be a good time to invest."

However, with these investments there is usually a risk that capital may be lost if the underlying index falls significantly, typically by over 40% at maturity. Another potential risk is counterparty failure, where the party issuing the underpinning financial instrument becomes insolvent; in these circumstances investors may lose their full investment. Understanding the financial strength of counterparties is therefore essential and we will only recommend products where we are comfortable with the counterparties.

In times when the FTSE-100 Index has fallen, investing in structured products arguably becomes more attractive, as the likelihood of loss of capital perhaps reduces. In addition, the returns offered from these products are usually higher during periods of increased market volatility, which is why now may be a good time to invest. Returns from growth plans are usually subject to Capital Gains Tax, so investors can use their annual CGT allowance of £11,100.

In conclusion, with a wide range of products available, we believe it is essential to obtain financial advice when investing in structured products. Investing in a portfolio of carefully selected plans, perhaps at different times, to provide diversification between counterparties and maturity dates, can be an appropriate strategy to adopt alongside a broader investment portfolio. Returns can be attractive, but you need to understand the risks involved, and due to their complex nature, structured products are not suitable for all investors.

For further information, please contact:

Elliot Gothold
T 020 7472 5543
E elliot.gothold@nlpfm.co.uk

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Active v passive investment

We have an unconstrained approach to portfolio management so can use any fund we feel is appropriate. This means we have to consider the merits of using active or passive funds to play out our themes.

Passive investment can involve buying all the constituents of an index in the same weighting as they appear in the index. Active investment involves managers actively selecting their favourite stocks or assets.

As passive management involves little skill it can be done cheaply. This has led to many suggesting that this is the most effective way to invest money. This argument is often supported by the supposition that few active managers consistently outperform the index. We take a more pragmatic view. We do believe passive investment has a place in portfolios and can often be an inexpensive way to get certain exposures, however we are firm believers that you do not want passive investment in all markets.

There are some excellent active managers who consistently beat their benchmark, and believe we have a good track record in finding them. One problem with passive investment is that it guarantees underperformance relative to the index once fees are taken into account. By finding managers who regularly outperform the index, even by 1-2% annually, considerable outperformance can result.

Over recent weeks, volatility in markets has increased and we expect this to continue for some time, creating marked swings on a daily basis. These large moves in stocks on a short-term basis are where active managers can score well. Quality tends to sell-off with the overall market as fear grips, but this can create excellent entry points for those prepared to look through the "short-term noise" and buy for the longer-term.

Another benefit of active management can be seen in less efficient markets. Small caps and emerging markets are not areas where we would use passive funds. Emerging markets encompass a wide range of countries and it is dangerous to class emerging markets as a homogenous region. An active manager can allocate to preferred countries whilst ignoring those deemed more challenged. Avoiding being in the wrong asset at the wrong time can be as important to returns as holding a 'winner'. Last year was a great example; active managers could significantly outperform simply by avoiding banks, oil and mining stocks, something trackers cannot do.

Small caps tend not to receive the in-depth research and scrutiny afforded to larger companies and hence value can be uncovered by the canny and inquisitive researcher. This is why we use passive management in the US which is an extremely well covered and efficient market where active managers can often struggle to add value.

We are prepared to combine both passive and active investments where we feel it is appropriate but have faith in our ability to find managers who can regularly outperform their benchmark and believe we are entering an environment where stock selection is becoming ever more important.

For further information, please contact:

Stuart Saberi
T 020 7472 5554
E stuart.saberi@nlpfm.co.uk

Auto enrolment – act now!

We have already helped many employers comply with Automatic Enrolment Legislation and anticipate enquires will increase as more employers are affected by the legislation.

If you are responsible for workers in a firm and have received correspondence from The Pensions Regulator requesting you act, please get in touch with us. At the outset, we can deliver a "phone-based" presentation detailing your duties and explain how we can help. We can then assist your firm throughout the process with our efficient service.

Research suggests many employers are ignoring or deferring acting on their duties until the deadline is upon them; our advice is to address this legal requirement early to ensure that the optimal solution is in place and you remain compliant with your employment duties.

For further information, please contact:

Andy Butcher
T 020 7472 5552
E andy.butcher@nlpfm.co.uk

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If you do not wish to continue to be on our database or receive any further correspondence from us, please write to Adam Katten at the address below.

NLP Financial Management Charles House, 108-110 Finchley Road London NW3 5JJ
T +44 (0)20 7472 5555 **F** +44 (0)20 7681 2780