NLPFM news

News and views from NLP Financial Management

NLPFM Model Portfolios – 10 Year Anniversary

NLPFM is celebrating the 10th anniversary of our Discretionary Management Service (DMS). We now manage assets approaching £500 million across the group.

During this decade, our original 3 risk-graded models achieved gross returns of 82%, 86% and 97%. The UK stock market (via the MSCI UK Index) increased by 72% and the average Balanced Managed Fund (via the AFI Balanced Index) increased by 73%. These results are even more impressive considering the Service was launched during 2008, the year of the Global Financial Crisis - the worst market conditions in 79 years.

From mid-2009 the markets bottomed out and started a slow recovery, driving interest rate levels close to zero, only to be followed by a new threat from the European debt crisis in 2011-12. We remain alert to global issues and have steered our model portfolios through a number of other challenges including the commercial property liquidity crunch following the EU Exit Referendum result.

Our investment portfolios are designed to target competitive returns with significantly lower risk, consistently reviewing the volatility of our portfolios to meet our company values of ensuring "peace of mind" for our clients. Since we launched our Cautious, Balanced and Progressive models, we have achieved our return with approximately half the level of risk of the UK stock market and quantifiably less risk than the average balanced fund.

Our investment philosophy is based on preserving capital whilst generating attractive returns through rigorous analysis by our own team of investment analysts with over 150 years of combined experience, chaired by NLPFM Director, Lee Pittal. Being fully independent, each investment is carefully selected on its own merits regardless of its source, through a proven qualitative and quantitative screening process. This allows us to choose the best funds to fulfil portfolio objectives which are continuously monitored for performance as well as regularly targeting new ideas in each sector.

Whilst our philosophy has not changed, our approach has evolved throughout the ten year period, and continues to evolve, as we adopt new processes and react to the changing trends in the industry and new investment opportunities. We feel that our experience of managing portfolios during different stages of the macro-economic cycle, especially during the Credit Crisis of 2008, stands us in good stead for the future.

We offer our clients an excellent investment proposition designed for low risk, attractive returns. As we celebrate our ten year anniversary, we aim to build on our track record over the course of the next decade and beyond.

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Inside this Issue

MiFID II & GDPR – What do they mean for you?

If you haven't already heard of MiFID II (Markets in Financial Instruments Directive), or GDPR (General Data Protection Regulation), then as we enter 2018 you soon will as both start being discussed in the media. But, what do they mean for UK consumers?

MiFID II

The principle behind MiFID II, which started on 3 January 2018, is to produce a transparent, level playing field for all EU residents when purchasing financial products listed in the EU, such as stocks and shares ISAs and pensions.

The focus is on the investments that sit within these financial products, the costs incurred, and how suitable these investments are for you. The companies providing each investment need to decide on the types of clients most appropriate for each investment, and the Independent Financial Adviser (IFA) then needs to ensure these are the right fit for those clients.

As part of the MiFID II regulations, existing investors in our discretionary investment management service will now receive portfolio valuations quarterly, regardless of when face to face adviser meetings are held.

There are additional "behind the scenes" MiFID II measures aimed at improving security for investors, giving regulatory bodies the ability to closely monitor transactions and identify anything suspicious. As a client you are also likely to hear more messages stating "your telephone call is being recorded", with records being maintained for a minimum of six years!

Over time there will undoubtedly be extra interpretations, but the main message for clients is not to worry! Additional information may be required before investments can be made, but this is aimed at increasing the protections clients receive on an ongoing basis.

GDPR

GDPR encompasses new data protection rules coming into force on 25 May 2018. Regardless of Brexit, the UK is legally obliged to comply with these new guidelines which are intended to stop the nuisance calls and emails and give consumers advice they actually want! Going forward, we will all have to give our express consent to any company that wishes to send us marketing messages and we will have the right to ask how our personal details are stored.

At the NLPFM group, we are already working hard towards becoming compliant before the May deadline and have always taken the handling and security of our customer data very seriously. Plus we only want to send you marketing information that is relevant to you. We will be contacting all our clients asking them to confirm how they wish to continue to receive key messages. This will enable us to keep you updated with any financial news, new products, promotions and recommendations.

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Cryptocurrencies and Blockchain

2017 was the year of cryptocurrencies when valuations of the two biggest cryptocurrencies, Bitcoin and Ripple soared by 1,400% and 20,000% respectively. Terms such as blockchain and cryptocurrencies have been the subject of comments by central banks and coverage by the media.

In a nutshell a cryptocurrency is a string of digits generated from a piece of software. According to https://coinmarketcap.com/ the market of cryptocurrencies is huge and fragmented: over 1,300 instruments with a total market capitalisation around $500 billion are traded on over 8,000 markets. Major cryptocurrencies are Bitcoin, Ripple and Ethereum.

Cryptocurrencies are based on the desire to avoid regulation, minimise intermediation and create a new financial regime post the Global Financial Crisis. This creates risks and opportunities. Many of these cryptocurrencies have attracted money from illegal activities (money laundering, tax evasion) but the underlying technology (blockchain) and the basic concept are not illegal. While central banks have issued warnings regarding the volatility and the lack of regulations, banks and companies have "dipped their toes" into this market via their venture capital activities and most recently with the trading of Bitcoin futures contracts on the regulated Chicago Mercantile Exchange.

In our opinion cryptocurrencies are new instruments with a combination of features, including currencies and virtual assets. While they sound very interesting, they lack the characteristics of a classic currency: storage of value and price stability. Investors in cryptocurrencies might not get their money back as the markets are fragmented, unregulated, volatile and potentially illiquid. In addition, there are differing fees and varying bid-offer spreads.

Mining is the process of creating and releasing new cryptocurrencies. In the mining and trading of cryptocurrencies, the transactions are verified and added to the public ledger, known as the "blockchain". Cryptocurrencies have no intrinsic value in the traditional sense and their price is solely a function of supply and demand. The new blockchain technology though has huge potential for business and financial markets.

Apart from speculating in these cryptocurrencies, there are opportunities to invest into established and new businesses which provide services to this new market (technology firms, service providers, platforms, banks).

Because these cryptocurrencies are new extremely volatile instruments and are difficult to value, we consider them too speculative for investment in our model portfolios. Blockchain is an emerging technology which may change the way business is conducted. While we believe that blockchain has much potential and some cryptocurrencies will survive – similar to the tech companies post the internet bubble – they cannot all be winners. We are currently studying how to best provide access to them and may add to the portfolios as a new theme in the future.

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Tax year end planning

Although the sunny days of spring seem a distant dream, they will be here very quickly – along with the tax year end…

As you know, the next couple of months will be the last opportunity to finalise your affairs for the 2017/18 tax year so here are some key considerations:

ISAs

The ISA allowance is now £20,000 per tax year so provides a great opportunity to move funds into an environment where income and capital gains are free of tax. Long term utilising your ISA allowance in full can build a substantial "pot" of tax-free savings. ISAs are available to any UK resident over 16 (cash only for 16 - 17 year olds) and Junior ISAs are available for children under 18 where £4,128 per annum can be invested.

For those aged between 18 and 40 and not yet on the property ladder, this tax year also brought the introduction of the Lifetime ISA or LISA where £4,000 per annum can be saved as part of your overall ISA allowance and subject to certain conditions will receive a 25% uplift from the Government.

Pensions

In general, a UK taxpayer will get tax relief on pension contributions of up to 100% of earnings, or the £40,000 annual allowance, whichever is lower. However, if you have "adjusted income" in excess of £150,000 per annum (including all taxable income and all pension contributions, including employer), the annual allowance of £40,000 may be tapered down to only £10,000. Unused allowances from previous years can often be "carried forward" to maximise pension funding.

Pension contributions can be extremely tax-efficient with tax relief on them, funds benefitting from tax-free growth within the pension, and falling outside your estate for Inheritance Tax.

Capital Gains Allowance

Capital Gains Tax (CGT) is payable on your overall capital gains above the tax-free allowance of £11,300. The CGT rate on investments is 10% for basic rate and 20% for higher rate taxpayers. Using this allowance can save tax of up to £4,520 for a couple liable to higher rate tax and enable profits to be reinvested into an ISA.

Inheritance Tax

We all have exemptions each year and while we are living, we can give away assets, or cash up to £3,000 without incurring Inheritance Tax. You can carry forward any unused exemption from the previous tax year so could gift up to £6,000 if you haven't made gifts previously.

VCT and EIS Investments

To encourage investors into these higher risk investments, legislation provides tax incentives, including 30% income tax relief on the initial investment. VCTs offer a tax-free dividend income, whilst EIS offer CGT deferral and often qualify for Business Property Relief (BPR) so their value is not included in your estate for IHT after being held for 2 years.

VCT and EIS investments can play an important part in establishing a tax-efficient and balanced portfolio.

Investors should be aware that VCTs and EISs are high risk investments and specific advice must be taken on appropriate schemes as they apply to individual investors. These investments are not suitable for everyone and must be held for a minimum of 5 and 3 years respectively to retain the initial tax incentives.

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Stick or **twist**?

It's a difficult decision that many have to make: Whether to continue to fund their pension and receive tax relief from HMRC on personal contributions, knowing they'll pay additional tax in the future, or cease contributions but pay more tax now and generally have a smaller pot in retirement to enjoy?

And the reason for this dilemma – the Lifetime Allowance Excess Charge (LAEC).

Since 2012, the government has set an ever-lower bar on the size of tax-efficient savings an individual can accrue in their pension. The position reverses with effect from 6 April 2018, when the Lifetime Allowance (LTA) rises from £1 million to £1.03 million, an increase of £30,000, as a result of CPI inflation.

There is no limit on the value of pension savings that an individual can build up. However, if you exceed the lifetime allowance when drawing benefits and / or age 75, then the amount in excess of the LTA will be subject to the LAEC tax charge. The tax rate applied depends on how this excess income is drawn by the member. If the excess amount over the LTA is drawn as excess income, then 25% of this income is deducted at source, before any PAYE income tax is applied. If instead the Lifetime Allowance excess is withdrawn as a lump sum, then 55% is deducted at source by the trustees, before the cash lump sum payment is made. These rates of tax are designed to act as a disincentive to accrue, in aggregate, a pension fund in excess of the Lifetime Allowance.

But is it always a prudent decision to consider the Lifetime Allowance a line not to be crossed? The answer is 'no'.

- Foregoing an employer's contribution is passing up on 'free money' – therefore notwithstanding the level of tax, whilst the tax remains lower than the accrual, it usually makes sense to continue to accrue contributions.
- What if you are a higher or additional rate taxpayer now, but expect to retire paying tax at a lower rate? It may still be beneficial to continue to accrue.

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- What if the Lifetime Allowance ceiling is raised more aggressively in the future? With restrictions on the tax efficient level of contributions that can be made annually, you may not have sufficient time to grow your fund without new contributions.
- What if the value of your investments fall markedly? As above, the shortfall may not have time to recover without pension accrual.
- Inheritance Tax might also be a driver. Even if a LAEC is applicable to the pension pot in the future, the fact that pension assets are usually outside of assessment to inheritance tax could result in a saving of 40% tax on the pension assets and can also provide greater freedom regarding transfer and tax efficiency of those assets in the future.

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