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RTM Financial Services

# R T M Financial Services

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*Your* independent *window on financial issues*

# Things could be worse ... and could get much better soon

***According to American investment guru, Warren Buffett, now may be the time to invest in equity markets; strange as it might seem.***

One of the wealthiest investors in the world, Warren Buffett has made his money—and, to be fair, lost some too—by not following the investment 'herd' but by being prepared to be different.

If this sounds counter-intuitive, it is worth considering (as we outline on page 2) that markets are currently undervalued in historic terms, so that there is scope for a significant recovery. What is not clear, is when this will take place, or how long it will last. Nor are there any guarantees—that is not how investment markets work.

What we can say is that every fall in market values to date has been followed by an upsurge in prices.

## No simple rule

If there was a simple recipe for investment success, everyone would be rich! In fact, any general comments always need to be viewed with a discerning eye, selecting only those indicators which appear to accord with the individual's attitudes towards risk and reward.

According to Buffett, the key to success is being prepared to be different from everyone else. Writing in the New York Times on 16th October 2008, he wrote: "Be fearful when others are greedy, and be greedy when others are fearful."

What he really means is that you should buy at the bottom of the market and sell at the top. By following other investors too closely, you can frequently end up doing the exact reverse. That is why it is so important to take professional independent financial advice before making any investment decision; and why we are here to help you.

It is worth also considering Buffett's other "money making secrets", which include being prepared to re-invest profits, being decisive (which he picturesquely describes as "never suck your thumb") and, perhaps most importantly, knowing when to quit.

## The economy

The measures announced in November's Pre-Budget Report (such as the reduction in VAT) and the cuts in base rate, have yet to make much impact on the economy and investment markets.

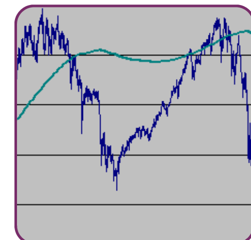
It is unlikely that much will happen quickly, because the cut in VAT is cosmetic and the impact of public spending plans will take time to filter through. Whatever one may think about the origins of the credit crunch and associated investment market downturns, we are now in a post-crisis world. That is not to say there will be no further reversals; such is impossible.

However, with concerted government action here and in most other parts of the world, we should be confident that recovery will come and that with it, those businesses that survive are likely to be leaner and more competitive. Ideally, it would be good to see a renaissance in British manufacturing, which has long been neglected in favour of the City of London.

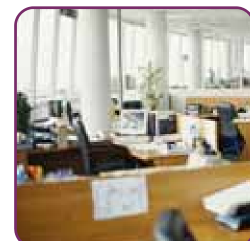
But whatever happens, by working together and taking a positive action, we can look forward to a better 2009 and beyond.

## THIS ISSUE

Things could be worse

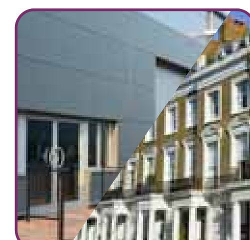


Undervalued markets



Protecting your income

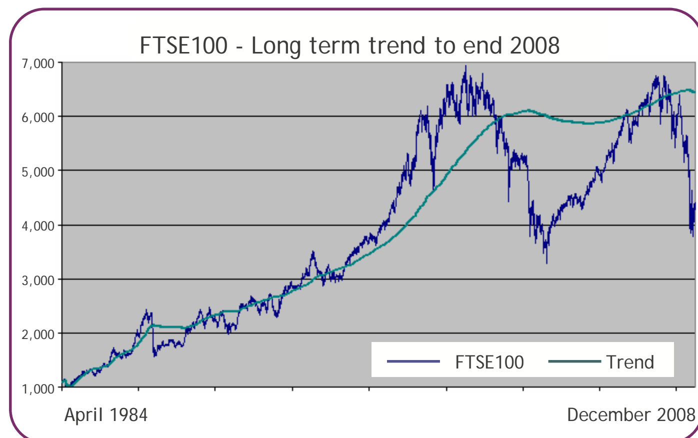
Pension statements



Property investments

# Undervalued markets

***Despite the best efforts of the press to scare us all with tales of doom and gloom, not all the news is bad if you take a long term view.***




The long term is, after all, what investments are all about. The FTSE100, which covers the largest companies in the UK, has been running in its current form for just under 25 years now. Starting in April 1984 at a base of 1,000, it ended December 2008 at 4,434, well down from its high point of 6,930 at the very end of 1999.

At that time many commentators were concerned that most world stockmarkets were overvalued and that a correction was inevitable. Which, of course, is what happened during the early years of this decade; with the FTSE100 falling to 3,287 in mid-March 2003. It then rose back again reaching 6,732 in mid-June 2007 before falling back to its current level.

## Why the history?

First we wanted to demonstrate that markets are volatile and should be viewed only over the longer term; they are influenced by external events such as the credit crunch, just as much as by the inherent stability of companies and their ability to continue paying dividends to investors.

The second reason, however, is that we wanted to draw attention to the long term trends inherent in the figures. By creating an 'average' of the FTSE100's daily closing prices over the entire period, we can add a 'trend' line showing the long term 'value' of the index.

What is really interesting is that the index is currently some 30% below its long term trend line. This could, of course, simply reflect that the market was, indeed, overvalued and therefore represents a correction that will remain in place for some time. But this would assume that markets act in isolation. In fact, they are influenced not just by economic factors but also by the pressure of money available for investment.

For the past year, money has become relatively scarce as people sell assets on a falling market and feel less well-off because of falling house prices. This has exacerbated the problem of falling share values as there have been fewer investors chasing an increasing number of available shares. However, this is creating pent-up demand amongst individual investors, who need to make provision for their retirement, and institutional investors, seeking a home for their funds.

## The future is bright

The result of this is that we can expect share values to bounce back at least in the direction of their long term trend, as soon as confidence starts to return to the market. It is possible that the election of Barack Obama as US President will be an engine of growth.

It is important to remember that the actual components of any index such as the FTSE100—the companies which are used to calculate its value—are not constant. Mergers, acquisitions, new entrants and the decline of some old companies combine to ensure that the index constantly reflects the fortunes of the largest companies in the UK by market value. This, to some extent, reflects the health of the economy but not entirely because market sentiment is also important.

Only one thing is sure; uncertainty will continue for some time.

As ever, you should take individual professional advice before making any decision relating to your personal finances. The value of investments is not guaranteed; you may get back less than you put in.

**Key points**

- **Investments should be seen over the long term**
- **Shares are currently well below long term trend**
- **Now could represent a buying opportunity**

# Protecting your income

***The first casualties of the credit crunch were those within the financial services community, where banks quickly started to lay off people in an effort to cut costs.***

Unfortunately, this trend is likely to expand into the 'real world' as businesses find they can no longer get adequate finance from the banks to sustain them through the downturn.

Increasing levels of redundancies are likely during the next few months and beyond and it is therefore important to be aware of the steps you can take to protect yourself.

First, companies proposing to make 20 or more people redundant must consult a union or staff representative 30 days before any notices are issued (extended to 90 days for firms making 100+ redundant). Employers should also consult each person to be made redundant in a 'dismissal meeting' which sets out the severance package.

One of the most difficult decisions any employer faces is how to select those who will be made redundant. The criteria must be fair and can reflect skills, adaptability, performance and attendance; it cannot be based on union membership or legitimate activities, maternity or other potentially discriminatory aspects.

Employers must also, where possible, offer alternative employment as well as time to make a transition without loss of rights; they must also allow reasonable time off for the employee to seek new employment.

State benefits can take the immediate financial pain out of the situation and include an age-based Statutory Redundancy Payment (SRP) which, subject to length of service, can provide up to £9,900 in

## News in brief

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**The FTSE100** finished the year with a bounce, recovering some of its losses throughout 2008 with a 3.41% recovery during December. Although it now stands some 31% lower than in January, the index is still almost 5% up over five years, before re-investment of income.

**Good news** for anyone with a mortgage who loses their job, or suffers a reduction in income. The eight largest UK lenders have so far signed up to a plan offering deferment of mortgage interest payments for two years for properties worth up to £400,000.

**Oil** prices have fallen back significantly during the latter part of the year, to end at US$45.59 per barrel for Brent crude 1-month futures, after breaching US$140 during the year. It is expected that electricity and gas prices (which are not directly linked to oil) will also fall now.

**Sterling** has had a rotten year, losing more than a quarter of its value against the dollar (ending the year at US$1.45) and almost as much against the euro (ending the year at €1.04). This will make exports cheaper, while increasing the cost of imports and foreign holidays.

tax free benefits. Employers can pay more than the SRP and anything up to £30,000 (other than contractual payments) is normally free of tax.

If any part of a redundancy package is likely to become liable to tax, employers could be asked to put it into a pension contribution; this would save employer and employee National Insurance costs and might appeal to the over 50s (over 55s from April 2010) who can immediately draw 25% as a tax free lump sum and then buy an annuity with the balance of the fund, or leave it within the pension fund.

Few people are likely to receive more than the minimum SRP so it is important to consider the adequacy of personal insurance. Many mortgage payment protection schemes include not just illness and accident, but also unemployment. These schemes normally, however, only cover interest payments, not capital, nor do they provide for general living expenses.

It is possible to arrange insurance to cover more general income replacement in the event of unemployment—although the market is contracting due to underwriters' fears of increasing numbers of claims during a recession. Such insurance is frequently hedged around with restrictions—many schemes will not cover the self-employed or those working for family businesses—and cover is normally only available for up to one or two years. On the other hand, few people believe that the recession will last for very long, so cover lasting 12 or 24 months should be adequate for most.

As ever, you should take individual professional advice before making any decision relating to your personal finances.

**Key points**

- **Unemployment is likely to grow in a downturn**
- **State benefits are minimal but can be topped up**
- **Pension contributions save tax and NI**

# Pension statements

***About now, many people receive a statement of benefits relating to their pension benefits.***

Members of defined benefit (final salary) schemes—most of whom are in taxpayer-funded government schemes—have nothing to worry about; for the rest of us, there is an 'opportunity'.

If your pension benefit statement shows that, despite you (and possibly your employer) having invested good money this year, your scheme is actually worth less than last year you are likely to be disappointed. But in fact, things are not necessarily as bad as you may think, unless you are just about to retire. Even then, you have some options that may make matters easier for you.

### Plenty of time to go?

If you have five or more years to go to your chosen retirement date, there is time for your pension fund to recover from the recent downturn in equity markets. Most markets are currently significantly below their long term trend values (see 'Undervalued markets' opposite) so there is every possibility that fund values will recover as the market goes up.

It is also worth considering that fixed contributions made during recent months will have purchased many more shares (or fund units) than a year ago. The effect of so-called 'pound cost averaging' is actually beneficial when equity values start to rise again, because you will have more shares for your investment, than if values had simply continued rising steadily during the intervening period.

### An extra opportunity

But low market values also offer a special opportunity for those in a position to make an investment now. Imagine, for a moment, that you earn £50,000 a year and have just inherited a similar amount. If you normally invest 10% of your income into your pension and your employer puts in 5%, you will be putting aside £7,500 a year. But new rules introduced in 2006 now mean that you can invest up to your entire earnings into a pension, plus anything your employer puts in, provided that together you do not exceed the annual allowance (which is £235,000 for 2008/9 and is set to rise in future years).

This means that you could now contribute a further £45,000 into your pension fund (less 20% tax relief, so you actually only have to put in £36,000 to get the same investment value). In addition, as a higher rate taxpayer you could get back more relief, up to an extra 20% of

the contribution, although you cannot get back more in relief than you would have paid in tax! With investment markets at long term lows, now could be just the time to take advantage.

### Retiring soon?

If you are close to retirement and have seen your fund value drop significantly, there is one thing you might like to consider. Rather than using your fund now to purchase an annuity—effectively locking in the losses for ever—you might like to consider taking your 25% tax free cash now and using an "unsecured pension" (what was called drawdown) to leave the balance of your fund invested in equities, in the hope that values will recover and you can buy an annuity later.

Of course there are costs associated with this approach and, as ever, you should take individual professional advice before making any decision relating to your personal finances. The value of investments can go down as well as up; you may get back less than you put in.

**Key points**

- **Many people have time for markets to recover**
- **Now could be a time to top-up contributions**
- **Taking an income can often be deferred**

# Property as an investment

***With house prices having plummeted recently—and commercial property being no better—what are the options for property investment?***

As with equity markets, low prices could well be creating buying opportunities for those who are able to arrange suitable finance. Within the housing market there could be opportunities for those wishing to move into the buy-to-let market, but mortgages are difficult to come by at the moment and professional advice is essential. However, that said, it is possible that as more and more people find it difficult to meet their mortgages, increasing numbers of properties could come on the market, further depressing prices, but also increasing the potential rental market.

With commercial property, which is particularly attractive for self invested pensions, the issues are slightly different, in that lower prices could make it increasingly attractive for firms to consider purchasing their business premises. Although some finance may be required to achieve this, it is also generally possible to use existing pension funds to provide much of the purchase price. Even if such funds are not currently held within a self invested personal pension or small self administered scheme, but rather within an insurance company plan, it should be possible to arrange a transfer of funds to facilitate the purchase.

It is important, however, to consider the impact of any penalties that might apply.

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## Back page briefing:

# Avoiding fraud (again)

***In the last issue we addressed 'boiler room' fraud, a sophisticated scam that aims to relieve investors of substantial sums of money.***

With an economic downturn looming and inflation running at relatively high levels, we can expect an increase in the level of criminal activity, as criminals seek new ways of generating an income. Some threats to personal finances do not even need you to be taken in by a trick; instead they rely on the side effects of 'normal behaviour'.

### Identity theft

One of the greatest threats we face today is identity fraud, which most commonly results from the theft of old credit card, utility and other statements. These can be used to establish identity so that criminals can set up bank and credit card accounts in your name—and run up large debts, ostensibly as you, which can damage your credit rating. You may have difficulty in proving that the debts are not, in reality, yours. Destroying old documents that identify you is essential.

### Phishing

Phishing is where an e-mail ostensibly from your own bank or someone respected like Google or e-bay asks you to 're-register' your details as they have had a computer failure. Entering your details on the fake website gives the criminals access to your account on the real one; so they can empty your account or incur liabilities for their purchases.

### Computer fraud

A more recent area that needs looking at is that if you use a wireless broadband connection, you must use password protection. If you do not, anyone can link in to your home network and not only 'steal' the internet access you are paying for, but also look at your files, banking details and other information, in order to defraud you.

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The value of land and buildings is generally a matter of a valuer's opinion rather than fact. The value of investments can go down as well as up and you may not get back the full amount you invested. The past is not a guide to future performance and past performance may not necessarily be repeated. If you withdraw from an investment in the early years, you may not get the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency.

Your home may be repossessed if you do not keep up repayments on your mortgage. Loans are subject to status and written details are available on request. Always seek independent advice from a qualified financial adviser. Think carefully before securing other debts against your home. Fees for mortgage advice maybe charged and for details of these please contact us. The Financial Services Authority does not regulate all the activities undertaken by the company, including taxation advice and overseas mortgages.