

# INVESTMENT BRIEF

YOUR LATEST UPDATE FROM SAVOY INVESTMENT MANAGEMENT SUMMER 2009



## Market Commentary

Looking at the gains in equity, commodity and corporate bond markets since March one might have been forgiven for thinking that it was all over and we were entering a new bull market as a few commentators have suggested. In fact there is still considerable uncertainty and risk surrounding the recovery. What we can say for certain is that the extreme fall in confidence, consumption and economic output that followed the demise of Lehman Brothers last September and characterised the credit crunch has passed and that confidence is returning. The medicine is working.

By June UK equities had returned to their level at the start of the year though many oversold stocks had performed far better. Many banks, property and other companies have now raised new capital to reduce their debt or to provide a war chest for acquisitions but a considerable

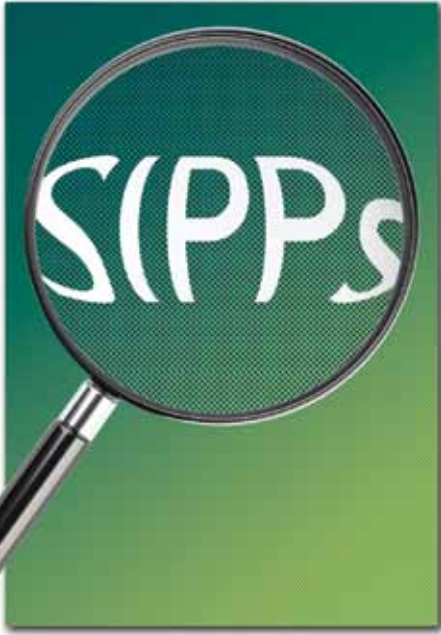
number still need to do so. A semblance of normality is returning to equity markets with what fell hardest last year tending to rally hardest. Commodity prices have recovered from their lows as expectations of recovery increased and as China bought reserves as an alternative to investing in US dollars. Underlying all of this is a series of rescue packages for banks, the motor industry and the consumer including the experiment with Quantitative Easing in the US and UK, sometimes referred to as "printing money".

So, an even greater disaster has been averted and equity prices have rallied and seem set to go higher. But these artificial stimuli cannot be maintained for ever and will soon need to be replaced by genuine economic activity and demand. There is already intense debate about what the recovery will look like and

some starkly contrasting views. Many believe that this year's weakness marks both the economic and market low while others argue that the credit bubble drove a decade of excessive consumer consumption and that after a sharp V-shaped recovery economic growth will slow to reflect the higher taxes, tighter credit conditions and rising unemployment facing the ageing populations of the US, UK and Europe.

There is of course no simple answer to this conundrum and that alone will keep many investors on the sidelines. Our expectation is that as economies recover from the apocalyptic lows of last year equity markets should rise but as we move forward investors will begin to discriminate in favour of well financed strong companies and the weak will fall by the wayside.

# SIPPs



## Tax increases on the way

Pension plans are one of the most efficient ways for those working to save for retirement but times are changing. When the pension rules were simplified in April 2006 nobody foresaw the credit crisis and subsequent deterioration of the government's finances. Just three years on and the pensions landscape is already shifting with tax relief on pension contributions for earnings over £150,000 tapering down from 40% to 20% from 5 April 2011 and a new 50% tax rate for all income above that from 5 April 2010.

Although most of us earn less than that we all know that higher taxes are on the way. That £150,000 threshold is likely to fall, dragging more of us into the net.

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## The rising age of retirement

If you are about to celebrate your fiftieth birthday or have done so in the last few years then you should be aware that from 5 April 2010 the minimum age from which you can draw pension benefits will rise from 50 to 55 years old. Unless you take benefits before then you will have to wait until you are 55 years old which in some cases will be five years.

Fifty may sound rather early to retire but one of the attractions of modern day pensions is that you can start to take benefits without retiring. For example you can take up to 25% of your fund as a lump sum with no tax payable on it to use as you wish – though you cannot recycle it into your own pension pot. And if you do not want to draw an income yet it can be set at zero, leaving the remaining fund to grow.

Tax treatment depends on individual circumstances and may be subject to change in the future.

# Inflation and the Fixed Interest Market

In March the government launched its quantitative easing (QE) program and also announced its funding plans in the Gilt market for fiscal 2009-10. Both actions raised the question of the extent to which this expansion of the money supply would lead to higher inflation in the long term.

The Gilt Market seems to think it will and demand for Index Linked Gilts has been strong since these announcements, with new issues snapped up quickly. In contrast yields on conventional Gilts have risen sharply, unwinding the gains made at the euphoric start of the QE program when 10 year Gilt yields plunged to a low of 2.9%. Investors are looking for higher yields to compensate them for the risk of inflation creeping higher as a result of increased net government debt issuance. Going forward, conventional Gilts may continue to underperform while Index Linked Gilts, discounting relatively modest RPI inflation of about 2.25% should outperform.

While the Bank of England aggressively expands the broad money supply some other parts of the QE plan are not working as well. The plan to drive 10-year gilt yields down to 2.5% and lower the borrowing costs for corporates has not worked and by focusing its purchases on high quality corporate issues they have created a two-tier market in corporate bonds with high-grade bonds (single A and above) significantly outperforming lower grade credits such as BBB. The strong get stronger.



Our expectation is that the old RPI measure of UK inflation, which includes sharply lower mortgage costs will be negative during the summer and then start to rise. Similarly the newer CPI or core measure will rise later this year. Both will be driven higher by the rising cost of imports that sterling's weakness has caused, by higher oil and commodity prices and by comparison with the period of severe price weakness that accompanied the credit crunch.

In the short term the threat of sustained deflation in the UK has been averted by the lower currency and deliberate expansion of the money supply. Inflation is back, albeit modest for now. As the economy recovers from last years plunge in activity so QE and other emergency measures will be withdrawn. Having spent almost two decades directing policy at lowering inflation recent events made it clear that a new policy is in place. Modestly higher and sustained inflation is actually the objective.

# Memory jogger – personal taxation on the rise



It does not take a genius to work out that it is the wealthy who will pay the price for a decade of financial mismanagement. In our view April's Budget is just the thin edge of the wedge. The last year has seen substantial change in our circumstances and the rules will continue to change. Has there ever been a more urgent need to review your wealth planning?

### Individual Savings Accounts (ISAs)

Just about the only positive in the Budget was an increase in the annual allowance from £7,200 to £10,200 for Stocks and Shares ISAs and from £3,600 to £5,100 for Cash ISAs. Though even this was complicated by letting the over fifties subscribe the new amount from October but making the rest wait until the new tax year.

### Investments

Tax on investment income greatly reduces returns. There may be a more tax-efficient way to hold your investments.

### Pensions

Saving into a pension scheme remains one of the most effective ways to benefit from the UK's tax regime but the rules are changing. With exceptionally generous unfunded pension schemes themselves government may find it difficult to make aggressive changes to benefits – but have already started chipping away at the tax break on contributions.

### Estate Planning

When did you last review your IHT planning?

### Capital Gains

At 18% the rate of tax is markedly lower than income tax at 40% or for "high earners" and Trusts, 50%.

### Mortgages

Higher inflation expectations are pushing Gilt yields and mortgages rates higher. Are you on the best deal?

### Life Assurance

A regular review is essential to ensure your current needs are met

Tax treatment depends on individual circumstances and may be subject to change in the future. Please contact your usual adviser.



## Letter from America

How quickly moods change. The doom and gloom that followed us into 2009 and pushed markets lower finally started to abate as the combined weight of rescue packages and the passage of time worked their magic.

For newly elected President Obama recovery could not have come at a better time, providing his administration with credit for solutions largely initiated by the previous one. It has also allowed him to stick to more of his election promises, not all of which are business friendly. The refinancing of General Motors, makers of Saab, Vauxhall, Opel, Chevrolet, Hummer and other brands will see the company become over 70% government owned. And many of the banks that borrowed money under the TARP scheme are keen to repay it rather than suffer continued government involvement.

Positive overtures to Iran, the Arab nations and Russia are a substantial positive, though to be fair it would be difficult not to improve on President Bush's foreign policy record. And positive moves in other areas, for example on the environment, have been welcomed.

Yet most of the hard work remains to be done. The collapse of the financial system and its knock on effect into the real economy may have been averted but what next? As the stimulus packages put in place over the last year expire the US will discover quite how much damage has really been done. President Obama's work has only just begun.

# Newsbrief

## Savoy expands into Lincolnshire

Savoy has opened a new office in Lincoln to be managed by Bill Fowler.

Bill is an experienced investment manager and stockbroker with 25 years investment industry experience and joins from Brewin Dolphin where he spent ten years. His background includes working for Local Authority pension funds, for Exeter Fund Managers where he ran Zero Dividend Preference and Balanced funds and for Greig Middleton as a private client investment manager. He is recognised as an industry expert in zero dividend preference shares (zeros), other split trusts and structured products. Bill has managed numerous portfolios on behalf of colleagues, where a requirement for zeros and similar instruments has been specified by clients and is interested in continuing this activity at Savoy.

Bill lives close to Lincoln, has one son and his interests include music, surfing (body boarding), swimming and dancing.

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*The imposing figure of (and star of 'The Davinci Code' film) Lincoln Cathedral, close to Savoy's new Lincolnshire office in Waddington. Well worth a visit if you are coming to see us.*



## London office expands

Savoy has expanded its London office with the addition of two investment managers.

### Michael Clark

Michael entered The City in 1995 after attaining a BA (Hons) in Business Economics at Leicester University. In 1999 he was part of a small private client broking firm that joined Insinger de Beaufort where he advised high net worth clients and institutions on UK and US equities, taking a particular interest in mining, oil and gas stocks. Michael has also been an active participant in the Contracts for Difference (CFD) market since its early days in 2004. Michael is an enthusiastic fencer and motor sports enthusiast.

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### Dennis Cooper

Dennis, joins from one of the largest mid-net worth investment teams at Fleming Private Asset Management where he became an Investment Manager in 1997. Following its takeover in 2000, he joined Smith & Williamson in 2001 with a team from Flemings, subsequently becoming an Associate Director at IAF Securities Limited. Dennis joined Savoy in order to continue his bespoke investment approach to equity and bond markets, principally for private clients. He is a Fellow of the Securities and Investment Institute.

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