S&S Tait Financial Services

PENSION & INVESTMENT NEWSLETTER

S&S TAIT FINANCIAL SERVICES

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GMT Mortgage Bureau and Financial Consultancy, 8 High Street, Coleford, Gloucestershire, GL16 8HF
stuart.tait@theopenworkpartnership.com | www.sstait.co.uk | 01594 835999

Pension lifetime allowance – how it affects you

In his 2021 Budget, the Chancellor announced a five-year freeze on the lifetime pension allowance. What does this mean for you and your retirement fund?

What is the lifetime pension allowance?

The lifetime pension allowance sets a limit on how much you can save in your pension before you start paying tax on anything over the limit. For a few years before the 2021 announcement, the limit had been tied to inflation, meaning that it rose in line with the cost of living.

With the global pandemic and surge in inflation over the past couple of years, the decision was made to freeze the limit – at £1.073 million – until 2026. It's hoped that the freeze will generate additional revenue as savers slow down or stop contributing to their pensions and don't claim tax relief from the government.

How are my pensions affected by the lifetime allowance?

The lifetime allowance applies to all types of non-state pensions in your name – so that includes any defined benefit (final salary or career average) schemes you have along with any defined contribution pensions.

The limit of £1.073 million might seem like a huge amount. But if you're a medium-to-high earner, have saved into pensions from an early age and are approaching retirement, you could one of the millions who are affected (and caught unawares) by reaching the threshold.

As pensions are so complicated, seeking advice is important and we can help clarify the status of your pensions, discuss your retirement plans and how to proceed.

What happens if you exceed the lifetime allowance?

Many of us have more than one pension, usually accumulated through different jobs over the years. Keeping track of them and how much they contain can be tricky and time consuming, as you'll need to look at their expected value when the time comes. Your adviser is best placed to gather this information and help with your next steps.

If your total exceeds the lifetime allowance, the excess amount will be taxed as follows:

- 55% if you receive the amount as a lump sum from your provider
- 25% if your payments are gradual or are cash withdrawals

These are large penalties on your savings, so it's worth acting now to find a way to protect your hard-earned pension.

Your adviser is ready to help you navigate the complex area of pension and ensure you move forward in the strongest position for you and your loved ones.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested.

Seek help to protect your pension

Protecting your pension and making sure you're able to live comfortably in retirement and keep up with the cost of living is something we can help with. So, if it looks like your pensions could be affected by reaching and exceeding the lifetime allowance, there are some options you can discuss with your financial adviser:

Divert savings into an ISA
You can earn tax-free and make withdrawals in most cases. Our advisers can help you calculate how much you will need to live comfortably in retirement and help plan your investment strategy to achieve that goal.

Combine pensions with your spouse
Consolidating your pensions can be an effective way to grow your retirement savings in one place. It can also save time on the administration involved, cut down on fees and create a more streamlined investment strategy.

Claim pension credit
Many pensioners are eligible for pension credit but fail to make a claim. It's available if you are over the state pension age and on a low income, are a carer, severely disabled or responsible for a child. It could boost your retirement income up to £182.60 a week if you're single, or £278.70 for couples. It's separate to the state pension, and we can help calculate whether you and your partner are eligible.

Pension allowance protection
Your adviser will be able to assess whether your pension could benefit from protections that help avoid the tax charge by offering a higher lifetime allowance. But there are several conditions and criteria you'll need to meet. Our experts can advise whether it would be applicable to your situation.

OW4198 Exp. 27/09/2023

Investing or saving?

Investing can beat inflation

Investing is a better option if you've got longer-term goals because inflation can erode the value of cash savings over the medium to short term, and your money may not have the same spending power as when you first put it away.

For example
If you have £2,000 in savings and the bank offers a 1% interest rate, each year you will get back £20. However, if the inflation rate is 6% the cash in your savings account will fall in value. After one year your cash would be worth £1,887. After five years it would be worth only £1,495.[1]

Saving money is a great way to prepare for unexpected expenses and investing your money can have the potential for higher growth than saving.

A lot of people put their money in a savings account and leave it there to accumulate interest. While this is a good strategy in the short term, you potentially risk losing out on higher returns in the long run, while also struggling to keep up with inflation. However, investing is a good approach if you have long-term financial goals and want to earn more money than you could by saving it.

What's the difference between saving and investing?

With saving you are setting aside cash for future use, while investing means using cash to buy assets that you expect to produce a profit or income. The biggest difference between saving and investing is the level of risk. With saving you will always get back at the very least what you have put in, as well as any interest on your deposits. You won't lose any money, making it a less risky option.

Investing your money means it will rise and fall over time and there is a chance you could lose some of your initial investment. Your financial adviser will be able to help you make sure you're aware of the risks and the minimum time you should consider investing for. A longer timeframe (at least five years) will give your investment more time to recover if there are any sudden market swings.

Speak to your financial adviser to find out about a range of investment opportunities to help you meet your financial goals.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested.

Types of investments

The main types of asset classes that investors could choose from – which your adviser can go into detail with you – are equities, bonds, and property. Different asset classes have different levels of risk and return. Usually, the safer an asset is the lower the returns will be, while the riskier an asset is, the higher the returns.

Property this could be investing in commercial property through investment funds, including retail, office, and industrial property. It makes a good long-term investment and is effective at beating inflation. Property can add diversification to your portfolio as it tends to perform differently to other assets in response to different market conditions. However, property does come with its risks, including a risk of a fall in value as well as the maintenance costs.

Bonds sometimes called fixed-term investments, bonds are issued by governments and companies looking to raise money. A bond is essentially a loan made to a company or a government by an investor for a set period – usually several years. In return they pay you a regular income in the form of interest over the life of the bond, after which they must repay your loan. Bonds typically offer stable returns and are a lower risk than equities, although they tend to offer lower returns in the long term.

Equities also known as stocks and shares, equities are issued by a public limited company and can be bought and sold on stock exchanges. When you buy an equity, you are basically buying a piece of that company and become a shareholder. Equities can make you money through increases in share price or you can receive income in the form of dividend payments. The disadvantage is that returns are not guaranteed, and the share price could fall below the level that you invested.

Investment strategies as you approach retirement

It's usually a good idea to start reducing the risk of your pension fund as you approach retirement. But it's important to strike the right balance so you can continue to power the growth of your portfolio for many years to come as well as draw an income.

As we move through the different stages of life it's important that our investment strategies adapt. Typically, your financial goals change when you retire. You may want a regular reliable income, which usually means you have to take less risk when it comes to investing. People nearing retirement traditionally switch savings out of risky investments and into safer assets to protect their portfolios from market downturns.

Reduce risk in your portfolio as you near retirement

Managing your portfolio's risk level (the possibility of losing the money you invest) as you get older is important to ensure you meet your financial goals. Younger investors with longer timelines to retirement (typically 30 to 40 years) are generally encouraged to take more risk in their portfolios as if there are any market falls, they have longer to recover.

As you get older and approach retirement the more important it is to preserve the wealth you have accumulated. This is because as the timeline to retiring gets shorter, your portfolio has less time to recover in the event of a market decline.

So, it's a good idea to lower the level of risk to reduce the possibility of your investments falling in value. In most cases, this means reducing exposure to equities and increasing exposure to lower-risk investments that produce an income such as bonds to shield your investments from the ups and downs of the market.

Why it's important to diversify

Portfolio diversification is a way of reducing potential risks by spreading your investments across different assets, rather than having it concentrated in one place. By investing across different asset classes, companies, countries, and sectors, you can help reduce the impact of any major market swings on your portfolio.

While you can't eliminate all investment risk, diversification can help smooth out any fluctuations that happen over time. For instance, stocks can earn more money than other asset classes, but they tend to be more volatile. Therefore, most financial professionals agree that as you approach retirement it is best to reduce the allocation to equities in your portfolio.

Government bonds are less likely to lose money than stocks and are seen as a better bet for retirement thanks to their predictability and income-generating potential. Bond prices are also not affected by the same market conditions that move stock prices. By shifting their investments out of stocks and into bonds, people nearing retirement can lower their risk and enjoy greater financial stability.

Finding the right balance

It's always important to review your investments before any big life changes, which is particularly true if you are approaching retirement. With any decision about your investments, there are trade-offs. The greater the risk you are prepared to tolerate, the more potential there is for your investments to grow.

While reducing risk with bonds can help shield you from any downturns in the market, your returns could be lower. As you approach retirement, it's important to strike the right balance between assets reducing risk in your portfolio so you can continue to power its growth for many years to come as well as draw an income.

A financial adviser can help you build a well-diversified portfolio appropriate for your risk tolerance and investment goals and adapt it, so the strategy always reflects your age and circumstances.

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OW4156 Exp. 14/09/2023

The effect of psychology on investors

You should base financial decisions on logic and facts. But psychology can have a much larger effect than you think, and it can lead to you making decisions that aren't right for you. Read on to find out more about what behavioural finance is and how it could affect you.

"Behavioural finance" was first coined in the 1970s by economist Robert Shiller and psychologists Daniel Kahneman and Amos Tversky. They used the term to refer to how unconscious biases and previous experiences affect the way people make financial decisions.

It can be used to explain why investors can make knee-jerk decisions or invest in opportunities that aren't in their own best interest. Rather than relying purely on facts, investors often have biases that affect how they react to certain situations.

Finance bias can lead to "irrational" decisions through shortcuts

There's a reason why people often make decisions based on biases: they can make the decision-making process quicker.

If you imagine how many decisions you need to make every single day, it's easy to see why this kind of decision-making can be useful. From what to eat for breakfast to which way to travel to work, it'd take up all your time if you carefully went through the facts for each decision you make. So, you make shortcuts by using biases.

However, while it can be a useful process in your day-to-day life, bias can have a negative effect when you're making important decisions, including financial ones.

Behavioural finance covers five concepts:

1. Mental accounting
Mental accounting can be incredibly useful when you're managing a budget. However, inflexibility could mean you miss out on opportunities.

The concept refers to how people may designate money for certain purposes. So, you may have different savings accounts for various goals. It's a process that can help you manage your outgoings and work towards goals.

However, it can also lead to irrational decision making.

You may not dip into a savings account that you've allocated to buying a new car even when you face an emergency and it'd make sense logically.

How you receive the money may also affect how you use it. For instance, you may put off using money that was given as a gift in an emergency because you believe it should be used for something special.

2. Herd behaviour
Herd behaviour is something that's often seen in investing. When you hear that lots of people are selling certain stocks or buying a specific share, it can be easy to be led by this and follow suit.

It can lead to you making decisions that, while possibly right for others, don't suit you or your circumstances. It's not just investing where herd behaviour can have an effect. You may be tempted to purchase an item after a friend has or choose a savings account because someone you know has.

3. Anchoring
When you have some information, you may focus on this – anchoring your views to this data.

Setting a benchmark can be useful, but it can mean you don't take in other information, especially if it's contradictory.

So, you may hold on to investments even after the value has fallen because you've anchored its worth to a previous valuation.

4. Emotional gap
Emotions often play a role in financial decisions. You may sell a stock because you fear that the price will fall, or make an impulse purchase because you're happy.

Being comfortable with your financial plan is important, but an emotional gap can fuel irrational decisions as you're more likely to overlook data.

5. Self-attribution
This concept refers to how investors are likely to have overconfidence in their abilities.

You may believe you can reliably time the market to maximise profits when the markets are unpredictable. In this case, it's common to see "wins" as being down to your knowledge, while "losses" are attributed to things outside of your control.

Unconscious bias may affect your decisions in ways you don't expect. If you have any questions about your finances and the decisions you need to make, please contact us.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

OW4262 EXP 6.12.23

3 important reasons for staying invested through market downturns

It's been a difficult year for investors so far. Inflation and political uncertainty have led to market volatility.

Market volatility can be scary, especially if the value of your investments drops, but it's important not to let fear guide your decision about whether to stay invested in your portfolio. Here are three reassuring reasons for staying invested in the stock market during uncertain times.

1. The best financial decisions are not based on emotion

Emotions can play a big role in your financial decision-making if you aren't vigilant. The thrill of seeing your investments increase in value can quickly be replaced with panic and fear when the value decreases during market slumps.

When you understand the cycle of emotions related to investing, you can reframe downturns as opportunities to maximise your returns in the long term. This is because when the value of investments falls, it becomes cheaper to buy more shares or fund units – providing greater opportunities to grow your wealth when conditions improve.

As Warren Buffett, one of the world's most successful investors, famously said: you should aim to be "fearful when others are greedy, and greedy only when others are fearful".

By looking at the situation objectively, without the influence of emotions, you will be able to make sensible financial decisions based on your understanding of how the markets tend to ebb and flow.

2. Bull markets tend to outlast bear markets

When markets are trending upwards and investments are generally growing in value, this is called a "bull market". This is when you will often see your investments increasing in value.

By contrast, a "bear market" describes periods when the market has dropped 20% or more from its peak. Despite rallying in October, the S&P 500 is currently down 22% since the start of the year, with many of the top-performing US stocks noting significant drops since the start of the year.

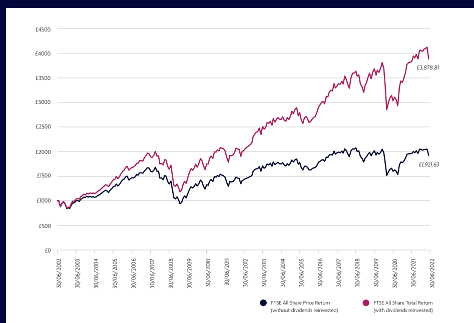
As seen in the chart below, bull markets have not only been more frequent over the past 60 years, but they have also tended to last far longer than the average bear market.

So, despite the rocky start to 2022 for investors, it makes financial sense to be optimistic about the prospect of markets recovering sooner rather than later. As the markets recover, you could see significant increases in the value of your investments.

3. Staying invested could produce better long-term gains than moving to cash

Attempting to time the market by moving your investments into cash during market downturns could lead to significantly lower long-term returns than if you had stayed invested throughout.

The chart below shows how returns on £1,000 invested can be affected by attempting to use this strategy.



The end results show that the initial investment would have created a final value of £1,993.32 if it had remained invested throughout downturns; if the same amount had been invested initially, but removed from investments during downturns, the final value would have only been £1,042.43.

The difference in returns is partly because the best days in the markets tend to occur immediately after a downturn. By attempting to time the market, you will often miss out on the significant returns generated on these important days. Compounding is the process of generating returns on the total value of your portfolio, including both your initial investment and any returns generated since then, so the impact of missing the best days in the market will be reflected in your portfolio's value for many years.

Get in touch

If you're concerned about whether the current market volatility will affect your long-term financial plans, seeking expert advice can help to reassure you and keep you on the right track.

We can help you to decide on the most appropriate next steps based on your circumstances and future goals. Please get in touch to arrange a time to chat.

Please note: *The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested. Past Performance is not a guide to future performance and should not be relied upon.*

OW4359 Exp. 28/03/2024

Is drawdown right for you?

2 important questions to consider

If you have a defined contribution pension, you can access your retirement savings in a variety of ways. One of those options is drawdown – a flexible approach for dipping into your savings when you need to. Read on to learn more about it.

What is drawdown?

Drawdown is the process of withdrawing a lump sum or a regular income directly from your pension fund, leaving the rest invested in your portfolio. There are some important tax implications to consider with drawdown.

You can access up to 25% of your total pension fund tax-free.

If you wish to withdraw more of your fund, you will pay Income Tax on anything above the 25% threshold. This means that taking large sums of money from your pension could push you into a higher tax bracket.

Pensions will usually fall outside of your estate for Inheritance Tax (IHT), provided they have not been moved out of your pension or drawdown fund. If you die after the age of 75, any income your beneficiaries receive from your pension may be taxed at their usual rate.

An annuity might be more appropriate for you

If drawdown isn't right for you, buying an annuity might be a suitable alternative. An annuity is a guaranteed annual income for life that you can buy using a lump sum from your pension. Some annuities pay a fixed amount while others rise with inflation.

Annuity rates rose by 44% between October 2021 and October 2022, making them an attractive proposition for those looking for financial security in retirement.

1. How much income are you likely to need throughout your retirement?

Your specific circumstances will influence how much income you need through retirement and the method you use to access your pension savings.

Cashflow modelling can help you to see if your savings are sufficient to support you throughout your life. Your financial planner can input data such as your current assets and savings, key event dates such as your expected retirement date, and any financial commitments you have now or in the future.

To forecast your future income, the software makes assumptions about the expected returns on investments, and how inflation might change things.

By regularly reviewing your cashflow model, you will understand how much income you are likely to need. We can help you to decide the best options for accessing your pension.

If your income needs are likely to vary throughout your retirement, drawdown might be an appropriate choice.

It's also important to be realistic about any later-life care costs you might require, so that you can plan effectively.

2. How long will your pension need to last?

For people living in the UK today:

— A man aged 55 has an average life expectancy of 84 years, and a 1 in 10 chance of living to age 97.

— A woman aged 55 has an average life expectancy of 87, with a 1 in 10 chance of living to age 99.

So, if you decided to access your pension at age 55, it may need to last you for more than 40 years.

One theory for ensuring your pension fund lasts long enough using drawdown is "the 4% rule". As a rule of thumb, you take 4% of your total pension fund in year one – the gross figure should include the cost of fees and taxes – then take the same amount of money each year thereafter, adjusting for inflation[7].

Since 4% may not be appropriate for your personal circumstances[8], it's important to consult your planner on the withdrawal rate that is right for you.

When you take a lump sum through drawdown, the remainder of your pension will need to be invested, so a further consideration is the fund that you will invest in. The value of this investment could go down as well as up, so you may also wish to set aside some money in cash or buy an annuity to provide a safety buffer in the event of market volatility. Life events might change the level of risk you wish to take with your investments, so you should review your portfolio with us on an annual basis.

Get in touch

If you'd like to learn more about whether drawdown is right for you, we can help. Please get in touch to arrange a time to chat.

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OW4327 Exp. 16/03/2024

The financial assets quilt

Why diversification is key when inflation rises

To stay ahead of rising costs and maintain your assets' purchasing power, your portfolio needs to provide positive returns. Diversification can help you achieve this.

What is diversification?

Diversification is investment jargon for the well-known proverb: "don't put all of your eggs in one basket".

While a well-diversified portfolio doesn't give you guaranteed downside protection, it can help you maximise long-term growth potential. Since the values of different types of assets don't always behave the same way or move in the same direction, holding a range of different investments can help reduce your risk.

Balance between risk and reward

The balance between risk and reward should be front of mind – diversification is key to this.

The chart below breaks down historical performance and volatility of different asset classes – cash, equities, real estate and so on – over time. The balanced portfolio – represented by the white boxes – highlights how diversification can help reduce risk in the portfolio and enhance returns.

Protect your downside

When global events provoke market volatility, a well-diversified portfolio can help protect your downside.

As illustrated below, when Russia's invasion of Ukraine caused volatility, some markets were more severely affected than others.

Had you invested the majority of your money in Europe, you would have suffered far greater potential losses than if your portfolio had been invested across all regions.

4 main asset classes for a well-diversified portfolio

Spreading your wealth over different asset classes should achieve a strong, well-balanced portfolio.

1. Cash
Secure and easily accessible, cash is generally considered to be the safest asset. However, it tends to provide lower long-term returns than other asset classes and its value can be eroded by inflation.

2. Bonds
Bonds are a loan you make to a company or organisation from which you receive interest payments. While usually considered medium risk, this depends on who is issuing them.

3. Equities (or shares)
Equities are an ownership stake in an individual company listed on a stock market index – the FTSE 100 in the UK or the S&P 500 in the US, for example. Many investors hold equity assets in funds, such as pensions, ISAs, or unit trusts, which are often pooled or collective investments. Investing in individual companies tends to carry more risk, so a collective approach can be extremely beneficial, especially since funds are looked after by professional managers. Because your money is pooled with other investors, you can often access a range of investments that might otherwise be unavailable.

While history shouldn't be considered a guide to the future, over the longer term equities tend to outperform other types of investment.

Shares can be volatile. Their value can go up as well as down and you may not get back the full amount invested.

Alternative investments
Property is one alternative investment. Its returns tend not to closely correlate with those of shares or bonds, which may be useful if you want to introduce another source of potential capital growth and income into your portfolio.

While property tends to be less volatile than equity or bonds, its value can fall as well as rise and is also less liquid; it can take longer to invest into and sell when you want to access your money.

Other alternative investments include:

— Infrastructure funds (large, high cost projects, often connected to public development of core systems such as transportation or electrical supply)

— Natural resources (companies that are involved in the extraction of oil, gas, coal, metals, etc.).

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Diversification is more than just the type of asset held

You can also diversify across:

— Geographical regions – the US, UK, Europe, or Asia

— Sectors – finance, energy, or transport

— Themes – technology, healthcare, or renewable energy

— Size – smaller companies (small cap) or larger companies (large cap).

3 reasons diversification is key

A well-diversified portfolio can help you:

1. Minimise risk and increase potential returns
Diversification spreads risk and helps to limit the impact of market volatility on your investments. When one sector, asset class, or geographical area falls, a rise in another area could help to offset the loss.

2. Provide greater opportunity for returns and eliminate investment biases
Diversification can help prevent you from falling foul of investment biases. You may be overly confident about the performance of sectors you know, or geographical regions that you're familiar with. These unconscious biases could see you miss out on potential growth, whereas a diversified portfolio won't be constrained.

3. Help you to consolidate gains
As your investment goal approaches, you might want to consolidate your gains. Diversification allows you to do this by rebalancing, increasing the number of lower-risk assets you hold.

This should help to avoid the value of your investments suddenly falling in value when you need to withdraw funds.

Get in touch

If you want to ensure that your portfolio is well-diversified and balanced according to your financial goals, we can help. Please get in touch to arrange a time to chat.

OW4328 Exp. 28/03/2024