moneyworks

The essential consumer guide to making your money work harder.

Summer Edition

How actively are your funds being managed?

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Stick or twist?

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Don't forget about your ISA allowance.

The 2018/19 ISA allowance is £20,000, and it remains a valuable benefit despite what some experts believe.

Ignore it at your peril.

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Heaton Financial
Independent Financial Advisers Ltd

Welcome

Welcome to the Spring issue of **moneyworks** and as we all look forward to a change in the weather, it is worth reflecting on the current financial changes on the horizon for you and your savings.

In this issue, we look at what impact a potential rise in interest rates will have on mortgages and how despite record lows in recent years, the tide could be about to turn for cheaper borrowing.

We ask whether now is the time to consider your options to help ensure you get the best deal and why a review might be pertinent to keep your mortgage repayments to a minimum.

We also address the issue of fund management and how the FCA have clamped down on active funds, that are merely just trackers. We take a look at the differences between active and passive funds and the importance of regularly keeping an eye on the funds you hold.

Elsewhere, we report on why the humble ISA is still an attractive option despite some commentators arguing they are no longer as fruitful as they once were. With the 2018/19 allowance standing at £20,000, we ask whether they are still a valuable benefit?

Finally, we look at the true value of receiving financial advice and why when it comes to your retirement, you should be taking every possible step to ensure your money is working as hard as it should be now.

We hope you find the contents of this issue helpful and informative and we look forward to bringing you more financial news and views over the coming months.

Best wishes

The **moneyworks** team

Contents

The News in Brief

A round-up of the current financial stories.

Mortgage payments most affordable in over 20 years

A mortgage is often considered to be our biggest monthly outgoing, but March 2018 research from Halifax has found the burden has fallen to its lowest level since 1996.

For the final three months of 2017, typical mortgage payments accounted for less than a third (29%) of householders' disposable income. This is a significant reduction on a decade earlier, when in 2007 a mortgage took up 47% of disposable incomes.

There are notable regional variations in how much mortgage payments take up of overall householder income; with the London borough of Brent accounting for 61.1% of income, compared to Copeland in Cumbria, where the figure is less than 15%.

Source:

https://www.theguardian.com/money/2018/mar/17/mortgage-payments-most-affordable-home-loans-halifax

Two out of five homeowners find the mortgage experience worrying

It's often said that moving house is one of the most stressful experiences in life, and for many of us that also extends to the mortgage process.

April 2018 research by Trussle discovered 41% of homeowners find the mortgage experience stressful. The main reason for these tense feelings is the huge amount of paperwork to complete – the average application for a house purchase runs to 219 sheets of paper. Another factor is the amount of jargon involved, which can be difficult to understand.

There's a risk people could experience higher mortgage costs, as a result of their anxiety towards mortgages. For example, if they're put off from re-mortgaging at the end of a fixed discounted term, they could revert to their lender's standard variable rate, and have to make higher repayments compared to other options available.

Source:

https://moneyfacts.co.uk/news/mortgages/41-stressed-by-mortgage-process/

Affluent London pensioners lead the way

A regional divide has developed over the standard of living for UK retirees, with the Government's own data revealing some Londoners enjoy a retirement income three times larger than people in Stoke-on-Trent.

In April 2018, Royal London analysed the government figures and discovered there are people living in the City of London who receive a pension income averaging £37,900 a year. Other affluent pensioner regions include Westminster, Kensington & Chelsea, Elmbridge, Chiltern and Guildford, where average annual incomes comfortably top £20,000.

In contrast, the top 10 lowest average pension income areas include Sunderland, Leicester, Southampton, Hull, Barking and Dagenham – plus bottom-of-the-list Stoke-on-Trent, where the average annual income is just £12,300.

Source:

https://www.theguardian.com/money/2018/apr/02/shocking-disparity-in-pension-income-revealed-by-latest-hmrc-data

Pension freedoms trigger new gender gap concerns

Keeping your pension invested in retirement has become a more popular option since the pension freedoms – but it appears men are getting a much better deal than women.

April 2018 research by Zurich UK discovered women who are in drawdown have 37% less annual retirement income compared to men, leaving them more than £47,000 worse off. This is largely due to the fact men in drawdown have an average pension pot worth £212,000, compared to £132,000 for women.

By selecting a 3% income yield, the average male pension could generate an annual income of £6,360, whilst a female pension would only command £3,990. To match their male counterparts, women would need to take greater risk with their money. But with only 32% seeking financial advice, they could find it difficult to make suitable decisions.

Source:

www.financialreporter.co.uk/later-life/new-gender-drawdown-gap-leaves-women-with-37-lower-retirement-income.html

How actively are your funds being managed?

The FCA is clamping down on active funds that are really just trackers, but genuine passive funds do have their benefits.

When it comes to investing, it can be reassuring to have an expert making decisions on your behalf. An actively managed fund is operated by a fund manager, who uses their research and expertise to select assets to hold – with the objective of generating strong returns.

Yet not all actively managed funds are truly offering this type of service, it seems. In March 2018, the Financial Conduct Authority* (FCA) revealed an estimated £109 billion was held in 'closet trackers' – funds promoted as actively managed, when in reality they do little more than track a market. The Financial Conduct Authority (FCA) ordered the refund of £34m of active management fees levied on funds that were simply tracking an index.

Are tracker funds a bad idea?

For many investors, a tracker or passive fund is a suitable way to invest for the future. The manager of these funds has a remit to track a particular stock market, by mirroring the shares that make up the index. During periods where the index is faring well, the passive fund is likely to replicate this performance – therefore generating strong returns. However, the opposite is also true in times when the market falls.

Whilst it can mean a bumpier journey for investors, passive funds are usually cheaper to invest into compared to actively managed funds. Many experienced investors like to hold some passive funds as part of an overall portfolio, so they have access to the upsides of specific stock markets, at a cheaper price.

In contrast, actively managed funds have a wider remit to invest into a range of asset classes. The fund manager will make portfolio changes on a regular basis, with the aim of providing greater value than simply tracking a market. This means targeting assets that can out-perform the general market and reducing exposure to under-performing assets. When stock markets fall, they can scale back their related investments, so investors don't feel the declines so sharply.

It can be difficult, in times of strong markets, for an actively managed fund to beat the index. But over a full market cycle, they will aim to provide investors with a smoother journey. Actively managed funds are also more expensive.

Finding an approach that's right for you

Investors in the funds the FCA has identified as hidden trackers have a right to feel let down. They are, after all, paying higher fees, without the extra benefits that are supposed to come with it.

This underlines the importance of regularly reviewing the funds you hold. Even if you're paying an appropriate level of fees, what was once the best place to invest won't always stay the same.

If you are willing to accept risk to your capital, sitting down with a financial adviser to assess your plans can make a big difference. They will be able to review your funds, and if they're providing a level of returns you can reasonably expect. They can even recommend other options – taking into account your feelings about risk, and the level of charges you're prepared to pay.

The value of your investment can go down as well as up and you may not get back the full amount invested. Investments do not include the same security of capital which is afforded with a deposit account.

(Sources: https://www.thetimes.co.uk/edition/money/investors-misled-by-cuckoo-in-nest-funds-pjcgcprk5)

Stick or twist?

As the Bank of England prepares to raise interest rates, there's still a window of opportunity if you're looking for a good mortgage deal.

It's been a great decade to be a mortgage borrower. As a legacy of the global financial crisis, the Bank of England has kept interest rates below 1% since March 2009. This has created an environment where it's very cheap to borrow money, and mortgage rates have fallen, reaching a record low level in April 2017.[1]

According to February 2018 figures from the Building Societies Association[2], the average 2-year fixed rate mortgage (75% LTV) offered by banks and building societies was just 1.49%. In June 2008, when the base rate was 5%, the average rate on this type of product was 6.35%.

Yet there are growing signs this low interest rate trend is starting to reverse. The Bank of England had previously hinted at slow and steady rises. But in February it amended this outlook by indicating the pace of interest rate increases could accelerate, should the economy remain on its current track.[3]

Mortgage rates mirror base rate movements, which means borrowers might start seeing a notable increase in the rates available over the next few years. February 2018 research by London and Country[4] hints that some borrowers could pay an extra £500 annually if the base rate goes up three times in the next year.

Do you need to consider your options?

If you're in the position of looking to arrange a mortgage, re-mortgage, or your fixed mortgage term is coming to an end within the next six months, this could be the ideal time to speak to a mortgage adviser.

Standard variable rate mortgage holders might also want to consider their options. This approach might have been a better option when interest rates were going down, as tying yourself up on a fixed rate mortgage could have left you with higher payments by the end of its term, in comparison. But mortgage rates are likely to rise in the future, meaning a fixed rate mortgage may prove a better option.

What are your long-term property plans?

If you plan to stay where you are for years to come, it could make sense to take out a long-term fixed rate mortgage – such as a two, five or a 10-year deal – at the current rates available.

However, if you plan to move in the near future, taking out a fixed rate deal could mean you face charges if you were to have to exit from it too early. You could transfer the fixed rate mortgage to your new home, but that might require you to borrow more money to keep the mortgage product.

You should also always check the full terms of the products on offer very carefully, as some of the current mortgages on offer come with hefty arrangement fees.

No one can predict the future and what will happen with interest rates, but experts are in agreement this era of low mortgage rates is coming towards its end. By speaking to a mortgage adviser about your future plans, you can benefit from expert advice on the best options for your needs.

Your home may be repossessed if you do not keep up repayments on your mortgage.

1. http://www.bbc.co.uk/news/business-39665533
2. https://www.bsa.org.uk/getdoc/b7f539df-3f0a-49e8-b57e-07eb07953ce4/Mortgage%20interest%20rates
3. http://www.bbc.co.uk/news/business-42986729
4. https://www.telegraph.co.uk/personal-banking/mortgages/bank-rate-rises-mortgage-could-cost-extra-500-year/

Don't forget about your ISA allowance

The 2018/19 ISA allowance is £20,000, and it remains a valuable benefit despite what some experts believe.

In some ways this is a quiet year for the humble ISA. The annual allowance has been frozen at £20,000. And with the government's Personal Savings Allowance (PSA) now more established, some commentators have argued[1] ISAs are no longer as important as they were.

The PSA means the first £1,000 you earn on your savings and investments is free from tax (or first £500 if you're a higher rate taxpayer, additional rate taxpayers can't benefit from the PSA). The PSA is useful, especially for savers who would struggle to earn more than £1,000 interest in this low rate environment.

Yet for savvy investors, the ISA allowance remains a hugely valuable benefit – and the new tax year heralds a great opportunity to grow more of your money in a tax-efficient environment. There is no tax to pay on any gains you achieve. Over the long-term especially, this could make a major difference to your wealth.

Dividends tax makes ISAs more attractive

Government changes to the dividend tax, introduced this tax year, make ISAs an even more important consideration. Previously, any dividends you received, which generated more than £5,000, would be subject to tax.

But this has now been reduced to just £2,000 a year. If you have investments that produce dividends in excess of this amount, you will have to pay tax at a rate of either 7.5%, 32.5% or 38.1%, depending on your tax position.

The difference this could make is considerable. Let's say your investments earned dividends of £5,000. Under the old rules, there would have been no tax to pay, but with the reduction in the allowance to £2,000, a higher rate taxpayer would now have to pay £975 in tax.

However, the good news is the dividend tax does not apply to all investments – specifically those held inside an ISA.

Passing on your ISA allowance

Another benefit of having your money inside an ISA wrapper is you and your partner can inherit each other's ISA investments – and keep the tax benefits. This is known as the Additional Permitted Subscription.

Let's say a couple invests £20,000 each for the 2018/19 tax year and, sadly, one of them passes away. The surviving spouse can inherit their partner's ISA investments – including the growth it has achieved – and receive the tax benefits, on top of their own ISA investments.

Looking for advice?

The various tax considerations that come with your savings and investments highlight the value of speaking to a financial adviser for support. The amount of tax you pay can have a significant bearing on the returns you enjoy, and an adviser can assess if you're making the most of the opportunities available.

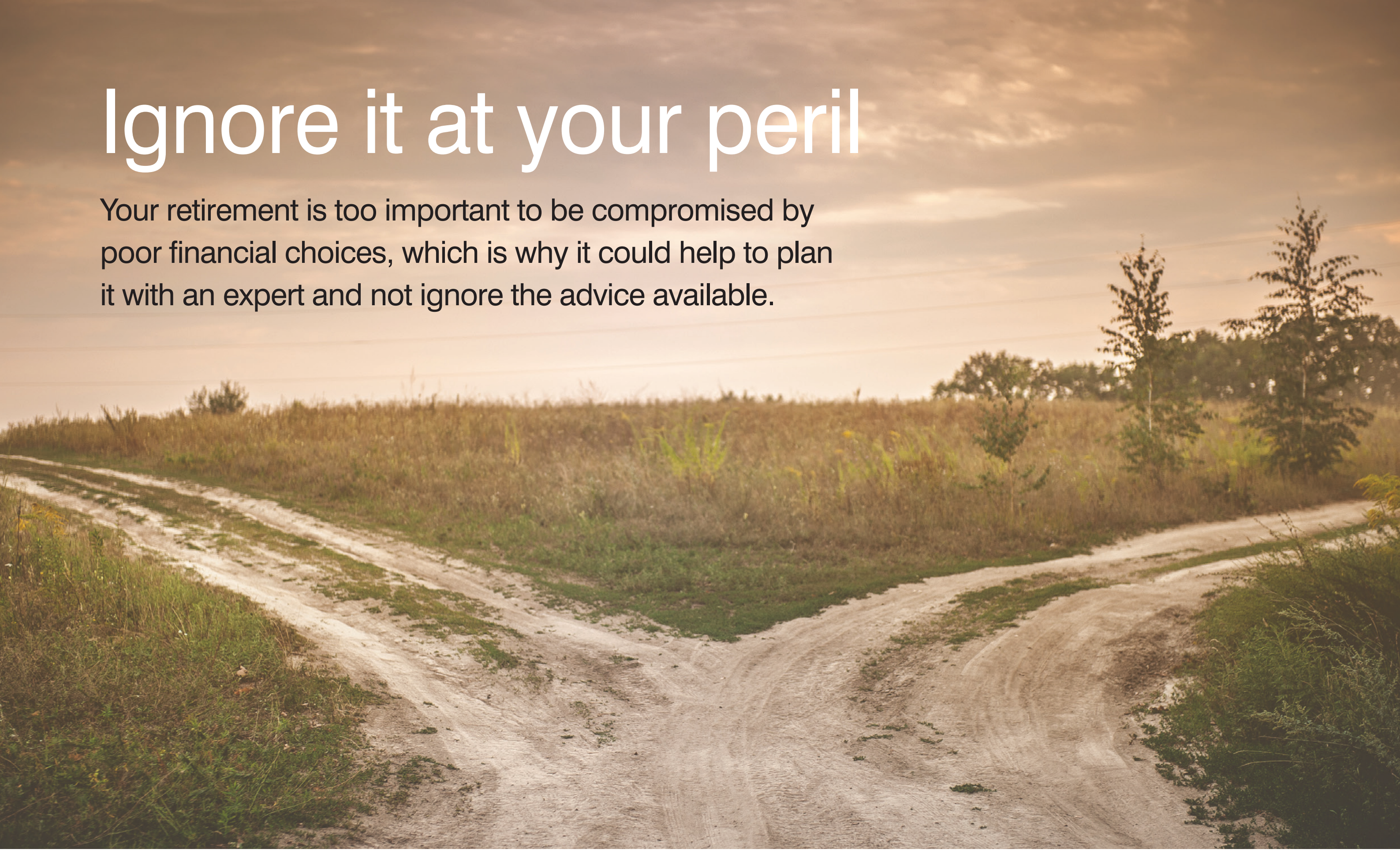
This includes your ISA allowance, which – despite this year's freeze – has more than doubled over the last decade.[2] You will need to accept risk to your capital. An adviser can help you consider what you want your money to achieve – and provide recommendations for using your ISA allowance in a way that's suited to your circumstances and aspirations.

The value of your investment can go down as well as up and you may not get back the full amount invested. Investments do not include the same security of capital which is afforded with a deposit account. The Financial Conduct Authority does not regulate taxation advice.

1. https://www.telegraph.co.uk/financial-services/money-comparison/current-accounts/are-isas-worth-it/
2. https://www.fool.co.uk/investing-basics/isas-and-investment-funds/historic-isa-allowances/

Ignore it at your peril

Your retirement is too important to be compromised by poor financial choices, which is why it could help to plan it with an expert and not ignore the advice available.



When it comes to your retirement, £13,000 is a lot of money. It could be the difference between an aspirational or more modest lifestyle and also provide the financial flexibility to look after yourself, and others, when you get older.

According to November 2017 research by Dunstan Thomas[1], £13,000 is also the average difference in annual income between a retiree who seeks professional financial advice, and those who opt to plan their future on their own.

Dunstan Thomas discovered two-thirds of Baby Boomers – people aged between 54 and 72 – have not had financial advice on building their retirement provisions, or on using their pension for an income. Only 23% plan to ask an adviser for help making sure they didn't run out of money later in life.

Of those who have chosen to plan their future without seeking expertise, the average retirement income they can expect is £20,373.40 a year. In contrast, savers who have received advice can hope for an annual retirement income of £33,577.45 – 39% higher, before tax.

The value of financial advice

Retiring will involve some of the most important – and complex – financial decisions you will ever face. Although you should be entitled to receive the state pension, it currently only pays £8,546.20 a year. On its own, it is unlikely to cover more than a frugal retirement.

In other words, the amount you are building up towards your retirement is going to go a long way towards determining your quality of life. Your workplace pension is only the start – are you paying in as much as you can be? Especially as you can benefit from employer contributions and tax relief.

You also need to consider how your pension is being invested. If you've never thought about it, the chances are you're in your provider's default fund, which might not mirror your feelings towards risk and reward.
Don't forget any old pensions you have too. If you've changed employers over your career, you're likely to have paid into a different pension pot.

The more you can commit towards your retirement now, the greater your prospects in the future. You might even want to think about setting up an individual pension, so more of your savings benefit from tax relief. You will need to accept risk to your capital.

Planning retirement

The 2015 pension freedoms have radically changed the options available for using your pension – but also put greater onus on you to make the right decisions. Dunstan Thomas found nearly a third of Baby Boomers don't understand the choices they will face, further emphasising the importance of financial advice.

Your pension savings need to last you for the rest of your life. Making a poor choice could erode your pension too quickly, especially given the important tax considerations around accessing your pot.

A financial adviser can get to the heart of what you want to achieve in retirement and advise you on developing a strategy. They will not only consider your initial ambitions, but how your needs might change as you get older.

Accessing pension benefits early may impact on levels of retirement income and is not suitable for everyone. You should seek advice to understand your options at retirement.

The value of your investment can go down as well as up and you may not get back the full amount invested. Investments do not include the same security of capital which is afforded with a deposit account.

1. https://www.ftadviser.com/retirement-income/2017/11/24/shunning-retirement-advice-costs-savers-13k/

And finally....

Why using your annual ISA allowance every year could be worth nearly £500,000

Despite their huge tax benefits, barely a third of UK adults used an ISA over the past 12 months, according to March 2018 research by Aldermore.

Yet another study, released the same month by the Association of Investment Companies, has demonstrated just how valuable investing your annual ISA allowance can be.

Using your full stocks and shares ISA allowance, for each of the 19 tax years since ISAs were first introduced, would have meant investing a total of £186,560. By placing that capital in the average investment company each year, your overall investment would have grown to a huge £436,894 by the end of the 2017/18 tax year.

(Sources: https://moneyfacts.co.uk/news/isas/only-34-have-used-an-isa-in-the-last-12-months/
https://www.theaic.co.uk/aic/news/press-releases/19-years-of-isa-investing-in-investment-companies-now-worth-%C2%A3436894)

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