BlueSKY INDEPENDENT FINANCIAL ADVISERS

Investing in 2011

By Mark Penston

Introduction

As I write, the FTSE seems to continue to defy gravity having passed the 6,000 barrier. Many economists say that valuations are low and that improving manufacturing indices prove that we are back on track and there's little to worry about.

Other economists say that inflationary pressures are growing and consumer confidence is falling. In their opinion we are far from being out of the woods yet.

So who is right?

Optimist or Pessimist?

With the wealth of information in the public domain it is easy for sentiment to vacillate from positive to negative and back again, depending on the latest report or opinion read.

Valuations

Based on the latest Purchasing Managers Indices (PMIs), manufacturing in most major economies is expanding with some increases being the highest for over a decade. It easy to view this data as encouraging and a sign that business are 'doing well'. Mathematicians will, however, remind us that 'record growth' may only actually represent a small recovery after a significant fall. It does not tell us anything about whether we are back to, or above, previous levels of production. Although production may be increasing, widely reported increases in input costs will reduce margins and / or increase costs. Profits will inevitably be affected with the likely knock-on effect of reducing dividends and hence valuations. What currently seems an attractive valuation may not be in the future.

The UK's PMI has shown growth partly due to the weak pound and improving exports. If this continues then this will support economic growth as long as prices remain at reasonable levels.

Taxation

We are all aware of the significant debt that the Government plans to repay. Spending cuts and tax rises are only just beginning to bite. It is difficult to know with certainty how this will affect the economy. Unless job losses are picked up by an increasing private sector it's difficult to see positive GDP for 2011.

Although the recent VAT rise will increase inflation, it is inflation largely due to tax rises which of course is of not as much concern to the Government as 'real' price increases would be.

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Individual Debt

Even if the UK is showing signs of recovery, UK households remain under strain. The Association of Business Recovery professionals estimate that 961,000 individuals in the UK are struggling with their debt.

Falling or stagnant house prices have exposed those with high loan to value mortgages. Unsecured debt in this sector has risen from 68% to 92% of mortgagors (Source:- NMG Consulting).

Despite the fall in bank base rate from 5% in October 2008 to 0.5% in March 2009, the proportion of households devoting more than 20% of their pre-tax income to mortgage repayments had fallen only slightly since 2008. A recent analysis of the 2010 NMG Consulting survey speculates that this may be due to the 48% of mortgagors still being on fixed rate mortgages and possibly lower household incomes. Those who can afford to are repaying debt.

The general response to the question 'To what extent is the repayment of these loans and the interest a financial burden on your household?' indicated that levels of burden were at their highest since 1995.

So, while some statistics indicate that the UK is showing signs of recovery, consumer sentiment would seem to be decidedly cautious.

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Differences of opinion regarding the performance of UK markets will undoubtedly continue. The story of UK issues is mirrored, to an extent, by many other Western economies. I suspect that the undertone of consumer sentiment will ultimately drive long term market direction.

As ever, diversification is key. Portfolio weightings are generally shifting to a more global basis where debt is less and economies stronger.

The rise of the Structured Product market place quenches the thirst for those who want exposure to markets but a guarantee of capital. Investec and RBS are amongst some of the providers that we favour, offering attractive potential returns and minimising counterparty risk.

Tax efficiency is obviously key to many and with legislation continually changing, keeping up with tax efficient strategies can be difficult for the majority of investors. In these times of HMRC trying to raise revenues many tax structures are coming under close scrutiny, not to mention the further tightening of tax incentives within pension planning.

Venture Capital Trusts

Given the reduced limits on pension funding from April 2011, many investors are looking for alternative or additional investment vehicles which offer tax incentives. Product innovation has produced competitively charged VCTs with a wide range of risk ratings. It is probably fair to say that some VCT offerings are much lower risk than they used to be. The tax incentives for investing into a VCT are:-

- ***A 30% tax rebate (subject to your total income tax bill).***
- ***Tax free distributions and dividends.***
- ***No capital gains tax on any capital profit on sale.***

Summary

Market volatility seems to be a certainty for 2011 which may deter many investors. However, poor deposit returns do not seem to be an attractive alternative.

As ever, careful financial planning can help to establish suitable investment vehicles that not only match the level of risk that an individual is willing to take, but also maximise the tax efficiency of the investment made.

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