Hidden Danger of Mortgages

Mortgage deals are improving with falling interest rates, but dangers still exist. Short term fixed interest rate deals have been improving, the best 2 year fixed interest rate is being offered with an initial interest rate of less than 4%. However, these deals are subject to having at least 40% equity in the property, something many borrowers do not have the luxury of, following significant falls in house prices.

At the time of writing, The Bank of England interest rate is currently 0.5%. Based on recent tracker spreads of only 0.9%, you should now be able to mortgage properties on interest rates below 1.5%. Sadly this is not the case, clients wishing to remortgage or even borrow for a house move are seeing average spreads of more than 2%. We feel this could cause more significant problems in the future because, whilst interest rates are at the lowest seen for a generation, some borrowers will not be aware of risks that currently exist.

Accelerated interest rate increases pose a significant risk to affordability in the future where many of the current deals just do not offer value for money. Aggressive interest rate cuts to stimulate the economy will most likely lead to an initial spate of sharp interest rate rises. We are not expecting to see interest rates returning to the dizzy heights of the late eighties, but a tracker rate mortgage will be in excess of 6%, should the Bank of England rate return to a more likely 4%. Clients that are on existing fixed and base rate mortgage deals are seeing greater value in returning to their lenders standard variable rate, rather than committing to another deal that normally attracts an application and valuation fee. This requires no action from the borrower and provides greater flexibility to time your entry back into the market when improved deals are being offered in the future.

In conclusion, fixed interest rates appear to offer more value for money should interest rates start to climb. However, they are likely to remain depressed for the foreseeable future and borrowers should not feel pressed to return to expensive deals offered by their current lenders.

Birchwood and the Credit Crunch

With the major banks needing government help to survive, and large firms of financial advisors announcing redundancies to stem financial losses, it is hardly surprising that some of our clients have asked what impact the Credit Crunch is having on Birchwood.

Whilst we are not complacent, and not unaffected, Birchwood is better placed than most firms of Independent Financial Advisors to deal with current market conditions for a number of reasons. We though it might be helpful to give you some insight into these.

The company was established in 1982 with the express aim of supporting the outplacement industry by providing sound professional financial advice to people being made redundant by major companies in that recession. Since then we have continued to develop our relationship with all the major outplacement companies and have had the experience of living through a number of more recent recessions. We believe, therefore, that we are in a particularly strong position to understand what the clients of outplacement companies are looking for from their financial advisor when they have been made redundant in a difficult financial environment. We are extremely busy in this aspect of our work, providing workshops on the state benefit system as well as taxation, occupational pensions and investments – and anticipate this continuing for some time to come.

Since the company was first established we have always been keen to develop long-term relationships with our clients, and have developed an income structure based on providing continuous monitoring and management of clients investments rather than taking large initial commissions. Whilst we share some of the pain of falling markets with our clients – in that the fees we receive from fund managers are directly linked to the value of the funds held by our clients and so fall in line with market values – we do maintain a level of regular income. This is in contrast to the large number of IFA businesses that are orientated towards large initial commissions on transactional sales that become increasing difficult to obtain during a recession.

Possibly equally important in these markets is the prudent way in which the company has built up financial reserves in positive markets rather than paying large bonuses to staff or indulging in ostentatious gestures. This prudent approach to managing our own finances provides a sound base that will ensure we can continue to provide all our clients with high quality financial advice throughout the recession, and emerge even stronger whilst many other firms will fail to survive the downturn. It is also probably one reason why an independent research organisation has listed Birchwood amongst the financially strongest firms in our profession.

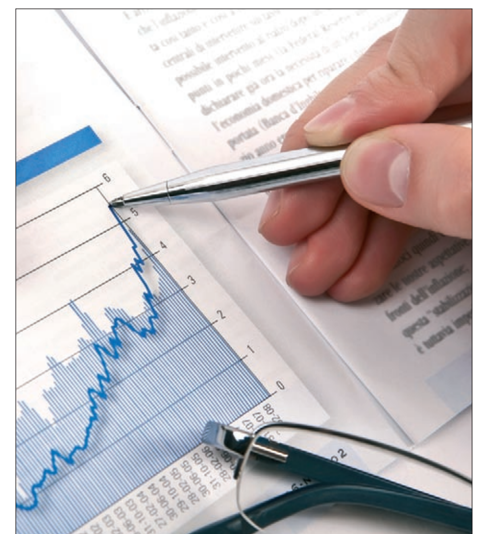
Current Account Overview

With the Bank of England cutting interest rates down to 0.5%, it is proving hard for savers to get a reasonable return on accessible funds.

For those with holdings in some of our prestigious Private Banks the picture is yet worse. For instance, those banking with Cater Allen will pay a monthly fee of £15.00 but receive no interest. Coutts do not fair much better, while not charging the monthly fee, there is still no interest on a standard Current account. In their Private Reserve Account you will receive the benefit of interest at 0.4% on credit balances under £100,000, however, this includes a bonus rate of 0.35%, which will be removed at the end of June 09.

On comparison, some of our traditional high street banks seem to offer a more beneficial range of packages. HSBC charge a monthly fee of £12.95 (introductory rate of £9.95 for the first 3 months), which gives the benefits of Worldwide Travel Insurance, Roadside Breakdown assistance, and Identity theft assistance. However, interest is at 0% for anything over £1,000. Barclays offer a similar package, with the addition of a Legal & Tax helpline, extended warranty cover and mobile phone insurance for a monthly fee of £14.00, but no interest on credit balances. One of the most attractive in terms of interest is the Alliance & Leicester, who will pay 5% AER on balances up to £2,500 for one year. After the year the rate reduces to 1% AER.

It is also worth stressing that many people are unaware of the background of many banking institutions. For instance did you know that Firstsave is backed by a Nigerian Bank? It is worth doing your research before setting up arrangements with a new account provider.



MARKET REPORT

GLOBAL REVIEW

Official figures have confirmed that global activity plunged in the final quarter of 2008, removing any doubt that the world had entered a period of recession deeper than most had anticipated. In the face of dwindling demand, production is being cut as companies continue to run down inventories. Comparisons continue to be made with the Great Depression of the 1930's, given the parallel crisis in the banking system, leaving investors with very little appetite for risk.

Governments and central banks have responded by slashing the cost of borrowing and injecting billions into the banking system in an attempt to stimulate spending. However, as interest rates approach zero, there are few signs these measures are having a significant impact, and governments have embarked on a series of stimulus packages, tax cuts and more direct intervention in the form of quantitative easing.

UK

The UK government's own program of quantitative easing will see the Bank of England creating £150bn of funds to be used in the purchase of gilts (government debt) and corporate bonds (company debt) primarily from commercial banks. It is hoped this new money will increase bank lending to households and businesses, as well as create wealth through the support of bond prices. The process is highly inflationary, and whilst this may help erode debt, it also has the potential to create even greater problems in coming years.

UK financial markets continue to be dominated by developments in the banking sector. The benchmark FTSE 100 Index fell to a 6-year low at the beginning of March following a statement from HSBC, considered to be one of the stronger banks, outlining a plan to raise £12.5bn in a rights issue. The previous week Royal Bank of Scotland and Lloyds Banking Group both announced multi-billion pound losses, with RBS announcing a figure of £24bn, the largest in UK corporate history.

US

The banking crisis remains similarly evident in the US as AIG reported losses of $62bn in the fourth quarter of 2008, the largest in corporate history, and the US government was forced to inject a further $25bn into Citigroup, the country's third largest bank, in addition to the $45bn already committed. Stock markets reacted accordingly with the S&P 500 falling to a 12-year low as the index posted its worst start to a year ever.

With interest rates already at, or close to, zero the new Obama administration announced its first stimulus plan in response to deteriorating economic data, most notably a rise in unemployment to 8.1%. The $787bn package, the equivalent of 5% of GDP, consists mainly of increased expenditure with some tax cuts. This is in addition to the Troubled Assets Relief Program, Capital Assistance Program and the Homeowner Affordability and Stabilisation Plan. Despite a total cost to the taxpayer of several trillion dollars, there remains some doubt over their combined effectiveness.

EUROPE

The European Central Bank (ECB) has now conceded to pressure, both political and economic, by cutting the cost of borrowing to 1.5% in March. Given the severity of the downturn in the eurozone, a zero interest rate policy together with some quantitative easing should now be expected. European governments and the ECB have been slow to accept that the region would be dragged into recession and must now accelerate their own stimulus plans.

In Eastern Europe it has been a familiar story of a banking system in crisis, with possible contagion a real concern given the exposure of Western European banks to the region. The World Bank, in partnership with two European development banks, will provide up to €24.5bn to help Central and East European banks and businesses cope with the global financial crisis. The International Monetary Fund has already bailed out Latvia, Hungary, Serbia, Ukraine and Belarus.

JAPAN

With interest rates already very close to zero following its own banking crisis in the 1990's, Japanese authorities moved to quantitative easing some months ago. The Bank of Japan has committed to the purchase of ¥33tn worth of corporate bonds in the first quarter of 2009 in an attempt to provide funds for the commercial banks. The collapse of SFCG Co., a bank focused on lending to small businesses, in February is a concern given the relative strength of Japanese banks, but is indicative of the lack of liquidity in the financial system.

At the beginning of March the Nikkei 225, an index of the country's largest companies, fell to its lowest level for 26 years. In a reflection of stock markets worldwide, investors' appetite for risk evaporated in the face of the deteriorating economic outlook. This has left many Japanese stocks trading below their book value, a basic measure of cash plus assets. Whilst profitability remains unclear in the short-term, it is difficult to argue against the long-term value at these levels.

ASIA

Many of Japan's problems are mirrored across Asia with company inventories soaring relative to shipments. Despite healthy household balance sheets, the region still relies heavily on overseas demand, and as exports fall so inevitably will production. The exceptions are perhaps India and China, as demand in these potential economic superpowers is overwhelmingly domestic. The Indian government's stimulus package may not have matched that of China's, but decisive interest rate cuts could provide the liquidity required to sustain moderate growth.

China's gigantic spending program has already seen a rebound in business confidence, industrial production stabilising and bank lending picking up. It has also provided some support for commodity prices, albeit at subdued levels. Ironically as inventories are rebuilt ahead of an anticipated growth in demand, supply has been cut due to falling profit margins. Gold has led the way, not on industrial or traditional Asian domestic demand, but rather due to its safe haven status.

18 March 2009

Are our savings safe ?

Unfortunately, bank collapses are no longer easy to dismiss. In the UK alone, we've seen the bail out of Northern Rock, RBS, Bradford & Bingley and Kaupthing, and the need to compensate Icesave savers.

All deposits in UK bank or building society savings products are covered by the Financial Services Compensation Scheme (FSCS). This is an independent fund set up by UK financial bodies and regulated by the FSA, which promises that, in the event of a bank collapsing, everyone would get some of their money back, no matter what their age, including children.

The FSCS protection applies **per institution NOT per account!** So only the first £50,000 is protected in each institution, even if it is spread between various accounts. Different banks that are part of the same group often count as just one institution.

Single Licensed institutions have their own UK banking licence and so offer the standard £50,000 protection (£100,000 for joint accounts), even if they are foreign-owned. Northern Rock, RBS and NS&I are fully guaranteed by the UK government.

Shared Licensed organisations don't have their own banking licence, but fall under the licence of other organisations. A maximum of £50,000 (£100,000 for joint accounts) is protected across **ALL** brands sharing one licence.

Any debts with the same institution are subtracted from savings. The FSCS rules dictate that any debts, such as a mortgage, loan or credit card, held with a bank that also holds savings will be subtracted from the savings. If you have £20,000 in savings and a £15,000 loan, you'll only get £5,000 compensation if the bank collapses.

Savers will be no worse off; as the debt would disappear, even if it were sold on to another institution (or if debts are bigger than savings any amount owed would be reduced). However, the choice of whether to repay debts with savings would be taken away, and although with most loans and credit cards this is a good thing, repaying mortgage debt is not always a good idea.

The FSCS ensures banks adhere to this system, but building societies are not bound by these conditions. Most do operate as described here, but some may not.

In the event of a bank collapsing, it is likely to take a few months for accounts to be processed and the cash returned; though there are moves underway to set up systems to make potential payouts quicker.

The local financial authority usually regulates any savings held offshore. The FSCS protection only applies to companies regulated by the FSA, so offshore savers should check with their lender where it is regulated. The FSCS does not cover savings outside the EEA, or even in the Channel Islands or Isle of Man.

Single Licensed institutions

Abbey	ICICI	Ruffler Bank
Alliance & Leicester	Investec	Sainsbury's Bank
Barclays	Julian Hodge	Scottish Widows Bank
Capital One Savings	LV	Standard Life Bank
Cater Allen	Lloyds TSB	Tesco
The Co-operative Bank	M&S	Triodos Bank
Coutts	NS&I	United Trust Bank
Coventry Building Society	Nationwide Building Society	Virgin Money
Egg	Nat West	Wesleyan Bank
FirstSave	Northern Rock	Yorkshire Bank
Hoare & Co	Norwich Union	Yorkshire Building Society
HSBC	RBS	

(All other building societies, apart from those listed below)

Shared Licensed institutions

Organisation	Licence Holder
AA	HBoS
Bank of Scotland	HBoS
Bradford & Bingley	Abbey
Catholic Building Society	Chelsea BS from Dec 08
Cheltenham & Gloucester	Lloyds TSB
Cheshire BS	Nationwide BS from Dec 08
Clydesdale	Yorkshire Bank
Derbyshire BS	Nationwide BS from Dec 08
Direct Line	RBS
First Direct	HSBC
Halifax	HBoS
Intelligent Finance	HBoS
LC&C Savings	Chelsea BS
Saga	HBoS
Smile	The Co-operative Bank

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