BIRCHWOOD
INVESTMENT
MANAGEMENT LTD
NEWSLETTER
JANUARY 2010

Keydata and NDF Update

In a co-ordinated declaration with HM Revenue & Customs (HMRC) on 13th November 2009, the Financial Services Compensation Scheme (FSCS) declared Keydata Investment Services Limited in default. This opened the Scheme to claims for compensation, giving priority to those investors who suffered a loss of capital – holders of Secure Income Bond (SIB) issues 1-3. Holders of these plans should already have received an application form from the FSCS, which we recommend be completed and returned as soon as possible.

Holders of Lifemark plans, SIB 4, Secure Income Plans 1-12 and 14, and Defined Income Plans 1-8 that have been ruled non-ISA eligible will also be receiving application forms in the New Year to claim for any tax losses incurred. However, the FSCS and HMRC are developing a process that would pay compensation on behalf of eligible investors directly to HMRC, avoiding the requirement for investors to pay liabilities up front and reclaim this amount at a later date. Investors in either the seven-year or ten-year options will not be required to submit applications, as the underlying investments of these plans have now been correctly listed on a recognised exchange and still have at least five years to run.

HMRC is also waiting on new legislation that would allow SIB 1-3 investors to place an equal amount of capital into a new ISA, on top of normal ISA limits. Investors do not have to wait for any possible compensation payment, but will be limited to the amount originally invested. Any reinvestment must be a single payment made before 5th April 2011. HMRC will have contacted those who are eligible by the end of December 2009. The remaining plans declared as non-qualifying ISA investments can regain their tax exemptions on maturity or early redemption.

The administrator, PricewaterhouseCoopers (PwC), has recently re-confirmed the assets underpinning the Lifemark plans, following the delay of income payments from SIB 4, Secure Income Plans 1-12 and 14, and Defined Income Plans 1-8. This has been presented as an administrative issue on the part of Lifemark, and we have received assurances from the plan managers that the monies due have now been received and are available for distribution to investors.

The Financial Services Authority has forced a number of other structured product providers into administration following the failure of Lehman Brothers Holdings Inc, a company providing the backing for a range of investment plans across the industry. Amongst these was NDF Administration Limited, whose directors appointed Grant Thornton UK LLP on 14th October 2009.

As required, upon the appointment of Grant Thornton, all assets were frozen, preventing maturity and income payments, as well as the return of capital due to cancellation. Grant Thornton was, however, able to fully reconcile client monies by 3rd December 2009 and all existing investments are able to continue as planned. In addition, all ISA investments have been declared eligible.

For maturities, cancellations and aborted NDF plans (Defined Income August 2009 issue), money will be returned in the coming weeks by cheque, direct bank transfer or, in respect of ISA transfers, to the previous ISA plan manager with the ISA wrapper intact.

Pre-Budget Report

As you will no doubt be aware, the Chancellor announced his Pre-Budget Report on Wednesday 9th December amid the news that public sector borrowing is estimated to be around £178 billion in 2009/10. The Treasury is expecting tax revenues to reduce the figure to £84 billion in 2014, although many independent forecasters feel that, if a more cautious view of growth potential is adopted, the Treasury has overstated its expectations.

Numerous political commentators feel that Mr Darling merely set out to acquire public support and secure votes rather than provide a substantial report during this difficult time.

Regardless of whether the report was met with open arms or obloquy and criticism, in this issue we look at the key proposals announced by focusing on changes that may affect you as a client, as well as news that may be of interest.

Bonus payment legislation

The much-debated bankers' bonus payments contributed to a significant part of Mr Darling's Report; as anticipated, he announced the introduction of a 50 percent tax payable on all bonuses over £25,000 between the Report and April 5th 2010. Rather than the tax being paid by the individual in receipt of the bonus, it is to be levied on the institution paying the bonus as a payroll tax.

Off the back of this announcement, HMRC has reiterated that it will be stringent on firms that attempt to exploit loopholes by using other methods to credit these kinds of payments.

Bonuses that are deemed a contractual augmentation rather than a one-off handout are exempt from the new ruling.

Tax and National Insurance

Personal allowances and thresholds remain broadly unchanged from those in the current tax year. This can be attributed to the Retail Prices Index in September 2009, used as the guideline for any increases, which was negative.

National Insurance Contributions (NICs) are set to increase by 0.5 percent from April 2011. This is in addition to the 0.5 percent increase announced in the 2008 Pre-Budget Report and applies to employers and employees. This increase will affect those with an annual income of £20,000 or above.

From January 1st 2010, Value Added Tax (VAT) returned to 17.5 percent from its temporary 15 percent rate.

Furthermore, the Inheritance tax threshold has been frozen at £325,000 until 2011, rather than the planned rise to £350,000, with the Chancellor describing the increase as a low priority.

It was also announced that legislation will be brought forward to ensure that anyone who fails to declare their offshore tax liability will face a similar penalty to an individual guilty of intentional tax evasion.

Pensions

As outlined in the October edition of our Newsletter, from April 6th 2011 new rules will apply to the amount of tax relief available on pension contributions for those with an annual income of £150,000 or more.

The higher-rate relief (currently 40 percent) would be reduced on a tapered basis for those with income of £150,000 or more, with a full loss of higher-rate relief for those with an income of £180,000 and over.

It is now proposed that annual "income" will include the value of employer pension contributions. Individuals with a gross income of £130,000 or less will be excluded from the restriction and will not need to value their employer-funded benefits.

The anti-forestalling threshold has been reduced from 9th December 2009. As a result, the special annual allowance of £30,000 for non-regular pension savings now applies to individuals with incomes of £130,000 and over.

It would be necessary to look at an individual's personal circumstance on a case-by-case basis to ascertain how they may or may not be affected by the legislation.

Green initiatives

The Copenhagen Climate Change Summit, which took place on 7th -18th December, evidently influenced parts of the Chancellor's report, at a time when all the political parties want to show alacrity in their attitude toward reducing our carbon footprint.

The government, in conjunction with several of the UK's major energy providers, plan to introduce a boiler scrappage scheme from April 2010; although the fine details of the scheme remain unannounced, it is expected to encourage people to switch to more energy efficient boilers by reducing the cost of doing so by around £400. In addition, energy providers have the discretion to enhance this grant.

In attempts to further reduce carbon emissions, Mr Darling proposes a five-year tax exemption for companies that provide electric cars for staff. This is due to come into effect in April 2010, and April 2012 sees the "lowest emissions" threshold reduced for company cars to 99g/km from the current rate of 120g/km.

Summary

So plenty of items have come out of the Report, some of which were more widely anticipated than others, while most have shaped many a debate and discussion. The Chancellor reiterated that he deems all of his proposals as fair and they will enhance the prosperity of the nation.

As we know, numerous legislative announcements are immediately binding whilst others are only future plans to be implemented, but the nation waits to see if Mr Darling will continue to hold the purse strings for another term in parliament.

If you are interested in the full facts and figures behind the PBR, please take a look at the full report on our website.

MARKET REPORT

GLOBAL REVIEW

The rally in global equity markets lost some momentum in October 2009, following concerns of weakening economic activity and a spike in US jobless claims, prompting investors to book profits. Stock markets recovered well in November, however, as manufacturing data was stronger than expected and retail sales bounced from September's disappointing number. Even Dubai World's failure to meet debt repayments was quickly dismissed by investors, although the event was particularly damaging for financial stocks at a time when confidence in the sector was beginning to return.

Whilst consensus agrees quantitative easing has been a global success in stabilising the financial system, the focus has shifted to the effects of the inevitable withdrawal of government aid. Politicians have acknowledged the need for a measured withdrawal and, to avoid shocks, this will undoubtedly be well signposted as and when there are firmer indications of a sustainable recovery. With government finances already stretched, investors are acutely aware of the additional burden on consumers as higher taxes erode already fragile demand.

UK

The UK economy shrank by 0.2 percent in the third quarter and thereby remains in recession, in stark contrast to the growth recorded by other major nations. UK GDP is expected to contract by 4.75 percent in 2009 and many remain sceptical of the Chancellor's prediction of economic growth in the final quarter. The government's growth predictions for the coming years have been questioned and suggest even greater public borrowing requirements than the current forecast of £611 billion. Net debt is likely to hit 58 percent of GDP in 2009/10, peaking at 78 percent of GDP in 2014/15.

Predictably the Chancellor did little to bring public finances under control in his Pre-Budget Report ahead of the general election. Despite his admission that government spending cuts and tax rises are required to reduce the public deficit, Mr Darling seems happy to maintain the status quo, deferring uncomfortable policy decisions. Whichever political party has to make these decisions, there will be obvious negative consequences for the economy. With lower overall demand from both government and the consumer, any recovery will be muted.

US

The US economy grew at an adjusted annual rate of 2.8 percent in the three months to the end of September, breaking a stretch of four straight quarters of contraction. Consumers took advantage of government programs such as "cash for clunkers" and tax credits for first-time homebuyers to boost demand. The return to growth has been greeted as a vindication of the massive stimulus measures introduced to combat the worst economic downturn since the 1930s. This has paved the way for further intervention that the Democrats hope will bring down the nation's double-digit unemployment rate before the November 2010 congressional elections.

The US jobless rate fell to 10 percent in November, marginally lower than the 10.2 percent figure posted in October. Whilst 11,000 jobs were lost over the month, this was far fewer than the 130,000 predicted, and the news was taken positively by financial markets. However, there are still 15 million people out of work in the US and the unemployment rate remains at double the pre-recessionary figure recorded in December 2007.

EUROPE

The 16 eurozone nations emerged from recession in the third quarter, growing by 0.4 percent and pulling the European Union as a whole along with them. France and Germany expanded for the second successive quarter, albeit less than forecast, boosted by substantially higher than expected exports. The eurozone also returned to inflation in November after five consecutive months of falls, with consumer prices rising 0.6 percent year-on-year. The European Central Bank has announced plans to ease off on some of its liquidity measures to prevent the risk of inflation climbing, but, as expected, kept interest rates unchanged at its latest meeting.

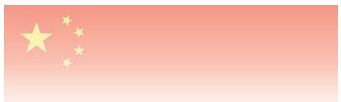
With few exceptions, global interest rates are expected to stay low for an extended period, as governments are more concerned with the risks of deflation rather than inflation. With the lack of demand, no pressure from wages and massive spare capacity in manufacturing, there is little evidence to support an inflationary push. Central banks may come under some pressure in 2010 as short-term inflation picks up, driven by the recovery in energy prices, but this will be a temporary event.

JAPAN

Policy makers will be desperate to avoid the deflationary malaise that has hung over Japan since its own banking crisis in the late 1990s. The Bank of Japan introduced a zero interest rate policy in 1999 and a program of quantitative easing in 2001, with limited success. Central banks, having followed the Japanese model, know that more is required, and this remains the logic behind the massive additional stimuli being pumped into the global economy. Japan's new government has recently announced its own \$80bn stimulus package designed to prevent a double-dip recession. This follows the Bank of Japan's decision to inject a further \$68bn into the financial system through low interest loans.

Third quarter GDP has been revised down to an annualised number of 1.3 percent, despite growing exports to Asia. Weak capital spending has been blamed, which fell at its fastest rate for seven years. The second successive quarter of growth for the world's second largest economy failed to stimulate investors, who focused on the strength of the yen and its impact on corporate profits. As a result, local stock markets lost further ground to their global peers.

ASIA



Asia continues to benefit from improving investor sentiment, buoyed by the recovery of the global economy. In contrast to western nations, the potential demand from an emerging consumer base with little or no debt has proven very attractive. It has still been necessary for central banks to provide additional stimuli to maintain growth in the region, but the results have been obvious. The World Bank has increased its 2009 GDP growth forecast for China from 7.2 percent to 8.4 percent and third quarter GDP growth in India reached 7.9 percent year-on-year, well ahead of expectations.

Intra-regional trade is rebounding as demand from China, in particular, picks up. The latest official figures from Beijing state that factory output has climbed 19.2 percent year-on-year and, whilst exports slid marginally by 1.2 percent, imports surged 26.7 percent. Australia is recognised as a particular beneficiary of China's resurgence as it fulfils a huge demand for commodities. Australia successfully avoided recession and expanded over the first half of 2009 on the strength of the mining sector. The Reserve Bank of Australia has been confident enough to raise interest rates for three consecutive months whilst tripling the country's economic growth forecasts for the year.

January 2010

Contracting out of the State Second Pension

As you may be aware, each year you choose to contract out, you will give up some or all of your State Second Pension (S2P) entitlement, and the rebates will be invested in your own private scheme. Your basic state pension is not affected; you will still receive this if you contract out of the S2P.

There is no hard and fast rule as to whether contracting out is a good idea, as this will vary depending on personal circumstances and your own opinion as to the likelihood of the government being able to honour the S2P obligations built up.

You may feel that contracting back into the S2P and relying on the Government to provide part of your pension income is less risky than contracting out. On the other hand, you may feel that over the longer term you would still be better off investing in asset-backed investments, via your own private scheme.

In the first case, you are taking a risk on the decisions made by future governments and any changes to the rules they may introduce. You may not be wholly confident that the benefit you have built up will be available when you retire – this is most likely to be a concern for those who are a good number of years away from retirement.

In the second case, you are taking a risk that your invested rebates may not grow enough to provide a higher pension income than you would have got from the S2P.

The following table gives an at a glance comparison of the options:

State Second Pension	Contracted-out Personal Pension
You accumulate a pension each year, which is based on your earnings.	The government pays an amount into your pension plan each year, depending on your age and your earnings.
This builds up over the years, and the government pays it along with the Basic State Pension.	Your final pension depends on how your fund grows and interest rates at the time you retire.
The S2P is paid from age 65 for men and age 60 for women (changing to 65 by 2020).	You can take your pension from age 55.
There is no option to take a tax-free cash lump sum.	You can take 25 percent of the fund value as a tax-free cash lump sum in return for a lower pension.
The amount of pension earned has some certainty, but a future government could change the rules.	The pension you get is not guaranteed and could be less than the State Second Pension.
The State will assume you are married and your pension will be paid accordingly.	If you are single at retirement, you have the option of providing a single life pension, which could give you a greater income.
If you die before you retire, leaving no spouse or civil partner, your estate will get nothing.	If you die before you retire, leaving no spouse or civil partner, your estate will get the value of your pension fund.

Contracting in is likely to be the right choice for many people, especially if:

- You have a more cautious outlook
- You are relying on the government to provide most of your retirement income
- You are within 15 –20 years of retirement

Some people may prefer to contract out, even if this result in a lower pension, especially if:

- You are prepared to take a greater degree of risk/ have a more adventurous outlook
- The extra flexibility of a personal pension is more important to you
- You are concerned that a future government may radically reduce the S2P

Whilst it is very difficult to advise on the best of course of action and whether you should contract out or contract in, we hope the points raised above will assist you in making an informed decision.

Bank accounts LOSE cash

Inflation may have increased slightly over the last two months, but all our major banks are still paying interest on their main savings accounts at well below the rate of inflation as measured by the Consumer Price Index. This means that the purchasing power of the money is actually falling, even for the Internet-based accounts that we have been conditioned to expect better rates from.

Alliance and Leicester's DirectSaver account offers 0.62% on balances between £50,000 and £2,000,000, but this is reduced to 0.42% for balances below £50,000. As these are gross rates, accounts of less than £50,000 represent a return of only 0.33% for standard rate taxpayers. For higher rate taxpayers, the returns represent an even more disappointing 0.25%.

Whilst Alliance and Leicester rates may be disappointing, they are better than those offered by HSBC, Halifax or Lloyds.

The Halifax Variable Rate Web Saver offers a gross rate of 0.25%, which is worth only 0.15% for a higher rate taxpayer; HSBC offers 0.25% gross (0.15% after higher rate tax) on their Online Bonus Saver; and Lloyds provides a gross return of 0.1% on their eSavings account (0.06% for a higher rate taxpayer).

These rates were quoted on the provider's web sites on December 23rd 2009. They highlight the importance of shopping around and ensuring that the account you hold is the best one offered by the bank at which you keep your savings.

Existing Client Questionnaire

We have enclosed a brief client questionnaire to accompany this Newsletter. If you have not recently returned this to us, please take this opportunity to update us with your current details, including your status and objectives.

This will enable your adviser to continue to offer the best advice based on the most accurate and up to date information.

Birchwood Investment Management Ltd, 8 Prospect Place • Welwyn • Hertfordshire AL6 9EN • UK
Telephone: 01438 840 888 *(Welwyn)* • 01454 878 722 *(Bristol)* • **Fax:** 01438 840 097
Email: info@birchwoodinvestment.com • **Website:** www.birchwoodinvestment.com