



BIRCHWOOD
INVESTMENT
MANAGEMENT LTD
NEWSLETTER
JANUARY 2012

One year to go and counting

In previous editions of our newsletter we have brought your attention to changes the Financial Services Authority plan to introduce from 1st January 2013. These will totally change the way financial advisors operate and we need to start making plans now to ensure we continue to provide all our clients with the service they have come to expect from us.

New regulations require all advisors to have increased levels of qualifications or they will have to stop advising clients by December 2012. Happily Birchwood has always put a high priority on ensuring that our advisors are highly qualified and the increased number of examinations has been less onerous on us than many other firms have experienced. However, a great deal of work has still been required to ensure that all our existing advisors achieve the new qualifications within the necessary timescale. On a broader note we are somewhat concerned at the number of advisors in other firms that have not even started sitting the new examinations. This could mean a significant number of experienced advisors being forced to retire from the industry.

Whilst we agree that it was necessary to improve the level of qualifications within the industry if it is ever to attain the level of professional respect associated with the accountancy and legal professions, the immediate impact is likely to be less obvious to the investing public than other changes, such as commission being banned.

From 1 January 2013 advisors will not be able to receive any commission from product providers and can only be remunerated by fees paid by clients, although, by agreement with clients, it may be possible to have the fees paid to the advisor out of product charges. This may appear to be quite similar to paying commission but there are significant differences. For example, it has been quite usual for a product provider to pay initial commission to an advisor when an investment is placed, to cover the costs associated with researching the best products and arranging the investment, but recovering this over three or five years as part of their annual management charges. This will no longer be

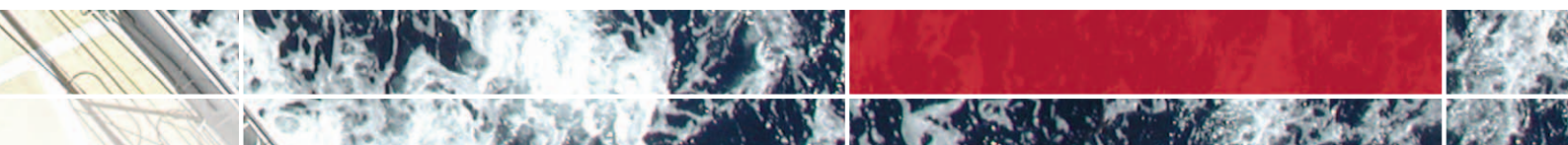


possible under new regulations, as any fees paid to the advisor will have to be deducted out of the value of the investment placed at the time it is paid and this could reduce the compound growth rate associated with the investment. Equally, renewal commission can currently be paid by the managers of a unit trust out of their annual management charges, to fund ongoing advice to the client, but this would now be regarded as a sale of units and could attract a Capital Gains Tax liability.

We are currently working out ways that will minimise the direct impact of these changes on our existing clients and will hope to gradually introduce these during the course of 2012 to ensure we do

not get caught up in a last minute rush to implement the changes before the deadline. For example, we plan to arrange to switch all our clients who hold investments on the Cofunds platform onto a fee agreement with fees offset by the renewal commission we currently receive out of the standard management charges applied by the fund management companies.

It is our intention to ensure that, where at all possible, any changes we need to make to comply with the new regulations will not increase costs to the client. There may however be some issues, such as the application of VAT on fees that was not charged on commission, which may be outside our control.



November

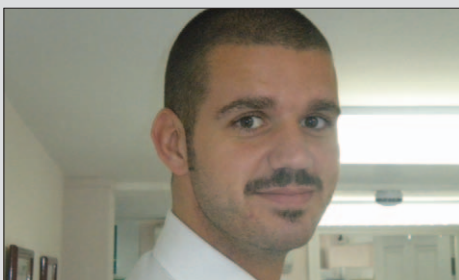
Throughout the month of November four of our chaps, Craig Selby, Stuart Holbrook, Adam Walker and Darren Weir took on the task of growing a mighty moustache in order to raise money and awareness for men's health issues, specifically prostate cancer and other cancers that affect men. The team, together with Craig's brother, Dell Selby, named themselves 'The Birchwood Bandits' and raised an amazing £641. We are very proud of them for their exceptional efforts and thought you may enjoy a smile at their 'interesting' facial hair!



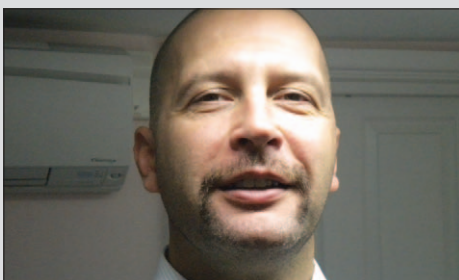
Stuart Holbrook



Craig Selby



Adam Walker



Darren Weir



HMRC relaxes pension 'carry forward' rules

HMRC has altered its interpretation of the annual allowance rules to let investors save more into pensions this year.

Rules came into force in April, stating the maximum pension contribution that could gain tax relief would be restricted to £50,000. If investors wish to pay in more than £50,000, they had the option to 'carry forward' any unused Annual Allowance (AA) from the previous three tax years. Each of these tax years are given a £50,000 reference contribution level, but if a contribution of over £50,000 had actually been paid in, then it would start to eat into the following year's AA and therefore reduce the amount that could be carried forward.

HMRC have now relaxed this rule, saying that even if contributions over £50,000 were made, they will effectively ignore the bit in excess of £50,000 so that it does not impact on other tax year's allowances.

This all sounds a bit complicated, so let's take an example. If we consider an extreme case to demonstrate the point; Under the old rules, if an investor had paid a pension contribution of £150,000 in 2010/11, they would not have been able to make a carry forward contribution in respect of 2008/09 or 2009/10, because the £150,000 would have effectively used up the £50,000 allowance available for each of the three years. Under the new interpretation of the rules, the £150,000 contribution in 2010/11 would only have used up one year's allowance of £50,000, because the excess will be ignored. This means the annual allowance of £50,000 for 2008/9 and 2009/10 will still be intact and is able to be carried forward.

Although this change may only be of benefit to a limited number of people, it is a welcome simplification of the rules.

Avoid the 60% tax trap

Income tax rules state that each individual has a Personal Allowance, which is the amount they can earn in any tax year before they start to pay income tax. For an individual under age 65, the Personal Allowance currently stands at £7,475. However, if your earnings go over £100,000, your Personal Allowance will start to be reduced by £1 for every £2 you earn over the limit. The removal of the tax-free band, together with a 40% liability to income tax gives those earning between £100,000 and £114,950 an effective tax rate of 60%.

Whilst many may dismiss this as not applying to them, do not forget that the definition of 'income' is all-encompassing and includes not only salary, but also pension income, rental income, interest from cash accounts, dividends from shares, in

addition to any redundancy payment over £30,000. When the redundancy is taken into the equation, someone who may usually never have to worry about the £100,000 ceiling, can find themselves inadvertently effected. The first £30,000 of a redundancy payment is tax free, but anything over that is taxed as income. So, as an example, someone earning £45,000, with a redundancy payment of £90,000 will find themselves breaching the £100,000 taxable income limit.

If you find yourself in the 60% tax rate, do not forget that pension contributions and charitable gifts are allowable against your taxable income. It may therefore be worth giving careful consideration to using these options to get your income back under the £100,000 threshold.

MARKET REPORT

GLOBAL REVIEW



Financial markets have adopted an attitude of 'risk on/risk off' trading with the ongoing European sovereign debt crisis very much at the heart of investor sentiment. Following the lows witnessed in September, equity markets rallied in October as hopes grew that a firm resolution to the eurozone debt crisis would be agreed in the latest summit meeting of Europe's leaders at the end of the month. However, sentiment quickly turned again in November as proposals from the meeting were deemed inadequate causing investors to turn 'risk off'.

The net effect for global equity markets was broadly neutral although co-ordinated action to increase dollar liquidity, to in particular European banks, by the US Federal Reserve, European Central Bank and central banks of Britain, Canada, Japan and Switzerland toward the end of November provided a welcome fillip to share prices. Whilst global equities, as measured by the MSCI World Index, have rallied over 10% from their August nadir, share prices still remain 6.5% lower year-to-date with investors favouring the short-term safe haven status of Government bonds despite the huge debt problems that persist and their poor long-term value.

UK



The FTSE 100, although proving marginally more resilient year-to-date, posted its worst losing streak since 2003 during November by falling for nine consecutive days prior to the combined intervention of the central banks. The timing of the announcement by the central banks was fortuitous given the content of the Chancellor's Autumn Statement that

confirmed forecasts of lower economic growth over the next three years and as a result higher Government borrowing requirements than initially predicted in the March pre-budget.

In contrast, pressure on the Bank of England has begun to ease with inflation posting back-to-back falls in October and November. Despite remaining well above the Government's 2% target, the Bank's Governor has confirmed the Monetary Policy Committee's view that inflation would fall back sharply over the next 6 months and approach 2% by the end of 2012. This may also pave the way for an expected additional £50bn expansion in its quantitative easing programme over and above the additional £75bn committed in October.

US



With inflation also seemingly past its peak in the US there is scope for the Federal Reserve to provide additional monetary stimulus. The Federal Open Market Committee may choose to postpone further measures however, given some recent encouraging data. Retail sales rose at the fastest rate for nearly two years in October and new unemployment claims fell to their lowest level since April.

However, US economic growth for the third quarter still suffered a downward revision, falling from an initial estimate of 2.5% to 2%, well below the average 3% trend. Negative contributors were slowing imports and disappointing manufacturing data added to concerns over stubbornly high unemployment figures, despite the private sector adding more jobs in November than at any other time in the last year. The 9% unemployment rate may encourage Congress to extend President Obama's payroll tax cuts that, in combination with the Federal Reserve's measures to keep long-term interest rates low, may promote stronger growth.

EUROPE



European equity markets are now priced for recession. Investor sentiment has dwindled as fears have grown that the sovereign debt crisis would engulf Spain and Italy following default by Greece. All have seen recent changes of Government as previous administrations failed to address financial imbalances. A recent auction of Italian Government debt pushed the country's 10-year bond yield over 7%, a threshold that has forced other nations into bailouts. With the world's third largest bond market, Italy's failure would have obvious negative implications for global financial markets.

With the 14th emergency summit of European leaders failing to inspire investors, the European Central Bank (ECB) was forced to step up purchases of Italian Government bonds and suppress yields. While stopping short of becoming explicitly the lender of last resort, it has suggested that non-standard measures would remain in place to prevent "the malfunctioning of the money and financial markets". By also lowering interest rates and participating in co-ordinated action by central banks to increase liquidity, it is clear the ECB is cognisant of the risks.

The 15th European emergency summit, despite agreement to rewrite the European treaty and impose greater control over national budgets, harmed rather than enhanced confidence with the Fitch Ratings Agency subsequently placing six eurozone countries on downgrade watch and declaring that a comprehensive solution to the debt crisis was technically and politically beyond reach.

JAPAN



The ratings agencies all have Japanese sovereign debt on a negative outlook as the Government's total spending commitments this year hit a record ¥106 trillion following

a third extra budget to combat the impact of the March earthquake. The International Monetary Fund also voiced concerns that a sudden spike in Government bond yields could make current debt levels unsustainable, particularly in an environment of low economic growth. The Japanese economy did expand in the third quarter after three consecutive quarters of decline with GDP increasing 1.5% quarter-on-quarter.

Investors continued to flock to the yen, still considered a safe haven from global economic uncertainty. It has reached record levels against the US dollar, forcing the Government to earmark almost ¥2 trillion to control the exchange rate. A strong currency hurts exports and profits, which could see an acceleration of the shift to overseas production, a trend that would have a noticeable impact on Japan's economic prospects.

ASIA



Despite much stronger Government finances, a healthy banking sector and robust growth prospects, Asian and Emerging Market equities have underperformed year-to-date as investors have retreated from these traditionally more volatile regions. Despite initial estimates that China's economy grew by 9.1% year-on-year in the third quarter, local equity markets fell 17% in the year to the end of November, whereas the FTSE 100 fell 3.4% over the same period with the UK economy growing by only 0.5% in the third quarter.

China's Government has staved off contagion from the slowdown in the developed world economies by forcing state-owned banks to keep lending and creating jobs by launching massive public works projects. By cutting corporate and personal income taxes it has also boosted consumption, with retail sales continuing to grow at an annual rate of 16-18%. With interest rates at 5.5% and foreign exchange reserves of \$3.2 trillion, the authorities can afford to maintain a more accommodative policy.

20 December 2011

Abolition of Protected Rights April 2012

As you may be aware, entitlement to a Basic State Pension is built up through paying National Insurance Contributions, with a full pension being available to anyone who has 30 years contributions on their record. In addition to this, it is possible to build up an additional, earnings related, top-up to the Basic State Pension. This is known as State Second Pension (S2P), previously known as the State Earnings Related Pension Scheme (SERPS).

At the moment, some pension schemes are set up to provide a pension that replaces all, or part, of the additional State Pension. This includes some company, stakeholder and personal pension schemes. When you join one of these pension schemes, you are said to be 'contracted out' of the additional State Pension (S2P).

The contracted out scheme receives National Insurance rebates, which are intended to provide benefits broadly the same as those given up in the additional State Pension. However, because

benefits from defined contribution schemes can vary, it is very difficult to predict with any degree of certainty what benefits you will receive at retirement. Due to this uncertainty and the difficult judgements that individuals currently have to make about whether they would be better off in the additional State Pension or contracted-out, the Government has decided to abolish contracting out on a defined contribution basis from 6 April 2012. From this date those who have contracted out will automatically be brought back into the additional State Pension and begin to build up entitlements from this time.

You will still be able to save into a defined contribution company pension, personal pension or stakeholder pension as normal and tax relief will still be available on any of your own payments, however, the contract will no longer receive a rebate of your National Insurance contributions.

Rebates already paid will remain in the scheme to

provide benefits in place of the additional State Pension for the time you were contracted out. If you wish you can transfer these rights to another pension scheme if the new scheme is prepared to accept them.

At the moment the rebates together with any investment return are known as "Protected Rights". There are currently restrictions on how protected rights can be used because they are intended to be used to provide benefits in place of the additional State Pension. However, following abolition, these restrictions will no longer apply and the accumulated Protected Rights value will be treated as Non-Protected Rights. As a result, those taking Protected Rights benefits will no longer have to annuitise based on unisex rates and it will no longer be compulsory to include a Spouse's benefit where applicable. Furthermore, the maximum guaranteed period for annuity payments will be increased from 5 years to 10 years in line with Non-Protected Rights benefits.

Auto-enrolment Update

A delay to the start dates of the Auto-enrolment system for small businesses has been announced in the Autumn Statement. Auto-enrolment is the scheme whereby employees are automatically enrolled into their employer's qualifying pension scheme without any active decision on their part. At present, many workers fail to take up valuable pension benefits because they do not make an application to join their employer's scheme. Auto-enrolment is meant to overcome this.

Each qualifying scheme must meet minimum standards

in respect of the benefits it provides or the amount of contributions paid to it. The scheme must also provide Auto-enrolment for all eligible workers, and for all new workers when they become eligible.

Although new duties come in from 1 October 2012, the Autumn Statement confirmed that the starting dates for small businesses has been amended. Firms employing 3,000 or less are now expected to auto-enrol employees from May 2015 rather than April 2014. More details will become available early in 2012.



Changes to State Pension Age

In his Autumn Statement on 29th November, The Chancellor of the Exchequer, George Osborne, announced that the State Pension age will now increase to 67 between 2026 and 2028. The decision was taken because of increasing life expectancy, to help manage the cost of State Pensions.

Existing Legislation planned to increase State Pension

age to 66 between November 2018 and October 2020. An increase to 67 was then planned between 2034 and 2036, with a rise to 68 between 2044 and 2046. Under the recent announcement the increase to 67 is brought forward by eight years. Anyone born after 5th April 1961 and before 6th April 1969 will have a State Pension age of 67, those born after 5th April 1960 but before 6th April 1961 will have a retirement age

between 66 and 67 depending on when they were born.

Given these changes it is highly likely that the timetable for the increase in State Pension age to 68 will also be brought forward.

This change is not yet law as it will require parliamentary approval.

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