

# Planning for the future and managing risk in difficult times

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Many of your clients' financial planning will have been blown off track during 2008. The major stock market falls in the second half of the year, combined with extreme volatility and global economies facing unprecedented turbulence as they moved into recession has meant that individuals have been more concerned with not losing what they already have than ensuring that future plans are on track.

This is perfectly understandable. Global equity markets fell by about a third over the year, although there has been some protection for those investing overseas due to the weakness of Sterling. Many investment portfolios have not been adequately diversified, with investors taking more risk than they realised, and so financial planning arrangements, such as retirement planning or providing an income in retirement, have been hit hard.

The New Year marks an opportunity to pause for breath and reconsider financial goals and objectives. What is it your clients want to achieve and what do they need to do in order to achieve it?

If their financial plans have been affected then broadly they have two choices; either do nothing or do something. If the former then they may need to accept some compromise in terms of their future plans, for example, it may be that they have to push back their planned retirement date or survive on a lower level of income. For some clients, particularly those without the means to increase savings or a desire to increase risk, this may be a harsh reality.

If they are able to commit extra money to their financial planning then this could help to ensure their financial goals remain achievable. However, it is important not to throw good money after bad or take on more risk than they are now comfortable with. Many clients' tolerance to risk has fallen dramatically in recent months and, while it is important that greed or fear do not dictate investment decisions, it is also important that they are able to sleep at night.

They, therefore, need to consider the level of risk they need to take to achieve their financial goals and compare this with the risk they are happy to accept. Again, there may be the need for some compromise. The most sensible approach for clients is a diversified multi-asset portfolio, which will help to manage investment risk. For example, a typical Towry Law client portfolio will hold 15 different asset classes.

If they are taking income from their savings, they need to decide whether the amount they are taking is sustainable. This again links to investment risk, but many people also take income from deposit accounts and rates from these have fallen significantly as the Bank of England continues to cut interest rates.

If you have clients in Unsecured Pension (income drawdown) they may now wish to consider buying an annuity with their pension fund. This will provide security and negate any further investment risk, though investment losses will mean they are buying an annuity with a smaller fund and so are likely to get a lower income.

Other investments also need to be reviewed to ensure they are appropriate and tax efficient. For example, the 2008 Budget changes to capital gains tax all but erased any tax benefits previously offered by investment bonds.

The introduction of a single rate of capital gains tax, coupled with the annual exemption for individuals (currently £9,600), means that a couple can enjoy gains of at least £19,200 each year before they need to pay tax on growth, and even then at only 18%. Contrast this with investment bonds, where all gains are treated as income for tax purposes and are potentially subject to income tax of up to 40%, with no opportunity to shelter growth using an annual exemption.

As a general rule clients should ensure, after using relevant tax-free allowances, that their investments are liable to capital gains tax in preference to income tax. All clients should, therefore, review their investment bond holdings.

For those with borrowings, including mortgages, these should also be reviewed. Falling interest rates could create opportunities to minimise interest payments and, particularly for those on tracker mortgages, they could consider repaying more of their capital for the same cost.

As we look ahead the general outlook for 2009 does not look too promising. However, you should ignore pundits' predictions, as most of them will be wrong. Your clients should ensure that short-term sentiment does not dictate long-term financial planning and that their investments remain diversified and tax efficient. They should also only take advice on an independent fee-only basis, where their adviser will not have a financial incentive to sell them an inappropriate product.



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