ATLMONEYTALK

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EXCLUSIVE DEALS FOR MEMBERS

The curse of long-term cash

Trevor Greetham, Head of Multi Asset at Royal London Asset Management, reveals why you should be seriously concerned when money in short-term cash deposit accounts turns into long-term investments.

There is nothing wrong with keeping some cash in an easy access deposit account on a short-term basis. Being able to pay unexpected bills is important and access to ready cash is part of prudent financial planning. But when short-term holdings of cash turn into a long-term investment we should be seriously concerned.

How cash savings can lose money

The buying power of large holdings of cash can be eroded by bouts of unexpected inflation, like the 1970s, or long periods with interest rates well below the rate of inflation – like today.

Since the financial crisis, cash has returned 1% or less a year, consistently below the prevailing level of inflation. We expect this situation to continue, with the Brexit negotiations keeping UK interest rates low as the weak pound pushes inflation higher, eroding the real value of cash savings.

Doesn't everyone know this already?

Many people still hold a significant part of their long-term wealth – excluding their home and pension – in cash. In 2015/16, nearly three-quarters of the £80 billion invested in adult ISAs went into cash ISAs, with millions of people getting negative real returns on their long-term savings.

A more appropriate long term strategy

By contrast, money invested across a wide range of asset classes (types of investments) – known as multi-asset investment – has beaten inflation and outperformed cash by a wide margin. However, not all investment funds perform well and no single asset class is likely to provide the combination of stability and returns which most individuals seek. In contrast, investments in a well-managed multi-asset fund can spread the risk whilst giving investors exposure to assets that have the potential to deliver higher returns.

Multi-asset funds better than cash since 2008

Since the financial crash of 2008, such a strategy would have consistently outperformed cash in each and every year. The difference between the two approaches is considerable. If you had put £1,000 into a cash ISA 10 years ago it would be worth less than £900 in today's money. If instead you had put your £1,000 in a multi-asset fund you could have an estimated pot of over £1,500 now.

Long-term savings require a long-term approach

ISAs are increasingly being used as part of a long-term savings strategy alongside pensions, but holding cash is not a sensible option when interest rates are close to zero and inflation is on the rise. In the short run, cash is safe but in the long run it is risky.

Stocks and shares ISAs, particularly those that invest in multi-asset funds, can offer a good home for your long-term savings, including for retirement. A professional financial adviser can recommend funds that match your objectives and expectations.

The value of your investments can go down as well as up, so you could get back less than you invested.

Source: The Curse of Long Term Cash - Royal London

Also in this issue

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How are you? Really?

How thinking a little differently could make a real difference to the income you get from pension savings you have outside the Teachers' or local government pension schemes.

"How are you?" "Good" or "Fine" you're likely to reply. That's because we all know that "How are you?" is an alternative greeting to "Hi". We know that it's usually said with nothing more than a passing interest in your well-being or health. And that's OK. Imagine if you were to launch into a long tale about being tired, wheezy with asthma, trying to lose weight, taking cholesterol medication and a history of heart disease. It's just not in our psyche or our reserved British nature.

However, sometimes there's a real benefit to talking about your health. You just might not realise the importance. It could make a big difference if you're approaching retirement and considering converting your defined contribution pension pot (pension savings outside the Teachers' or local government pension schemes where benefits you receive are not linked to your salary) into an annuity for a guaranteed income for life, or drawing down income.

So what are we suggesting?

First, think about 'personalising' or 'tailoring' your income. Forget about whether you 'qualify' for increased annuity rates due to your health.

Guaranteed income for life

What does this really mean? Generally, when you look at buying a guaranteed income for life (an annuity) you would be asked about your health to see if you are ill enough for an 'enhanced' or 'impaired' annuity. If you qualified, it would mean your income would be higher.

But, like everything these days, underwriting moves on as life expectancy predictions change and medical science continues to improve. The scope of personalisation "underwriting" is now so broad that it's becoming almost impossible to second guess if someone might 'qualify' or not.

It isn't just about whether you have a serious condition such as heart problems or cancer. It can also cover more everyday things such as raised blood pressure, where you live, smoking, alcohol intake and diabetes to name but a few. The idea of qualification is becoming redundant. Everyone can now get their own 'personalised' rate.

If we think about it at its simplest, everyone has a height and weight. Everyone is likely to have a postcode. Therefore, everyone can obtain their own personalised underwritten annuity rate. You don't need to be seriously ill to get a higher guaranteed income for life.

This means that if you're thinking of buying an annuity you shouldn't be settling for anything 'standard', off-the-shelf or ordinary. Instead, think about having your plan tailored to your exact specifications. It should be bespoke. It could make quite a difference to the amount of income you receive.

Underwriting for drawdown reviews

People have more choice in how they use their money in defined contribution pension schemes, with drawdown becoming the popular choice. Understandably, flexibility is often high on their wish list. The tricky part though is knowing whether you're taking too much out of your pot when you need income.

Obtaining a personalised annuity quote will provide an example of the level of guaranteed income for life you could receive. This can then be used as a benchmark for the income you'd like to take out of your drawdown plan. It will help you determine if your investments are providing the returns you need, and if the income you are taking is sustainable.

Asking your financial adviser to arrange for you to be underwritten at each drawdown review or annuity purchase will ensure that you're getting the most out of your retirement, and have a truly tailored retirement income solution.

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Little things add up

Most people need to save extra for retirement – and the sooner you start saving, the greater the chances of having enough income – especially if you harness the potentially big long-term advantage of "compounding".

The need for people, and especially younger people, to take personal responsibility for building their pension pot is also becoming ever greater. This is particularly true for ATL members, in light of the Teachers' and local government pensions being switched to career average benefits and increases based on the Consumer Price Index (CPI).

While your Teachers' or local government pension is likely to give you enough income to cover your basic needs when you retire, you probably need to save more if you want to maintain your lifestyle. You therefore need to make additional savings – and the sooner you start doing this the easier it should be to boost your pension.

The International Longevity Centre, a think-tank that focuses on policy on longevity, ageing and population change, has recommended that young Britons should be saving 18% of their salary in order to live the same type of retirement as today's pensioners. As a guide, the Teachers' and local government pensions are based on contributions of roughly 16% of your annual salary. That leaves a gap of around 2%. However, if you are older and haven't been making additional contributions, you may need to save more.

The need to make additional contributions

With this gap between the required and the actual saving levels, you should consider being proactive in ensuring that smart investment decisions help pay for your later years.

One way to make up this shortfall could be by embracing the mantra of "the little things add up" and harnessing the power of compounding. Compounding is the process by which your future returns are based not just on your initial investment, but also on any growth on your investment. Compounding plays on a simple truth: if you can find yourself a small but regular advantage, apply that over a long time and it will compound into a big difference.

Compounding can make a significant difference

Compounding can be used by pension savers in their twenties, thirties, forties or even fifties, to make a potentially significant difference to their retirement fund. Obviously the earlier you begin investing the more powerful the potential long-term impact of compounding could be on your overall investment pot.

A range of investment options

Premier Asset Management is responsible for managing £5.8 billion of assets (as at 30.06.2017) on behalf of clients. Their money is invested in a range of different investment solutions designed to achieve different long-term investment objectives, such as long-term growth, a regular income or a balance of both, and with different risk profiles to cater for the varying risk appetites of investors. The box on the right gives an overview of their four Risk-Targeted Portfolios.

With retirement lasting longer than ever and with other more immediate financial burdens to meet, it is important to consult a financial adviser at an early stage. He or she can advise on the suitability of investment options that can fit around other financial considerations and help you try and avoid facing a shortfall in your pension when you retire. By utilising suitable investment portfolios and harnessing the power of compounding, we believe that everyone can have the best chance of enjoying a comfortable retirement.

The value of your investments, and the income you receive from them, can go down as well as up, so you could get back less than you put in. A pension is a long-term investment and inflation will reduce how much your income is worth over the years. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation.

The four Premier Risk-Targeted Portfolios aim to provide long-term investment growth by investing in a diverse blend of Premier funds.

The portfolios are actively managed by the Premier Portfolio Management Service investment committee, and Premier's specialist investment teams, who choose the underlying funds in which the portfolios are invested.

Their investment teams believe it is very important to constantly monitor and manage client portfolios with the aim of keeping each portfolio on track to achieve their long-term aims.

They believe diversification (spreading the risk) is important to help manage investment risk (not putting too many eggs in too few baskets) and to expand the investment opportunities available.

Premier
Asset Management

It's time to talk about inheritance tax

HMRC recently published statistics revealing that the amount paid in inheritance tax has risen from £2.4bn in 2009/10 to £4.7bn (provisional) in 2015/16. That's a staggering 96% increase.

Tax year 2009/10 isn't simply a random year. It is the year since which the inheritance tax nil rate band (the amount above which inheritance tax is charged) allowance has been frozen at £325,000 and it will remain frozen until 2020/21. As a result more families are being dragged into the inheritance tax net.

How does the nil rate band work?

Inheritance tax is a tax on the estate (the total value of property, money and possessions) of someone who has died. Any part of the estate that is left to a spouse or civil partner will typically be free from inheritance tax. However, when their spouse or civil partner dies there could be inheritance tax to pay on their estate.

When someone leaves their estate to people other than their spouse or civil partner, such as children or grandchildren, inheritance tax is payable on the amount that exceeds the nil rate band. Tax rules make it possible to transfer any unused nil rate band to the surviving spouse or civil partner.

What about the £1m nil rate band?

If you have seen reports suggesting a £1m nil rate band per couple then you might be scratching your head. A new, additional nil rate band called the residence nil rate band is being introduced. It broadly applies when you leave your house to children and grandchildren. The allowance is being phased in over four tax years starting at £100,000 per person in 2017/18 and rising to £175,000 in 2020/21. The residence nil rate band will be gradually withdrawn for estates with a net value of more than £2 million.

What can you do to reduce inheritance tax?

Making gifts while you are alive can reduce the value of your estate. Gifts to charities, gifts up to £3,000 in a tax year and regular gifts out of income can all be immediately exempt from inheritance tax. This is useful if you have surplus income and, for instance, you make regular pension contributions on behalf of family members. You reduce the future inheritance tax bill and the recipient can enjoy a boost to their pension and tax relief. Other 'one-off' outright gifts are exempt, if the donor survives for seven years or more.

Using a flexible trust could be an option

If you need to remove larger amounts from your estate it may be appropriate to make gifts using a flexible trust where the trustees have control over who benefits and when. While this can be an effective strategy, it is a complex area and you should take professional financial advice before doing anything. A professional financial adviser can recommend inheritance tax planning strategies appropriate for your circumstances and future financial needs. As usual, the sooner you start planning, the more options you are likely to have.

Tax advice which contains no investment element is not regulated by the Financial Conduct Authority.

The residence nil rate band

Harry died in 2015 and left his entire estate to his wife Sally. There was no inheritance tax to pay on Harry's death. He had not used any of his nil rate band. When Sally died in 2016, her personal representatives claimed Harry's 'unused' nil rate band as well as her own, giving a combined nil rate band of £650,000. This was before the residence nil rate band was introduced.

Let's now assume that they both lived longer. Harry died in February 2016 and left everything, including his share in the family home, to his wife Sally. No inheritance tax was due on Harry's death. In December 2020 Sally dies and leaves her entire estate to her two children. The nil rate bands available on Sally's estate are:

Sally's nil rate band	£325,000
Harry's unused nil rate band	£325,000
Sally's residence nil rate band	£175,000
Harry's unused residence nil rate band	£175,000
Total	£1,000,000

If Sally had not had children or had left her estate to nieces and nephews then the residence nil rate band would not have applied to her estate.