Edward T James & Company

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A Very Warm Welcome to Our Latest Newsletter

AS the year closes, the financial world appears to have moved on considerably from the uncertainty and nasty surprises of 2008 and early 2009. We think it would be true to say that we end the year on a positive note.

Here at Edward T James & Company we have been pleased by the success of our unique approach to regular planned reviews. Portfolios have recovered significantly, with each client benefiting from their individually planned strategy and the flexibility of our carefully researched arrangements.

We have been asking you what you think, and we are pleased that you have been telling us that you enjoy this very personal service, and appreciate the benefits it brings to you and your wealth. Thank you for your confidence. If ever you think of a way we can improve our service please let us know.

Having achieved the proper induction of all our clients, this has also been the first year in which we have been introduced to new clients. This has been mostly through kind referrals from you, our valued existing clients. As most of you know, we do not actively market our services and all clients come to us through personal recommendation.

We know from experience that the best relationships are more likely to emanate from successful existing relationships. So if ever you feel that family or friends would benefit from meeting us we will always be happy to do so.

We hope that you enjoy reading the carefully selected articles in our latest newsletter, and as always we welcome any feedback or questions that you may have and will look forward to hearing from you. In the meantime, we wish you a happy and prosperous New Year.

Chris Polawski and Simon Bullivent

The Market Rebounds

Fast market recovery but slow economic revival?

THE FTSE 100 Index has rebounded from the six-year depths of only months ago. The blue-chip index finally regained the psychologically important 5,000-point level in September, reaching its highest level for almost a year, and rallying by more than 40% since the March lows. Although it remains considerably below the levels reached before the demise of Lehman Brothers, there is concern that the UK equity market's rally has surpassed realistic prospects for corporate earnings.

Hopes of a burgeoning economic recovery in the UK and strengthening economic data from France, Germany and the US have provided investors with some encouragement. Corporate earnings from many companies have provided positive surprises, although it is worth remembering that some of these gains were achieved from cost-cutting and downgrading rather than through increased demand or higher turnover. The path ahead is unlikely to be trouble-free, and prospects for the UK stock market and economy remain far from clear. Looking ahead, if the economic backdrop does continue to improve, this is likely to provide further impetus for corporate earnings. However, if the early signs of economic revival begin to wane, then sentiment is likely to change rapidly from tentatively positive to negative.

On balance, the recent share-price rally is encouraging, not least because it demonstrates that UK investors are willing to go back into volatile equity investments. However, keep an eye out for news which might undermine investor sentiment.

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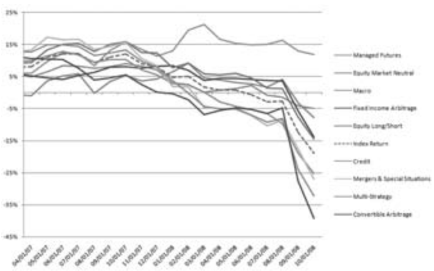
Hedge Funds

An alternative for diversity

THE term 'hedge fund' covers a wide range of investment strategies, from the lower risk, aiming to preserve capital, through to the very high risk, perhaps even using large amounts of debt – gearing – to try and boost returns.

They usually have high minimum investment levels and lack the transparency of traditional funds – indeed, many will not reveal how they make their money in case it moves the market and jeopardises their returns. They are also generally unregulated and most are based offshore.



For example, a hedge fund manager might aim to produce 'absolute' returns of, say, 10% per year, regardless of whether equity markets go up or down, as opposed to 'relative' returns, where a fund manager aims to outperform a benchmark. They might aim to do this by using a technique called 'shorting' to make money from a stock if its price falls, as well as holding stocks in a traditional way to make money if its price rises.

Other more sophisticated 'macro' techniques might aim to make money from currencies or interest rates. And some hedge fund managers will borrow to try and magnify their returns - and it is these highly-geared funds that have been the source of most of the sector's well-publicised problems. Because of all these different techniques, hedge funds are only suitable for the most sophisticated or experienced investors who can understand the processes and therefore appreciate the full extent of the risks involved.

Retirement Choices

The options from Pensions

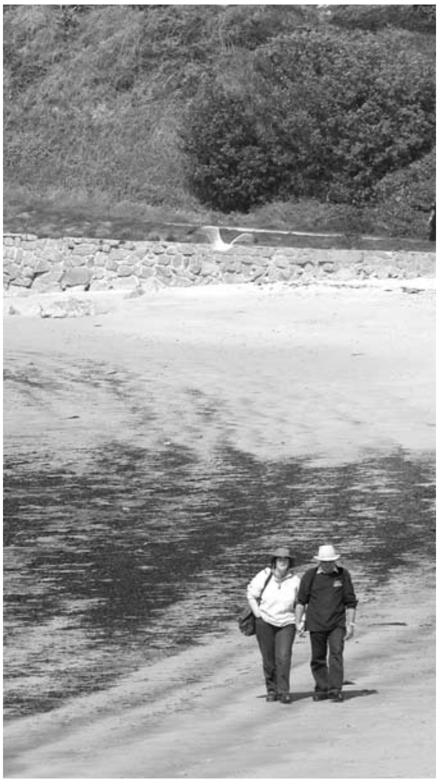
ASSUMING you have saved diligently over the years, when you reach retirement age you will have some important choices to make – the first being when that retirement age will be. As the minimum age increases from 50 to 55 in April 2010, this needs some thought. In addition, the statutory age (ie: the age when you become entitled to state benefits) is also increasing for women from 60 to 65 by 2020, to equalise them with men.

As a general rule, it is better to hold off retirement for as long as possible. Deferring state, employment and/or personal pension benefits should ensure you receive a larger income as annuity rates tend to improve, the older you are. Equally, if you choose to downsize your career but can still earn some income after your chosen retirement date, you may be able to 'phase' your retirement, using only a portion of your pension fund to start with, leaving the remainder invested until a bit later.

However, the most important choice you will make will be over the actual annuity, or unsecured pension (also known as income drawdown) product, as this will determine your ultimate income. There is also the option of taking 25% as a tax-free lump sum, which could pay for a long holiday or be re-invested elsewhere to generate additional income. An annuity will provide you with an income stream for life, but this does mean you give up all right to the capital – and your descendants will not inherit anything if you die shortly after retirement. You therefore need to think carefully about whether you include guarantees in your annuity choice (thereby securing some of that fund value at least for the short term) and also the rate being offered to you, particularly if you smoke or have certain health conditions.

With an unsecured pension (income drawdown) arrangement, you retain your entitlement to the capital and draw an income directly from the value each year. This will likely be less than you might receive with an annuity, but it does mean you preserve some of your pension fund - at least until age 75. These schemes do, however, leave your investment in the hands of the market so you risk the value going down as well as perhaps going up. They are now quite flexible, though, and offer access to a wide range of underlying investment funds so you can decide what risks, if any, are worth taking and allocate your money accordingly. An adviser will guide you through the process and make sure you understand everything before you make a decision.

Finally, you could decide to take an annuity for part of your pension fund, giving a basic income stream, and then take some risk with the remainder of your capital. Such a combination could offer a decent half way house for some, so do examine all your options carefully before making your move.



Low Interest Rates

What is good for the economy is painful for savers

UK interest rates are currently at 0.5% - the lowest level in the Bank of England's 315-year history. The dramatic series of cuts was aimed at easing the credit crunch and getting the banks to lend again. Even back in March, the Building Societies Association described the move as "a kick in the teeth for savers", while the Confederation of British Industry described the cuts as "becoming less and less effective as a means of stimulating the economy". Lower rates have also taken their toll on sterling, which has lost ground to other currencies - particularly the Euro.

So in an attempt to revive consumer spending and economic growth the Bank is expanding the amount of money in the system by £200bn through the process known as "quantitative easing". So far, the Bank says it has spent £175bn on this policy - with another £25bn to be injected by the end of January 2010.

The surprisingly weak third-quarter GDP (Gross Domestic Product) numbers, which showed the economy contracted by 0.4% between July and September, indicated the economy is still struggling to recover – this would suggest that low interest rates will be with us for some time. There are however some glimmers of positive news coming from the economy and from the housing market. Whether these shoots can mature into something more substantial once interest rates increase and the fiscal stimulus is withdrawn, remains to be seen.

And for your cash reserves now? The best bet is to shop around, and even consider putting some money away for a year or two which commands the highest rates. A good impartial source for this is www.moneyfacts.co.uk.

Inheritance Tax

Can you give away your house?

INHERITANCE tax (IHT) allowances have failed to keep pace with soaring house prices and many more people now have to consider the IHT legacy they are leaving to their beneficiaries. What options do you have to avoid IHT if your house takes you close to or over the current £325,000 IHT limit (£650,000 for married couples and civil partners, tax year 2009/10) without allowing unscrupulous or disorganised relatives to leave you without a home?

Firstly, the one thing you definitely can't do is simply sign your house over to your descendants and continue to live in it. This is called a 'gift with reservation' and is ultimately inefficient for tax planning purposes as the house will continue to form part of your estate. The only way to get round this is to pay the beneficiaries a market rent, but this is unlikely to be a popular option for those who have scrupulously paid off their mortgage in order to enjoy a comfortable retirement. It also opens the door to your house being sold from under you if your beneficiaries get into financial trouble.

So what options do you have? You could move out and rent or move somewhere smaller and gift the remaining capital to your beneficiaries. This gift is called a potentially-exempt transfer (PET) and becomes IHT-free as long as you survive 7 years. If you have a big enough house, you could arrange joint ownership and live together in the house. That proportion of the house then is then a PET and again, is IHT free as long as you survive 7 years.

For larger estates, there are some more complex schemes. 'Shearing' involves selling the freehold and obtaining a short-term lease. Another arrangement involves selling the freehold in return for a lease for life and cash. This cash goes into a trust and the freehold becomes a PET. However, such schemes need to be constructed with the help of a financial adviser to make sure they meet the regulations – and that an equitable deal is done.

There are no easy ways to avoid the IHT on your main house, but you can maximise your allowances to ensure you at least way lay the tax man and still keep a roof over your head.

China & India

Two Emerging Markets to watch

JAPAN'S reputation as a major economic power is long established – but now other Far Eastern countries are making the jump from "developing" to "developed". In particular, the last two decades have seen China evolve from bystander to economic superpower and its growing economic influence has led some commentators to speculate about its longer-term position in the global pecking order. For now, the US remains the economic powerhouse of the world, but China is already viewed as a force to be reckoned with.

The rise of the middle class in China is significant, particularly at a time when the US, Europe and the UK have been experiencing a consumer slowdown. Demand from affluent consumers in developing nations could provide some support for companies whose established customer base is feeling the pinch.

However, soaring food prices are having a negative effect on China's population, many of whom have become accustomed to a relatively comfortable existence over the last few years. China's agricultural capacity and processes have not kept pace with its urban and industrial expansion and, although incomes have grown significantly, food prices are now rising faster than wages.

Will China go unchallenged as a global economic force of the future? Perhaps not. For now, China remains the most populous country in the world with 1.3 billion people, closely followed by India, which has a population of 1.1 billion, and whose booming economy has also been the focus of much attention. Looking ahead, the Chinese government's official "one-family, one child" policy is likely to mean its population begins to plateau over the next few decades, while India's population is expected to continue to grow.

China's development has influenced almost every area of the global economy. Strong demand from other nations for its cheaply manufactured products has helped the economy expand rapidly; however, this vibrant economic growth has had its downside, and the Chinese government has sought to cool down the country's export-fuelled growth.

Meanwhile, inflation has been high, stoked by surging food prices, while the country's insatiable appetite for raw materials and oil, driven by the rapid development of its infrastructure and booming demand for its exports, have been key to the surge in commodity prices of the last few years.

In common with the rest of Asia, China has not proved immune to the full effects of a US-led global slowdown, leading to its government announcing its own stimulus package.

ISA

Rare gift of Tax Efficiency – use it or lose it

THE Individual Savings Account (ISA) is a rare opportunity which the Government offers you to shelter your money from the tax man. For every pound you put in, you pay no further personal tax on any profits earned and do not even have to declare its existence to the tax man. This year, you can invest up to £7,200 - or, if you are over 50, up to £10,200. However, as the year end (and then tax year end) start to creep up on all of us, you need to make sure you act or you lose this year's opportunity forever.

Of the £7,200 (£10,200), up to £3,600 (£5,100) can be invested into cash - on deposit with a bank or building society or via cash funds. The rest can be invested in the much more volatile world of stocks and shares - or a fund of stocks and shares, the latter of which will at least spread your risk a bit further given that the value is at risk in this area and it is possible you may not get back the amount you originally invest.

ISAs are available for lump sum investment but also for regular savings. Whatever you choose to do, however, the deadline is approaching and you therefore need to start planning to make sure you can take full advantage. Of course, you do not have to use the whole allowance - but if you can, or if you have investments elsewhere that could be transferred over, sheltering them within an ISA does provide a more tax efficient way to hold on to any gains you do make.

Please note: the exact tax benefits of ISAs vary depending on your circumstances and are subject to change.

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