



The Street Lamp News

Summer 2010

A return of risk aversion dictated the path of investment markets in the second quarter. Although resilient global growth suggested that the recovery remained on track there were fears that the effects of the action taken to reduce government debt would paralyse the economies in the eurozone and this led to the major equity markets suffering their worst quarterly return since 2008. Defensive stocks were to the fore as confidence ebbed. However despite the escalating government debt concerns, bond markets were a beneficiary of the slump in risk appetite and made gains over the quarter.

In the UK sentiment was also undermined by worries that May's general election would not deliver a conclusive result and this indeed proved to be the case. The key market development was the halving of the BP share price in the wake of the Gulf of Mexico oil spill. With the US government holding it responsible for the environmental catastrophe, the company bowed to political pressure to suspend its dividend. Bank and commodity-related stocks also ended the quarter on the back foot as fears grew over the sustainability of the global economic recovery.

Continental European markets were buffeted over the quarter as macro-economic concerns re-asserted themselves amid fears that Greece would default on its spiraling debt. Wrangling over the bail-out of Greece raised fears that contagion would spread to other highly indebted countries such as Spain and Portugal. However, despite unemployment breaching 10% in the eurozone, economic data in the core nations continued to support the view that economic recovery is gaining traction, with industrial production remaining on a positive trend. A further weakening of the euro against the dollar also boosted the outlook for exporting economies such as Germany.

US stocks slightly outperformed the global average over the quarter as macro data suggested that the economy was recovering more or less satisfactorily. Manufacturing data was particularly strong, with output being boosted by a rebound in motor vehicle production. There was nevertheless some disappointing news on employment, which rose by less than had been expected, and weak retail sales, which failed to reflect robust levels of consumer confidence. Adversely affecting sentiment later in quarter was the dire ecological consequences of a catastrophic oil spill from a BP drilling platform in the Gulf of Mexico and banking shares were hit by news that Goldman Sachs was to be investigated by the authorities for fraud relating to sub-prime mortgages.

Emerging equities traded lower in the second quarter in response to falling risk appetite globally, they nevertheless outperformed the global average. Asia was weak in reaction to concerns about slowing Chinese growth and escalating tensions in Korea after North and South cut diplomatic relations. Ironically, the possibility of the Chinese economy decelerating boosted the Chinese stock market as investors felt that it made interest rate hikes there less likely. In South America, Brazil was hit by weak energy and commodity prices but returns from Peru were robust as the market which is sensitive to the gold price gained ground on heightened global risk aversion. European emerging markets were hit hard by the sovereign debt crisis, with Hungary, Poland and the Czech Republic all falling back sharply.

As you are aware we have had a positive view on corporate credit for some time. This, as mentioned above, is due to the fact that the current economic environment is supportive for corporate bonds. The asset class is still pricing in a recessionary scenario and a much higher level of defaults than it has experienced historically - despite many companies being in good financial health.

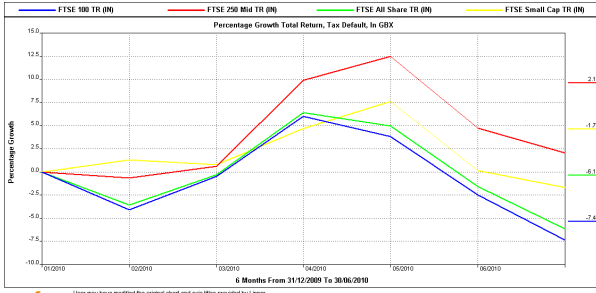
Whilst inflation is rising it is not an issue to either the corporate bond market or government bonds, particularly given that the output gaps present in developed economies are unlikely to close for some time. Current rates of inflation, combined with very low yields on cash, are creating a negative real return on cash deposits. The additional yield available on corporate bonds is therefore attractive.

We do not expect that there will be double-dip recession in the UK and Europe. However, if the UK does enter recession again, corporate bonds should not come under significant pressure. This is due to the fact that corporate bond spreads are already pricing in a downturn. We expect economic growth to remain weak but positive. Investment grade bonds have traditionally performed well in such an environment. If economic growth is too high, bonds suffer from inflation fears and outflows of investor money to equities. But if growth is too low, they suffer from increased fears of default risk.

The difference between the yield on government bonds and corporate bonds has risen in recent months in favour of corporate bonds and this is compensating investors for the risk of default, however the actual default rate of corporate bonds has fallen sharply.

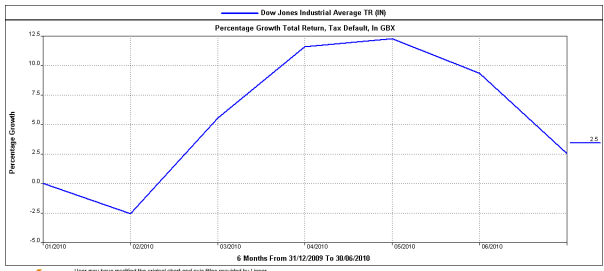
While many governments continue to issue bonds to finance their deficits, a lot of corporate refinancing has already taken place. Consequently, less corporate bond issuance is taking place. However, government bond issuance continues apace. Relative to government bonds, the supply of corporate bonds is therefore falling, again making them attractive.

Commercial property has continued to register positive total returns and rising capital values although the pace has eased back. Institutions have increased their net investment in property and are driving the UK market as overseas buying, although remaining positive on balance, has become less pronounced. Investment transactions so far this year amount to £9.3 billion, higher than the same period in 2009 but a slowdown from the levels seen at the end of last year. There are signs that buyers are becoming more cautious and there is less competition for stock with some assets being withdrawn having failed to reach the asking price. The level of occupancy has seen some upturn from low levels whilst the number of empty properties has reduced but the market remains fragile. Rents are generally still under pressure although the Central London office market, among the worst affected during the downturn, is showing signs of recovery at the prime end.



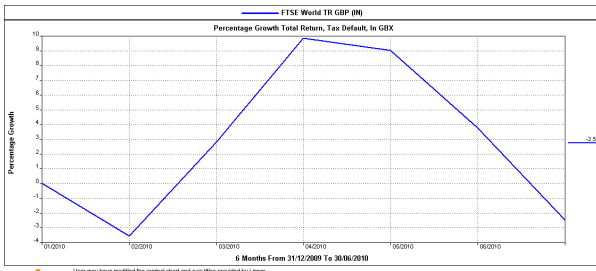
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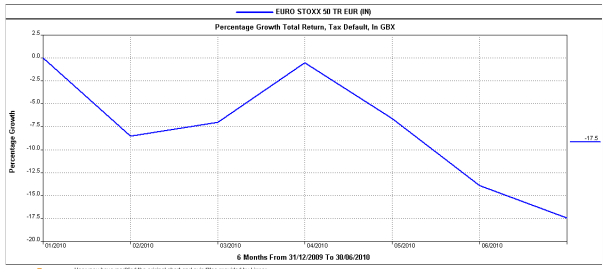
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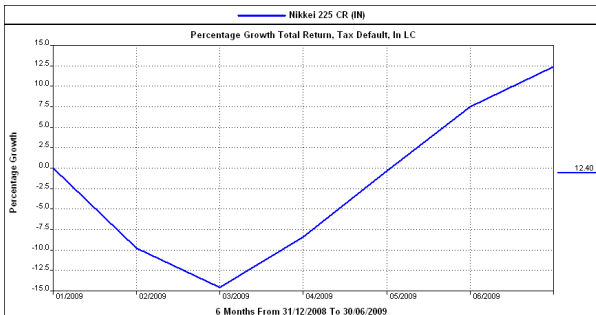
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MARKET REVIEW

During the six months ending 30th June 2010 capital changes in the main markets have been as follows: -

	31/12/2009	30/06/2010	% Change	£
<u>United Kingdom</u>				
FTSE 100 Index	5412.88	4916.87	- 9.16	
FTSE All Share Index	2760.80	2543.47	- 7.87	
FTSE Mid 250 Index (exc. Inv trusts)	9718.16	9782.85	+ 0.67	
FTSE Small Cap. Index (exc. Inv trusts)	2327.93	2205.40	- 5.26	
FTA Brit. Gov. Securities Index				
Fixed Interest - All Stocks	152.13	157.44	+ 3.49	
Index Linked - All Stocks	357.48	368.57	+ 3.10	
<u>North America</u>				
Standard & Poors Composite Index	1115.10	1030.71	- 7.57	- 0.23
<u>Japan</u>				
Topix Index	907.59	841.42	- 7.29	+ 5.28
<u>France</u>				
CAC 40 Index	3936.33	3442.89	-12.54	-19.04
<u>Germany</u>				
DAX Index	5957.43	5965.52	+ 0.14	- 7.73
<u>Switzerland</u>				
Swiss Industrial Index	6545.91	6128.06	- 6.38	- 3.14
<u>World</u>				
FT World Index	316.01	303.73	- 3.89	- 3.89

*This column adjusts the capital changes to reflect the movement of Sterling against the relevant local currency.

Composite Index - 5.74 %

This Index is calculated on the basis that a client's Portfolio is invested as detailed below with net income re-invested at the payment date: -

Building Society Deposits	30.00%
UK Government Index Linked Stocks	10.00%
UK Equities	40.00%
Overseas Equities	20.00%

Bulls & Bears

Equities

UK Equities	The market can make headway, supported by valuations and the benefits of sterling's depreciation on overseas earnings, but faces headwinds from weak real income growth and fiscal tightening.
US Equities	Supported by improving corporate cash flow into 2010 on the back of strict cost control but the upside is limited by the consumer debt and housing market overhangs restraining domestic demand.
European Equities	Profitability is restrained by less cost cutting than is taking place in the US and UK, plus the impact of euro appreciation, albeit some firms are supported by their exposure to emerging market economies.
Japanese Equities	Exposure to the Asian and US economies is offset by very weak domestic dynamics and tighter fiscal policy; government action has been unsuccessful so far in stimulating consumer spending or ending deflation.
Developed Asian Equities	Cautiously selective on Asian economies benefiting from strong Chinese growth but wary of inflation pressures building in some countries unless central banks take firm action to dampen liquidity.
Emerging Market Equities	Some are benefiting from the upturn in commodity demand and upgrades to sovereign debt ratings. Others still face external financing problems awaiting a strong recovery in export growth.

Corporate Bonds

Investment Grade	Spreads over government bonds are still historically wide, although not as attractive as last year. Improving corporate cash flow supports a peak in bond default rates.
High Yield Debt	This benefits from an attractive carry, improving corporate cash flow and a peak in the default cycle as the global economy recovers. Investors still need to be aware of selective default risk.

Proposed New Pension Rules

In its consultation document, the Government has set out a number of radical proposals to remove the need to take an annuity with your pension fund.

The main proposed changes are:

a) Retirement Benefits

From 6 April 2011 there will no longer be any specific date (e.g. 75th birthday) by which members of registered schemes have to 'annuitise' or otherwise secure their retirement benefits. There appears to be no requirement to crystallise benefits at all. There will be an option to take flexible (unlimited) drawdown amounts, provided the member can meet certain criteria.

It will be possible for the lump sum to be taken after age 75. It is unclear, however, from the consultation whether it must, as at present be taken alongside a relevant pension or whether it can be taken on its own. If it has to be taken alongside a relevant pension will the current rules apply, i.e. must it be taken from the contract within the period 6 months prior to and 12 months after the member's benefits were crystallised to provide the relevant pension benefit?

If your total pension fund benefits are less than 1% of the current lifetime allowance i.e. £18,000 you can take the whole fund as a lump sum. The current rules requiring this to be paid before a member's 75th birthday will be removed, enabling such a benefit to be paid on or after age 75.

b) Death Benefits

Any lump sum death benefit will be subject to a tax recovery charge of 55%, unless it is a lump sum paid in respect of uncrystallised benefits where the member died before age 75. There will be no 55% tax charge, nor any Inheritance Tax (IHT) charge where any part of the death benefit is used to provide a dependant's pension.

Value protected lump sums can be paid on the death of a member while in receipt of a lifetime annuity/scheme pension irrespective of whether the member dies before or after age 75. Any such lump sum will be subject to an automatic tax charge of 55%, as opposed to the current 35%. It is presumed that those individuals who already have value protected annuities where a lump sum can only be paid on the member's death before age 75, will continue to be subject to the age 75 restriction as the annuity will have been underwritten and costed on this basis. The position is less clear for protected scheme pensions.

In most circumstances any lump sum death benefits should be paid free of IHT. This is irrespective of whether the lump sum death benefit is paid before or after age 75. HMRC will, however, be monitoring this position carefully to ensure that the 55% tax rate does not leave open incentives for pension saving to be used to reduce inheritance tax liabilities.

c) Tax relief

Tax relief on member contributions will only continue to be available where these are paid prior to the individual's 75th birthday.

d) Flexible (unlimited) drawdown

An individual aged 55 or over may be able to move from capped drawdown to a flexible drawdown, if they wish to take a greater income than that available under capped drawdown. This option will enable the member to draw down unlimited amounts – taxable as income – from their pension fund. It will, however, only be available to those members who can demonstrate that they have secured a sufficient minimum income to prevent them from exhausting their savings prematurely and falling back on the state. This Minimum Income Requirement (MIR) test will be undertaken by the provider before the member's withdrawals are permitted to exceed the maximum capped drawdown.

The Government will require an individual to provide sufficient evidence of their eligible income to the drawdown provider. Unless the provider is able to determine that the individual meets the income requirement, any drawdown will be restricted to the capped level.

When assessing the MIR the following will apply:

- Only pension income will be considered
- The pension income (including state pension benefits) must be currently in payment; be guaranteed for life; and take into account reasonable expectations of the future cost of living.

There are likely to be other requirements, yet to be decided. The required MIR should be age dependant, being highest at the youngest eligible age 55 and decreasing the older the individual is. The MIR levels will be reviewed periodically by Government.

The consultation paper set out a number of possible criteria for determining the MIR thresholds but did not settle on a particular level.

e) Inheritance tax

Under the present rules there is a specific IHT charge if a lump sum benefit is paid on the death of a member taking drawdown after age 75. The consultation paper proposes that generally there will be no IHT charge on lump sum death benefits, irrespective of whether they are in respect of uncrystallised or crystallised benefits and of whether the member died before or after age 75. This will be subject to meeting the other requirements for benefits to be paid IHT free (e.g. the need for the benefits to be paid at the discretion of the scheme administrator/trustees).

f) Benefit Limits and Tax Relief

Although the Government will be removing the requirement to effectively annuitise benefits at age 75, it will still require tests to be undertaken at age 75 in respect of uncrystallised benefits and drawdown benefits at that date.

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