



The Street Lamp News

Autumn 2010

Gross Domestic Product (GDP) is the total of all economic activity in one country or area and is used by most economists, fund managers and anyone involved in investment for tracking the position of an economy at any one point in time. The figures can be distorted and should only ever be used as a guide. Revisions to GDP are a regular occurrence as more accurate information about a particular period becomes available. Furthermore GDP is a backward looking piece of data. It cannot be used to predict the future but can be used as a guide to the future direction of an economy.

Many parties such as the European Commission, the World Bank and the Bank of England attempt to estimate future GDP. They use data readily available from companies to try and predict what will happen over the coming months. This data is notoriously inaccurate but nevertheless is still widely followed.

In the UK the economic outlook is far from certain and with this uncertainty comes a greater difficulty in forecasting future GDP. The current consensus for GDP is for it to increase by 1.4% in 2010, 2.4% in 2011 and 2.7% in 2012. These views assume that the removal of Quantitative Easing will be offset by an increase in activity in the private sector. The newspapers, widely renowned for their negative views, argue this is overly optimistic and hence articles predicting that the UK will fall back into recession in 2012.

Net borrowing in the UK is likely to reach £160bn, 11.2% of GDP by the end of 2010. This will be the highest in the G7 group of countries. The Government has already shown its commitment to reducing this figure and the consensus is that this will fall in the future to £76bn.

As far as interest rates are concerned it is likely they will remain low for some time to come. The Bank of England's target is to maintain inflation within set boundaries. Whilst the rate of inflation is above target at present and is likely to continue to be so for some time to come it is unlikely the Bank of England will raise interest which would have the effect of cutting back spending in the private sector would reduce GDP and delay the recovery.

In summary there are a number of uncertainties in the economy and the future direction cannot always be accurately predicted. From an investment point of view there are many companies in the UK continuing to be market leaders in their field and with good stock selection fund managers should continue to be able to outperform the general market.

Pension Contributions

The Treasury have recently announced changes to the maximum annual contribution allowed known as the annual allowance to pension schemes. From April 2011 the total contribution which can be made in any one tax year will be cut from £225,000 to £50,000. The government estimates that this will affect 100,000 individuals of whom 80% enjoy incomes of over £100,000.

Anybody making a contribution of more than £50,000 may be subject to a charge but any annual allowance unused may be carried forward to the following three tax years, which may mean that contributions above £50,000 may still be made and not attract the charge.

At the same time the maximum amount allowed to be accumulated in a pension scheme, known as the lifetime allowance will be reduced from £1.8m to £1.5 million from Autumn 2012.

For those people with personal pensions or money purchase company schemes it is easy to calculate whether their pension pot exceeds the lifetime allowance. For those in final salary schemes it is more difficult to value their benefits. However, this is done by applying a formula which is also going to be revised which will have an effect of significantly increasing the value. This may affect the number of higher earning members of final salary schemes facing the prospect of penalties. Although there is a three year smoothing mechanism to allow members to average out any significant pay rises.

Contributions to a pension fund made by individuals will still attract tax relief at their highest marginal rate. For example someone paying the higher rate of 50% will get 50% tax relief on eligible contributions.

These measures are expected to raise an additional £4bn per annum and aimed at helping to reduce the UK's deficit.

However, most of the above will not affect the majority of people and pensions continue to be a tax efficient way of providing an income in retirement. If you would like to discuss pensions, review your existing schemes or to consider how the new legislation might affect you please do not hesitate to contact us.

MARKET REVIEW

During the six months ending 31st October 2010 capital changes in the main markets have been as follows:-

Indices			Percentage Change %	Adjusted Change % *
	30/04/2010	31/10/2010		
United Kingdom				
FTSE 100 Index	5553.29	5675.16	+2.19	
FTSE All Share Index	2863.35	2936.15	+2.54	
FTSE Mid 250 Index (exc. Inv trusts)	10899.7	11385.8	+4.46	
FTSE Small Cap. Index (exc. Inv trusts)	2449.3	2515.51	+2.70	
FTA Brit. Gov. Securities Index				
Fixed Interest - All Stocks	153.01	158.89	+ 3.84	
Index Linked - All Stocks	364.03	374.63	+ 2.91	
North America				
Standard & Poors Composite	1186.69	1183.26	-0.29	-4.45
Japan				
Topix Index	987.04	810.91	-17.84	-8.2
France				
CAC 40 Index	3816.99	3833.5	+0.43	+0.51
Germany				
DAX Index	6135.7	6601.37	+7.59	+7.67
Switzerland				
Swiss Industrial Index	6616.82	6472.23	-2.19	+2.64
World				
FT World Index	341.8	334.7	-2.08	-2.08

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

Composite Index 0.82%

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

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

US equities are 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 seen in the US and UK, plus the impact of tight fiscal policy on economic growth, albeit some sectors are supported by their exposure to emerging market economies.

Japanese Equities

Helpful exposure to the Asian and US economies is offset by weak domestic dynamics and limited cost cutting; government action has so far been unsuccessful in stimulating consumer spending or ending deflation.

Emerging Markets

Some markets are benefiting from the upturn in commodity demand and upgrades to sovereign debt ratings. Others still face external financing problems or valuation concerns.

Asia Pacific Equities

We are 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.

Property

We are optimistic on the outlook for commercial property despite the recent rally with the view that attractive yields will continue to attract investors.

UK Gilts

Concerns about the economy's fiscal position and sizeable gilt supply in the years ahead make us cautious but interest rate increases remain unlikely for some time.

Investment Grade Bond

Spreads over government bonds are still historically wide, although not as attractive as seen last year. Strong corporate cash flow supports the improvement in bond default rates.

Non Investment Grade Bonds

The asset class is benefiting from 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 and periodic risk aversion.

Long Term Care

With local authorities short of cash and cutting budgets even further, financial help for those in need of long term care is not only limited but likely to fall further. In the future only those on the lowest income, with little assets or with the most severe health needs are likely to receive state help. At present those with assets of more than £23,500 are unlikely to receive any state help. In most cases this also includes the value of any property.

An estimated 140 people go into care every day and have to cover the cost themselves. On average the cost of care for a year is more than sending a child to Eton for a year. This causes a huge financial burden on millions of families. With the cost of running a care home increasing rapidly the fees are more than outstripping inflation.

There are ways to improve chances of getting assistance. Older people are entitled to a personal assessment. Whilst this does not guarantee help after the assessment it gives them the chance to discuss ongoing health needs with an expert. The assessment does not mean they will end up in a care home as there are other alternatives. These include assistance in adapting a current property, receiving help in the home or moving to more sheltered accommodation. People retain the right to have their needs reassessed at any point, should their condition change.

Although those with assets of more than £23,500 are expected to meet care costs in full, there are certain situations in which the value of the home will be disregarded. The value of the home should not be taken into account if a surviving spouse or partner lives there, or another relative aged 60 or over. So if a daughter or sister has moved in as a carer, this could help reduce future care costs. Furthermore the property should not be included if care needs are temporary. If the value of any other assets, apart from the home, is less than £23,500, care should not have to be paid for in the first 12 weeks.

Many couples do not realise that they may be able to take the home out of the care equation altogether by altering the way in which it is owned. Most couples buy a property as "joint tenants", which means that, on the death of either, their share is automatically transferred to the other.

But for a small fee ownership can change "tenants-in-common", which gives either party the right to bequeath their share to whomever they like. If on the death of the first spouse their half of the home is passed to the children, or into a trust, it is possible that the whole home may be disregarded should the surviving spouse need nursing care at a later stage. It is not possible to simply gift your share of the property away immediately with a view to increasing the financial assistance you receive. Local authorities have the right to include the value it is proven to have been deliberately disposed of to avoid fees.

Finally for those with a property you cannot be forced to sell it. The local authority can simply have a charge on the property which would then be repaid on death. This could give you the ability to rent out the property to assist with care costs and benefit from any rise in property prices.

For those with some time to go before care is likely there are insurance contracts which can help with the ongoing costs of long term care.

If you would like to discuss any of the above please do not hesitate to contact us.

Featured Fund

The award-winning Neptune Japan Opportunities Fund is an actively managed portfolio which looks to outperform its peer group and benchmark throughout the economic cycle. Managed by Chris Taylor, we believe the Fund successfully combines the Neptune global sector research process with Chris's high conviction approach.

Japanese firms have been the quickest to lower their breakeven levels and adjust their organisations to match the lower product demand levels prevailing across the world. This has happened across a vast swathe of sectors in which they are already dominant globally and reflects their Companies management's experience of having to continually cut back since 1995 due to Japan's shrinking economy.

Japanese firms still dominate and lead many global industrial sectors from autos via specialist materials and capital goods to consumer items, i.e. from Suzuki to Nintendo. Therefore as the global economy regains its composure, Japanese firms should disproportionately benefit from their geographically well diversified sales base, particularly their exposure to non-OECD countries.

Both local market participants as well as foreign investors have had relatively little exposure to Japanese equities as they do not yet appreciate the substantial turnaround in Japanese corporate fortunes. As a deeply unloved and under-owned region, we believe it has the potential to surprise significantly on the upside in 2010.

All the factors that were positive for the yen since mid 2007 have gone into reverse, such as interest rate and growth differentials, whilst the country's debt and governmental budget deficit positions continue to deteriorate. This will reinforce Japanese firms' competitiveness and should raise their rate of earnings growth above that of their global rivals.

Japan is a higher risk asset class is would not be suitable for very investor. This is not a recommendation for investment. If you would like to discuss this in more detail please do not hesitate to contact us.

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