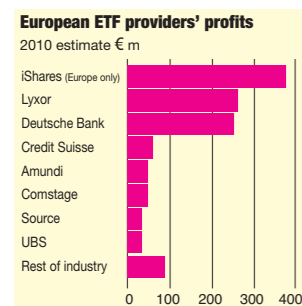


## Straight ETFs safest

DESPITE giving mutual funds a 69-year start Exchange Traded Funds (ETFs) seem poised to move ahead in the contest for global investors' confidence.

That is the conclusion of a major report by Deloitte, the international accounting firm, which says that ETFs are now the fastest growing investment product as funds from declining mutual funds transition to ETFs.

In this context it is surprising to find how few UK investors seem to be aware of the very existence of ETFs.



Global market research group, Mintel, says: "One simple reason for their growth prospects is that most potential investors have never heard of them."

Beginners need to be aware of the two main streams of ETFs, namely: those that replicate their index through actual investment and those that adopt the "synthetic" method involving

counterparties.

By far the biggest provider of physical ETFs is iShares, formerly part of Barclays Global Investors and now controlled by BlackRock, the giant US asset management group.

iShares runs over 400 ETFs worldwide and only two of them are synthetics: MSCI Russia Capped Swap and S&P CNX Nifty India Swap.

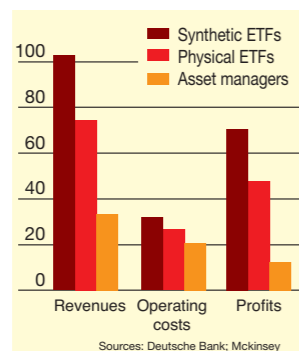
It is mainly the synthetic ETFs, produced by such groups as db-x trackers, Lyxor, Amundi, Comstage and Source, which have achieved huge sales recently and have attracted the attention of the regulators.

Estimates by Deutsche Bank indicate that the synthetics command profit margins far in excess of the physical ETFs – about 71bps (or 0.71pc) of assets compared to (0.48pc).

Analysts suggest that synthetic providers generate significantly more revenue than physical ETF providers because their swap arrangements bring them a share of the income from the trading operations of their parent investment banks.

Synthetic providers incur higher costs due to the expense of providing collateral for their swap contracts, but are still more profitable overall.

Most UK investors are likely to feel more comfortable with iShares.



Sources: Deutsche Bank; McKinsey

## Charges raised to beat the ban

AHEAD of the introduction of the Retail Distribution Review (RDR), which should become effective in 2013, and which is intended to slash the fees and other add-ons to mutual funds and other savings products, providers are busily ramping up their charges while they have the chance.

One of the biggest offenders is Standard Life, the giant insurer, which has raised the annual management charge levied on seven retail funds and two funds aimed at institutional investors.

At two popular funds managed by Standard Life Investments, UK Smaller Companies and Global Equity Unconstrained, yearly fees are set to rise from 1.5pc to 1.6pc which will take effect from November.

A report released in July by *Consumer Focus*, says that the Financial Services Commission (FSA), the regulator, "estimates that a third of a pension value could be lost in fees and charges".

## Funds say "No change"

THE ban on funds paying commission to advisers due to become effective in 15 months' time will not reduce the costs to investors, according to a poll carried out for the *Financial Times*.

More than a third of 200 fund managers said that annual management charges for active funds should not fall significantly after 2012 to a level that many in the industry say is fairer for investors.

The Investment Management Association said fund managers might seek to recoup costs of distribution in other ways from 2013, which could mean maintaining present charges.

## Inventor's Notebook

**SCHEME PENSION** is a registered pension arrangement that was considered a niche solution for wealthier, older investors who did not want to buy an annuity or used the "alternatively secured pension" option.

But it has taken on a broader appeal since April, when the compulsory annuity purchase rule was lifted and the maximum cash available under income drawdown was significantly reduced.

Some investors are now being offered up to 30-50pc more income from scheme pension than they can get from any other arrangement.

★★★★★

**PENSION** savers can apply to protect their funds if they will exceed the lifetime limit for pensions when the ceiling is lowered next year.

The total that may be saved into pensions and qualify for tax relief will fall from £1.8m to £1.5m on April 6, 2012.

Anything in your pension fund above that threshold when you retire will be taxed at 55pc.

The required form for protection is available on HMRC website at [hmrc.gov.uk/pensionschemes/apss227.pdf](http://hmrc.gov.uk/pensionschemes/apss227.pdf)

Clients will appreciate that life assurance and pension plans are generally long-term investments and there may be penalties for terminating such plans prematurely; that past investment performance is no indication of future prospects and values can fluctuate; that in relation to house purchase their home is at risk if they do not keep up the payments on a mortgage or other loan secured on it. Some of the products and services mentioned in Money Planner might not be among those regulated by the Financial Services and Markets Act 2000. The information in Money Planner is for guidance only and our expert advice should be obtained before any action based on it is taken.

## Fidelity owns up

IN recent issues we have reported in some detail on the UK growth of low cost investment media, mainly through index and exchange traded funds.

Both are relatively recent imports from the USA where the concept has developed from the teaching, over the last 30 years (which alone deserves a moment's reflection) of Jack Bogle, founder of the Vanguard group, Ken Fisher, distinguished columnist for *Forbes Magazine*, and no doubt others.

Our reporting naturally focused on the excessive charges levied by the only alternative previously available to retail investors, namely, mutual funds which together now control investments valued at £594.6bn.

We are happy to acknowledge the support provided by our distinguished contemporaries the *Financial Times* and the *Telegraph* group which will share our satisfaction at the response of *Fidelity International*, one of the UK's largest fund managers, which has freely accepted that "fees reduce the value of your investments".

*Fidelity* suggests a new way of measuring the costs of an investment which falls short of answering the case against excessive charges but we report the details inside.

**Income drawdown** THE requirement for pension savers to purchase an annuity on reaching 77 (previously 75), unless they were opting for an unsecured pension, was abolished with effect from April 6 this year.

These measures were replaced by new concepts "capped drawdown" and "flexible drawdown" and we provide further details in this issue.

## Economies stagnate as UK-US look for rescue by QE3

FEARS of a re-run of the 2008 recession (or worse) began by mid August to haunt the economies of both the UK and the USA, with the prospect of unknown further contagion from the eurozone and only a further resort to the printing press (that is, QE3 or "quantitative easing") was considered likely to have the desired effect.

Such was the mood created by the inability of the American congress to resolve its escalating debt crisis, after fractious deliberating before an embarrassed world, which finally resulted in the loss of its AAA credit rating to be replaced by AA+.

As if this news was not bad enough a new crisis in the eurozone was caused by the addition of France to the cases of injured pride with doubts about its ability to solve its own credit problems.

These events coalesced in a sudden collapse in equity markets with the FTSE 100 plunging from 5800 to below 5000 in less than a week.

This came in striking contrast to earlier expectations as the index had breached the 6000 barrier in January while some analysts' forecasts had it touching 6750 by the year's end.

Much of the surprising volatility, however,

was blamed on the computerised trading in the UK's biggest companies.

High frequency trading, which accounts for as much as 50pc of trading in London, has been blamed for exacerbating intra-day swings and putting ordinary investors at a disadvantage due to the speed with which such trades are placed in the market.

Meanwhile, UK house prices were tipped by accountants PwC for a nine year wait before they reach the levels of 2007.

"By 2020," its report concludes, "there is just a 53pc chance that house prices will have risen by 1pc."

In recent years the UK has usually been able to look to the USA for encouraging signs that its thrusting economy would provide the engine for shared growth but that is not at present or in the foreseeable future an available offer.

This view gained strength on August 26 when Fed chairman Ben Bernanke in a crucial speech at Jackson Hole, Wyoming quietly dismissed any hope of an immediate resort to QE3.

Instead, probably at the risk of attracting derision from some quarters, he challenged the politicians to promote stronger economies by adopting growth inducing policies.

Meanwhile, the seething anger in Germany over the eurozone's rescue package aimed at alleviating the debt crisis threatened a constitutional confrontation which could topple the Merkel government.

## "High charges and risk deter savers"

A DAMNING review on the inadequacy of UK workers' pension provision which will result in millions retiring without enough to live on blames "the costly and inefficient system that relegates the consumer's interest to second place".

The review by the Workplace Retirement Income Commission (WRIC) was funded by, but independent of the National Association of Pension Funds (NAPF), finds that workers will not bother to save for a pension unless they were getting a better

deal.

In a bleak summary of the plight facing workers throughout the country the review says: "14 million people are not saving into a workplace pension scheme at all."

Commenting after the release of the review pensions minister, Steve Webb said: "This is a wake-up call. We need to get people saving younger. If they don't plan now it will be a meagre existence".

Changes being introduced next year will see workers automatically enrolled into

a pension scheme (Nest) unless they earn a very low wage or opt out.

The WRIC review says that the government should consider increasing the minimum amount that is contributed by these workers. It also made recommendations on:

Charges – which it claimed were "too opaque".

Annuities – which "should be more flexible", and

Risk – which should be mitigated for those in "defined contribution" schemes.

## Fidelity offers sympathy for funds' excessive charges – but does not ask: Are they justified?

IN its reply to criticisms of excessive fund charges Fidelity International has become the first big City institution to admit publicly that investors should be warned about a whole range of hard-to-spot fees when putting money into stock market funds.

Fidelity which invests billions of pounds for more than 660,000 UK customers said that the headline annual fee on one of its popular funds was only a third of the actual cost.

As a result the typical expense of an Individual Savings Account is hundreds of pounds more than most investors appreciate, and

thousands of pounds more for a larger investment.

Unfortunately, the question that Fidelity avoids addressing is: "Are all such expenses, like excessive dealing charges, justified?"

Fidelity is calling on the industry to publish "simple, transparent" fees that will show the "on the road" cost of different funds, rather than the far lower annual management charge, which is all that is disclosed by most funds.

"Fees reduce the value of your investments," Fidelity said, "so everyone should be clear about what they are paying and what they are getting in return."

Fidelity compared the current situation to "no frills airlines" which charge passengers extra for tax, airport levies and checking in baggage.

Airlines now have to disclose the total cost before a customer pays.

Gary Shaughnessy, a managing director at Fidelity, said that the whole industry received feedback warning that customers found it difficult to compare products.

"When buying a fund, even one as apparently cheap and simple as an index-tracker, investors need to be aware of the total "on the road" cost of buying and owning it," Fidelity's

statement continued.

But the problem is not simply one of transparency and disclosure of funds' fees.

Investors and their advisers need to continue asking: *Are such charges justified?*

Last year the *Daily Telegraph* disclosed that Britain's 8 million savers lost an average of £800 a year to hidden levies.

Research compiled by the *Financial Services Authority* and leading data analysts suggested that investors could lose 3pc of their investment each year in charges and fees, which can have a dramatic effect over the long term.

## Age care may require new tax

THE Dilnot recommendations in *Funding Care and Support* published in July will limit to £35,000 the costs that individuals will need to pay towards their care and will raise to £100,000 (from £23,250) the total of assets that will qualify for state assistance.

The report estimates that the proposals will cost the government "around £1.7bn" a year.

If the government accepts them then the earliest they will become law is unlikely to be before 2014.

There are several matters of confusion, however.

Many people will assume that the £35,000 will restrict the total cost to be undertaken by individual beneficiaries.

That is not so. Further costs of between £7,000 and £10,000 per year will be needed to pay for accommodation and food.

These costs will usually be expected to be met from pension income.

It is important to understand that the residential care envisaged in the Dilnot

recommendations is that provided by the local authority.

Higher costs for superior care homes will need to be met by individuals.

Although the report's intention is to avoid pensioners being forced to sell their houses to pay for a care home place it seems unlikely to be achieved.

The average house now costs about £163,000 according to the latest Halifax house price index so most home owners would still find themselves having to pay for their own care – at least initially.

Andrew Dilnot, chairman of the commission, said it was up to the government to decide how to fund the reforms but hinted that pensioners could be forced to pay national insurance for the first time.

Most of the insurance schemes that were formerly used to finance the burden of care costs have been wound up but a new range of financial products is expected to become available in response to the Dilnot report.

## Changes to pension drawdown

THIS year's Budget announced some significant changes to the pension drawdown rules and death benefits which have now become law.

The "unsecured pension" which allowed income to be drawn from the pension fund before the age of 77 (previously 75) has been changed to a similar facility called "capped drawdown" but the requirement to purchase an annuity has been abolished.

The maximum income that can be taken under capped drawdown is 100pc of the amount that would apply to an annuity – a reduction from the 120pc which applied previously.

**Capped drawdown:** As the requirement to purchase an annuity has been withdrawn, along with the Alternatively Secured Pension (ASP) the new legislation provides for the capped drawdown facility to be used from age 55 throughout life.

Anyone already receiving an ASP will come under the new capped drawdown rules.

**Flexible drawdown:** Provided there is at least £20,000 a year secure pension income\* available a flexible drawdown arrangement will not be subject to the income restrictions under capped drawdown.

Any amounts can be drawn from the fund which will be classified as pension income and taxed as income.

\* "Secure pension" includes state pension, annuity or scheme pension (*Please see Investor's Notebook*)

**Death benefits:** Before taking benefits:

(pre 75): The fund can be paid as a taxable dependant's pension or a tax-free lump sum subject to a recovery charge at 55pc on any excess over the lifetime allowance.

(post 75): the fund can be paid as a taxable dependant's pension or as a lump sum subject to a 55pc recovery charge (or a combination).

After taking benefits: the fund can be paid as a taxable dependant's pension or as a lump sum subject to a 55pc recovery charge.

If there are no dependants the fund can be paid tax-free to charity.

## Top fund manager's China setback

AFTER enjoying a near 30-year run of almost unhindered success in running Fidelity's Special Situations fund Mr Anthony Bolton, whose China Special Situations investment trust was launched in April last year, has bravely acknowledged a temporary reverse to his ambitious plans for a repeat of his record run.

Mr Bolton's fund has lost 14.2pc over the last six months and for the first time since May 2010 the share price of the fund dipped below the net asset value – a phenomenon that suggests a dip in investor confidence in Mr Bolton's ability to produce the consistent double-digit returns that have been the hallmark of his investing career.

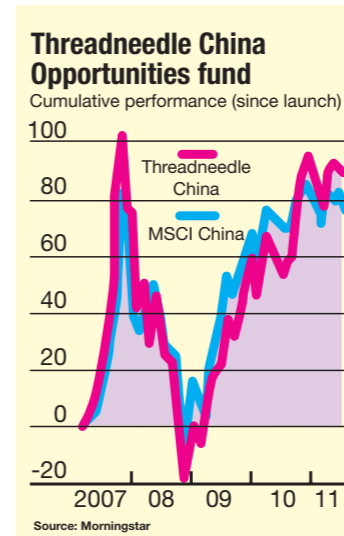
Acknowledging that he had been "disappointed" with the performance, Mr Bolton said that the period from April 19 last year, when the fund first listed in London, to March 31 this year had been a year of two halves and that the performance since the year-end had deteriorated.

In striking contrast, Threadneedle's China Opportunities Fund has reported a strong performance over the two years since mid-2009.

Gigi Chan, manager of the £84.2m fund is playing into the growing Chinese consumption theme.

This approach seems to have worked well for Ms Chan recently, as her fund is ranked first out of 27 in the IMA China/Greater China sector over one year.

It returned 20.8pc over the twelve months to December 31, 2010, compared with a 3.7pc for the MSCI China Index.



## Donate and invest to reduce IHT

THE £325,000 freeze, which establishes the portion of an estate's assets which is exempt from Inheritance Tax (IHT), was fixed in the 2009 budget until 2014-15 and it is naturally now concentrating people's minds on what the situation will be when it is lifted.

The nil rate band is an obvious candidate for review in future budgets but there is no guarantee that it will be raised sufficiently to reflect the effect of inflation.

Many of the routes to mitigation formerly available have been closed, either through legislation or due to inappropriate economic conditions but there are still several that are available.

The most obvious are gifts which can qualify for IHT exemption if the donor survives for seven years after making them and there are several others which are also allowed.

This year's budget introduced a further major inducement: A reduced rate of IHT of 36pc will apply where 10pc or more of a deceased's net estate (after the nil rate band and other exemptions) is left to charity.

Investments in AIM shares if held for two years at death will also avoid IHT as also will investments in EISs but not those in VCTs.

## Reclaim tax on overseas dividends

INVESTORS who hold foreign shares in their portfolios and Sipp's but fail to reclaim the tax deducted from their dividends are missing out on about £250m every year, according to research by tax specialists *Taxback.com*

Most countries impose a withholding tax before dividends are paid to overseas shareholders and leave it up to individual investors to ensure that they pay the right tax and reclaim anything they are owed.

Where the UK has a double taxation treaty with the country where the shares are listed,

investors are entitled to reclaim the difference between the rate the foreign country applies and the reduced rate specified in the treaty.

Research by *Taxback.com* reveals that just 7pc of all withholding tax on company dividends is currently reclaimed globally.

*Taxback* estimates that investors lose around 13pc of overall dividend returns as a result.

Some overseas shares popular with UK investors are Richemont, the luxury goods group, BMW and Electrolux.

## Money Digest

RECENT personal finance pages have featured:

**TO SECURE** the fresh funds promised by the eurozone, the Greek government has had to commit to years of strict austerity. The country's future seems to promise blood, sweat and tear-gas.

– *Gideon Rachman, Financial Times*

★★★★★  
**TODAY** the emerging markets' central banks are the major global creditors and foreign owners of US Treasury bonds. Their actions will determine the fate of the dollar and their currencies are likely to appreciate by 30pc against the dollar in the next few years.

– *Jerome Booth, Head of Research, Ashmore Investment Management, Daily Telegraph*

★★★★★  
"HIDDEN fees are costing investors thousands of pounds, admits leading fund manager". "The great savings rip-off"

– *Front page headlines, Daily Telegraph, June 18, 2011*

★★★★★  
IT will take a recognition by Germany that this is not just a liquidity crisis. Germany must be willing to buy or guarantee Spanish and Italian debt, and in doing so to cross the Rubicon to fiscal union or accept that EMU must break up – large matters beyond the intellectual visions of Germany's current leaders.

– *Ambrose Evans-Pritchard, Daily Telegraph.*

★★★★★  
**THESE** are only a few of the underlying trends that will in the end matter more than share price gyrations: a mismatch of the unemployed and available jobs; the withdrawal of government purchasing power as a source of growth; banks less able to lend and consumers less able to borrow.

These will be with us long after calm replaces panic on the world's stock markets.

– *Irwin Stelzer, Sunday Times*