

News & Views



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Options for savers

UK interest rates have now been on hold at their historic low of 0.5% since March 2009. This might be good news for borrowers, but not so for savers who have witnessed plummeting rates on their bank and building society accounts. According to Moneyfacts, mortgage free pensioners who rely on their savings have been particularly hit, with their expenses rising by 2.3% (in line with the Consumer Price Index) whilst their savings have fallen by 1.77% in real terms. Many are looking at how to make the most of what's left.

A cash ISA is one alternative. Rates are not always any higher than the rates on normal deposit accounts, but ISAs do at least pay interest tax-free - and from October, if you are aged over 50, the allowance for cash increases to £5,100 for this tax year. Meanwhile, with UK interest rates at unprecedented lows, bonds could offer the chance to receive a stable income stream with less volatility than the equity market.

Investments can fluctuate in value and you may not get back the full amount you invest. However, if you are willing to take the risk then the upside of falling share prices does at least mean dividend yields have improved and equity income funds have become more attractive. Admittedly, in the current climate, some companies are cutting or cancelling dividends as they attempt to protect their profits from further economic turmoil. Nevertheless, an equity income strategy does allow you to benefit from a decent yield whilst also offering the chance of capital growth when the recovery does kick in.

Investment bonds

Investment bonds are tax wrappers offered by life companies that give you a choice of how money within them is invested. The most popular funds used to be with-profits, managed and distribution funds, which combine different assets within one fund. Today, however, more options are available, as life companies also offer external links to fund management houses, increasing the opportunity to mix and match. Onshore bond funds automatically pay tax on the income and gains internally and this is deemed equivalent to the savings rate of income tax. Basic rate taxpayers therefore pay nothing more on their profits and higher rate taxpayers pay just another 20%.



Welcome to the latest edition of News & Views, our update on developments in the world of financial services.

We hope you find the contents of interest. If you have any questions, or would like to discuss any of the points raised, please give us a call.

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Interest rate rises

Increases in interest rates don't just affect individuals, they affect companies as well. First, more profit is needed to pay higher debt charges - which could ultimately hit the share price. The price of corporate bonds will also be affected. As interest rates go up, the price of bonds goes down - because interest payments on bonds tend to be fixed, and rises mean these fixed payments become less attractive compared with other bonds or cash. All these issues can have an effect on the performance of your portfolio. However, if you have taken a long-term view, and your objectives are unchanged, the short-term ups and downs should be no real cause for concern.

Explaining the credit crunch

In a nutshell, 'credit crunch' describes a situation where businesses and consumers find it difficult to raise finance because lenders are concerned about the risk of defaults. The current, prolonged credit crunch arose because of rising defaults in the US sub-prime mortgage market and the consequent fallout across institutions who held that debt and were not going to be repaid.

The build up to all this originates in the low interest rate environment of recent years. Given confidence by booming economic activity, lenders made it easier for those with lower credit scores to obtain mortgages (and other loans). These 'sub-prime' loans were then bundled up with mainstream lending and sold on to other financial institutions who were attracted by the income, including banks and hedge funds.

However, as interest rates began to rise and defaults started, these debt packages began to lose value - and banks were left holding assets worth much less than they initially paid. The problem was that, because the bundles holding this debt had become so complex, no one really knew who held what. As a result, the bundles became difficult to sell on and some banks had no other option but to write off entire bundles and, in some cases, close investment funds which had exposure to them.

The ability of buyers and sellers to trade on the financial markets is known as liquidity. When credit becomes expensive (because the risk has increased), the liquidity in debt markets becomes restricted - and because existing debt cannot be sold easily, institutions become less willing to lend to new entrants. For anyone trying to borrow now, this is very bad news.

The fallout from this situation has wide ranging consequences. A lack of borrowing means corporate management cannot easily turn to the market for financing. Private investors buying and selling shares might see losses from companies whose business plans depend on credit. New mortgages are also difficult to find, meaning a fall in demand for housing - and a drop in price for anyone who already owns one. Demand for new housebuilding and home improvements also slow down. As homeowners see their equity fall, they are less inclined to spend income - which then hits consumer retailers and their suppliers. Eventually, unchecked, the situation could affect the entire economy.

Indeed, whilst there are signs that the housing market has risen a little in the last three months, tight credit conditions continue to mean only the highest deposits and cleanest credit histories will obtain mortgage offers. The Office of National Statistics has also confirmed negative growth of 0.6% for quarter 2, bringing the total for the previous twelve months to -5.5%. Many experts think higher unemployment and the end of fiscal stimulus will mean that, despite some apparent green shoots, we will be well into 2010 - or even further - before the impact of the credit crunch has worked through the system.

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