

CONCEPT NEWS

December 2008



2008 A Year that history will remember

In an exceptionally surprising year, it is probably not surprising that 2008's pre-budget report has mutated into a fully-fledged emergency budget containing measures to help the Treasury withstand the worst effects of the recession and kick-start the UK economy. The government is bringing forward £3 billion-worth of capital spending from 2010 and 2011 in order to boost the economy. Overall, the government plans to inject £20 billion into the economy; however, these plans will create a massive budget deficit. The UK's borrowing will hit £78 billion during 2008 and £118 billion during 2009. Borrowing is forecast to fall to £105 billion from 2010 and to £54 billion by 2012.

From April 2010, those earning more than £100,000 will see their tax allowances cut or removed altogether. In addition, from April 2011, those earning more than £150,000 will be hit by a new higher income-tax rate of 45%. Meanwhile, from 2011, National Insurance contributions will increase by 0.5%, although those earning less than £20,000 will pay no National Insurance. In a controversial move, VAT will be cut from 17.5% to 15% until the end of 2009. The Chancellor expects the economy to grow by 0.75% during 2008 and to shrink by between -0.75% and -1.25% during 2009. By 2010, he anticipates that the economy will start to recover and should demonstrate growth of up to 2%, although comments from some independent bodies suggest that not everyone is quite so optimistic.



For much of this year, markets have been driven by short-term sentiment. Whether it has been Han Paulson's bailout package, interest rate and inflation numbers or political factors, day-to-day news flow has tended to govern the direction of the markets. In this climate good stocks have been marked down with bad and scant attention has been paid to long-term corporate prospects.

In an attempt to shore up confidence, the Bank of England has cut interest rates by 2% over the past month. Although the inter-bank rate could remain out of sync for a while, lower base rates will go some way towards helping corporate and individual borrowers. Also, although the size of this cut initially spooked investors a little, markets do tend to react positively to interest rate cuts. Of course, interest rates are not the only issue – governments, particularly that of the UK, will face huge debts long after this crisis is resolved and this will be a significant headwind for economic growth.

The market will, eventually, begin to re-recognise value. Many companies are on historically high dividend yields and this may be important in a post-credit crunch climate.

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Recession beating tips ...

NO 1: DIVERSIFY

This is also the first rule of investing but worth reaffirming. Different asset classes perform well or poorly at different times. If your portfolio is exposed to a single asset class – say, equities – its performance will follow the fortunes of only the equity market, and returns will be volatile.

However, if your portfolio contains a selection of different asset classes, and is also spread across different countries and regions of the world, the different elements will perform differently – so if one is doing badly, the chances are another will do better and compensate for some of the downside.

NO 2: CONSIDER LOOKING OVERSEAS

With diversity in mind, perhaps you can start looking overseas for opportunities. A UK-focused portfolio is a sensible and conservative option for a UK-based investor. However, this strategy leaves you at the mercy of only domestic sentiment. Other areas of the world might offer a more positive outlook during this time, or could simply be better placed to help through a domestic downturn. You need to be aware of the additional risks involved with international markets but even a first step into developed, western economies could diversify some risk.

NO 3: ROLL WITH THE PUNCHES

Your attitude during negative periods is as important as your portfolio's structure. Economies cannot keep growing indefinitely - recessions are part of their nature and should be expected by investors at least every few years. Successful investors therefore tend to be pragmatic. They invest for the long term and expect that whilst there will be good times, there will also be some bad ones along the way. A short term downturn should therefore be prepared for in advance and not be seen as reason to panic.

NO 4: LOOK BEYOND THE DATA

Remember that economic data is backward looking. At the start of a slowdown, figures will continue to appear positive, perhaps contradicting our everyday experiences, as old data remains in the calculation.

Similarly, once economic growth begins to recover, it will take a while to be fully reflected in the new data. Headlines that scream "worst figures for 30 years" confirm what we have just experienced but do not necessarily reflect the prospects for tomorrow. What they do, however, is fan the flames of investor uncertainty - and sell newspapers!

NO 5: DON'T JUST HEAD FOR CASH

During a recession, it is very tempting to get out of the stock market and head for the safety of cash. However, this strategy can be risky. Stock markets are volatile so, just as they can fall quickly, they can also recover quickly, with no warning. If equities are the right asset class for you, moving out when you have already suffered a loss could mean missing out when they finally begin to recover. Moreover, inflation can impact the purchasing power of cash over time. You can be assured that you will not lose the capital value of money when invested in cash but it should not be considered entirely "risk-free"!

NO 6: LOOK FOR QUALITY

During recessions and stock market downturns, high quality, established companies tend to fair better than their newer or more debt laden peers. A tough environment separates the wheat from the chaff as struggling companies are forced to cut their dividends and release negative trading statements. They will not be immune to the effects but quality stocks could help you through the worst of the storm. It is also worth noting that, if everything is falling, it could actually provide an opportunity to pick up more quality stocks at relatively cheap prices

NO 7: THINK LONG TERM

'Recession' is commonly defined as two consecutive quarters of negative growth (in the Gross Domestic Product or GDP). Six months in the average lifetime of a portfolio is not long – and even if you take into account the negative behaviour of markets both in anticipation of and in the aftermath of such data, it is still only a short time compared with the 20 plus years over which we plan for our retirements. If your portfolio meets your personal criteria and is well diversified, a recession should not cause you to change plans: sometimes doing nothing is best.

NO 8: PLAN WELL AND STAY CALM

Remember the saying 'If you can keep your head whilst all around you are losing theirs...'? Market downturns are a great example of when this applies. A fire drill is a good thing: the fire might never actually occur; however, even if the worst happens, at least you can be confident you have taken all the right precautions! The real secret is to make sure you plan your portfolio properly, with an expert, at the outset. Then, when a downturn strikes, you can stay calm and review with confidence - rather than be panicked into radical, unprofitable change.

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