KILSBY WILLIAMS & GOULD

Newsletter February 2014

Should you gold plate your portfolio?

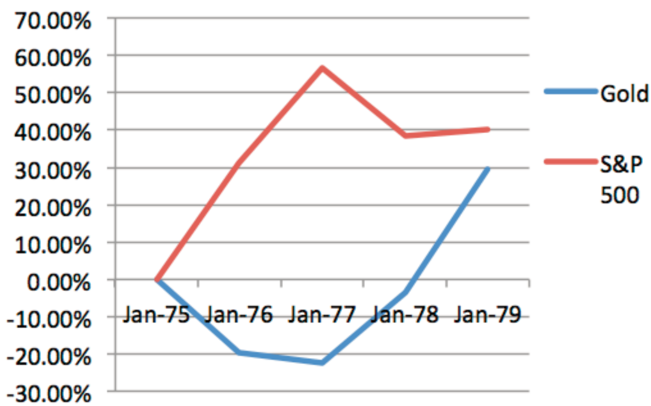
By the end of 2013, the price of gold had fallen 29% compared to its price at the beginning of the year. By contrast, developed equity markets went up significantly – disaster, or opportunity?

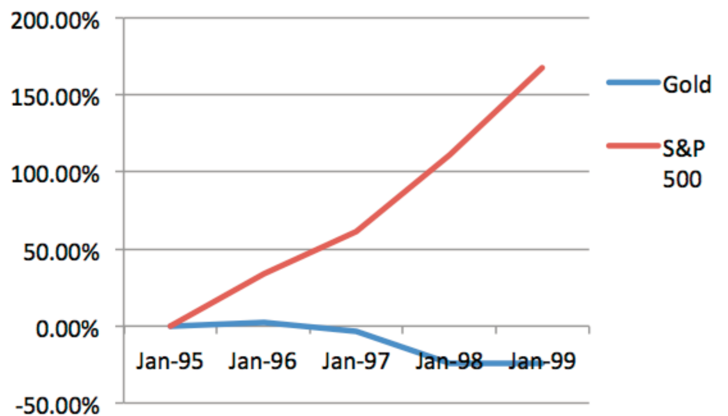
It would be a reasonable and sensible point to state that investors like to see the value of their investment portfolio increase, and that conversely, don't like to see their portfolio fall in value.

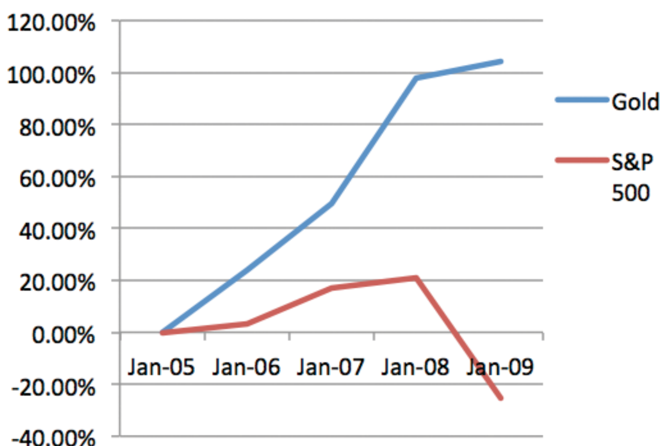
So, in times of economic hardship and falling markets, is there anything that can be done to supress investment loss? Is there anything out there that may offer capital protection, or even growth, in such troubled occasions?

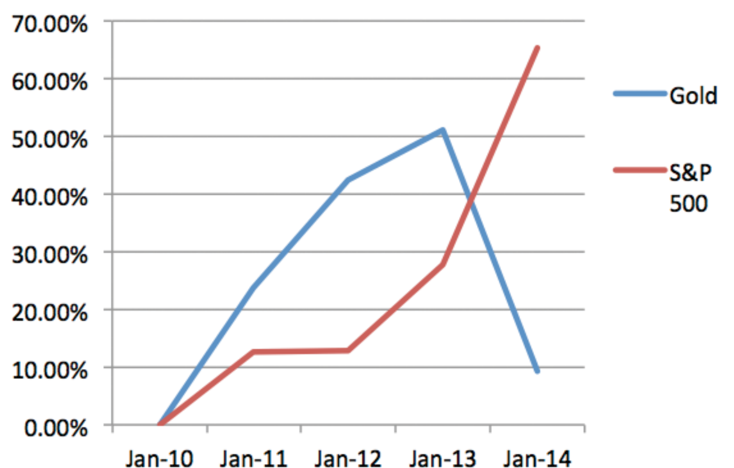
Historically the price of gold has hardly any correlation with the price of other investment categories, and because of this it has previously provided an insurance policy against systemic and other risks that have affected the majority of investments and savings.

The graphs below illustrate this point a little clearer, by comparison the price of gold against the S&P 500 Index, in 5 year time windows.









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As the graphs illustrate, there is a degree of a negative correlation between the price of gold and the S&P 500. A 3 year correlation figure of -0.37 (e.g. if the S&P 500 were to fall 10%, a correlation figure of -0.37 would suggest the price of gold would be anticipated on average to rise by 3.7%, and vice versa) going back to 1956 would also appear to endorse this position.

In other words, gold could be a useful hedge against the impact of an economic calamity on the rest of an investment portfolio, and on the basis that it can add that further layer of diversification to a portfolio, we believe physical gold fits in to the 'alternative investment' asset class.

There are other factors to be considered before we look at gold however:

- If inflation picks up, gold tends to perform well. US inflation is currently at its lowest point since the end of 2008. Not surprisingly, with inflation down, the price of gold has also fallen.
- If the dollar weakens, gold tends to perform well. The dollar is currently above the pre-crisis price against the Yen, Sterling and the Euro.
- If demand outstrips supply, the price will rise. In 2013:
- In early April, Cyprus sold its bullion supplies to finance a 400€ million bailout. Could another country do the same?
- Later in the same month, analysts such as Goldman Sachs slashed their gold outlook suggesting investors 'short' the metal. This manipulation of the gold price by banks is expected to continue in 2014.
- Demand remained resilient in emerging markets, particularly India and China. However, the Reserve Bank of India imposed restrictions on imported gold in May and as a result, between the end of March and the end of June, gold consumption in India fell by 50%. Due to the smuggling that this led to, the Indian government is expected to reduce import duties in the near future.
- Gold supply fell by 3% in 2013, but due to lower production, delayed mine development, cuts to exploration budgets, and the implosion in South Africa's mining industry, a more serious supply crunch is expected in 2014.
- There is perhaps evidence of a floor in gold's price at $1,200/ounce. If gold were to drop to this level, then demand for the commodity is likely to pick up, which should drive the price back up.

In light of the positive outlook we have for gold, the question then is what proportion of the portfolio should be held in gold, and when is an appropriate time to invest.

Less than 5% of a portfolio and you're not really hedging anything! But the metal has virtually no fundamental, intrinsic value, and doesn't produce cash flows.

Whilst trying to pick the perfect time to invest is fraught with difficulty, we believe a holding in gold, or gold shares, of 5% of your portfolio is worthy of consideration at this point in time.

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Tax Year End Planning

With the 5th April almost upon us, you should consider whether year-end tax planning opportunities have been utilised in full. Many exemptions and allowances are lost if left unused and therefore I will run over some of the key points to consider and ask you to get in touch with us directly if you wish to utilise any of these opportunities.

Personal Contributions to Pensions

Whilst company pension contributions may be subject to different accounting periods, personal contributions will need to be made by 5th April at the latest if they are to be relieved against income tax payable in the tax year.

- The maximum that can be contributed is 100% of relevant earnings (salary, bonus, benefits in kind), subject to the annual allowance of £50,000 (although any unused allowance from the previous three years may be able to be carried forward).
- Individuals not in employment or with no relevant earnings are able to contribute £3,600 gross at a cost of £2,880 net of basic rate tax.
- Taxpayers with earnings of over £100,000 gradually lose their personal allowance on earnings up to £118,880. Individuals whose earnings are in this region could consider making a lump sum contribution which will effectively reduce their taxable income back towards the £100,000 level and reinstate part or all of their personal allowance. Such planning results in tax relief of 60% being received!

ISA Allowance

The ISA allowance for the current tax year is £11,520, half of which may be paid into a cash ISA. The advantages are that interest received is not subject to income tax, dividends are only subject to

the 10% tax credit, and there is no capital gains tax to settle upon eventual sale.

Many of you may also be interested to know that ISA allowances can now be utilised in the ‘AIM share’ environment, potentially bringing additional inheritance tax benefits after a two year period. Such investments are high risk but do potentially carry higher rewards, as well as an exemption from stamp duty on purchases made.

ISA allowances could be utilised by monies already invested in other wrappers if affordability is an issue.

Capital Gains Tax exemption

Each individual has an annual capital gains tax exemption of £10,900 for the 2013/14 tax year, which cannot be carried into future tax years if left unused. At least partly utilising this exemption each year increases the tax-efficiency of investing, as the cost of your investment can essentially be ‘rebased’ without suffering any tax. This provides further scope for future, tax-free capital growth.

Where a husband and wife are each sitting on an unrealised capital gain, it may be possible to effectively ‘swap’ investments, locking in some gains tax-free, and rebasing the costs.

Annual Gifting Allowance

Any individuals with an inheritance tax mitigation strategy may wish to consider that they are able to gift £3,000 per tax year which falls immediately outside of their estate for inheritance tax purposes.

Regular Gifts ‘out of income’

Again, individuals with an inheritance tax mitigation objective and annual surplus income could gift this excess income each year. As long as the gifts are made from genuine excess income and are regular in nature, the monies should fall immediately outside of the estate for inheritance tax purposes.

The tax-efficiency of making such gifts could be enhanced further by gifting into pensions or ISAs for children or grandchildren.

Venture Capital Trust (VCT) and Enterprise Investment Schemes (EIS)

These are high risk vehicles that invest into unquoted UK companies. They attract income tax relief at 30% of the invested capital (and in the case of EIS can be used to defer capital gains tax too). These tax reliefs are offered as these products carry higher risks than ‘mainstream’ investments and are not appropriate for your typical investor. But for those clients with material financial wealth or high income they can be a useful mechanism for reducing an income tax bill, deferring any one-off capital gains which have been incurred, or establishing a tax-efficient stream of income.
The Financial Conduct Authority does not regulate tax advice. VCT and EIS investments will not be suitable for all investors and individual circumstances will be taken into account before discussing the suitability of any VCT or EIS investment.

Our Investment Committee has shortlisted propositions within both the VCT and EIS market and if you would like to discuss them further please do get in touch.

The Financial Conduct Authority does not regulate tax advice.

You should remember that the value of an investment and the income from it could go down as well as up. The return at the end of the investment period is not guaranteed and you may get back less than you originally invested

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The Platform Competition in a Post RDR World

It has been just over twelve months since the Retail Distribution Review (RDR) took hold of the Financial Services Industry. The introduction of transparent charging and 'clean' share classes is good news for investors. Clients of Kilsby Williams & Gould, in most cases, will have seen their portfolio charges reduced via changes recommended at their annual review.

At Kilsby Williams & Gould, we have found that the use of Platforms to be a positive step in providing clients with a transparent charging structure. However, RDR generated a flurry of press articles surrounding how the Platform and Wrap market generated their profits from client portfolios.

Firstly, let's clear up any confusion over the difference between a Platform and a Wrap. A Platform is the provider which operates the facility to hold investments. It acts as a 'filing cabinet' and can hold different 'wraps' within the platform. A Wrap is another word for the structure or type of investment that surrounds all of the investment funds; these are commonly known as an Individual Savings Account (ISA), General Investment Account (GIA), a Self Invested Personal Pension Plan (SIPP) and Investment Bond (Onshore or Offshore).

Each Platform has administration costs which need to be settled by the investor, and there is the facility for advisers to receive an advice fee with the agreement of the client. In addition there are fund charges and dealing costs. As advisers we want to provide our clients with the most cost effective proposition possible so that more of our clients' money is retained within the investment. However, cost is not the only factor to consider and having used Platforms since 2005, we have experienced both good and bad propositions.

As a business we conduct detailed research and due diligence on an annual basis to ensure that we are providing compliant solutions drawn from the whole of the platform market. When selecting a Platform we use the following criteria:

Financial Strength: We only deal with companies that are financially strong and are rated at least a 'B' by AKG Actuaries and Consultants. We also request audited accounts and review the profitability.

Investment Options: The ability to hold those investment funds that are on our internal shortlist and 'clean' share classes (no hidden fund manager charges) – this includes both Open Ended Investment Companies (OEICs) and Investment Trusts.

Platform Functionality: All platforms vary in the additional support and facilities available to the user. Poor functionality can mean added time costs for us if they do not meet your and our requirements. This includes Online Valuations, Capital Gains tax calculations, service provided by the client services department.

Charges: A cost comparison of administration and dealing charges including any tiered charging structure.

In summary our preferred Platform Provider for 2014 is A J Bell – SIPP Centre for the following reasons:

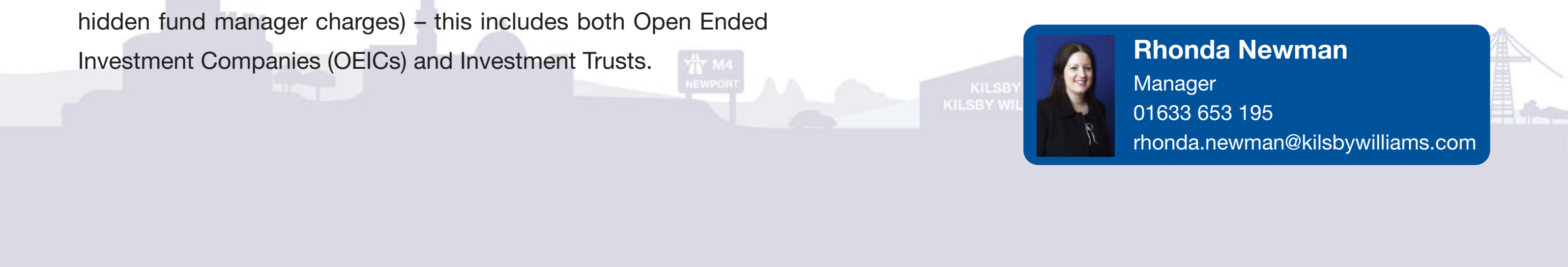
- The most cost effective platform for our clients, with transparent fees which are competitive in today's market place
- The company is financially strong
- SIPP Centre continue to win awards for their platform proposition and remain in the top 5 Platforum Market Monitor
- Awarded "Best All Rounder" by the Lang Cat report September 2013
- Investment choice is extensive and suits our investment proposition
- Easy to use online facilities
- Literature is clear and easy to understand
- Experience in stockbroking with the partnership of A J Bell
- Adviser support is available with a dedicated business consultant

At the beginning of 2014, the Platform world was hit with Hargreaves Lansdown's revamped pricing structure – as platform leaders in terms of volume and funds under administration this was keenly anticipated. In comparison to other companies that we shortlisted, Sipp Centre's annual charges are the most competitive and summarised below:

Portfolio Size	£50,000	£75,000	£100,000	£200,000	£500,000
A J Bell SIPP Centre	0.28%	0.25%	0.24%	0.22%	0.21%
Ascentric	0.36%	0.31%	0.29%	0.27%	0.26%
Cofunds	0.37%	035%	0.33%	0.30%	0.26%
Hargreaves Lansdown	0.45%	0.45%	0.45%	0.45%	0.35%
Nucleus	0.35%	0.35%	0.35%	0.35%	0.35%
Standard Life	0.40%	0.40%	0.40%	0.37%	0.32%
Transact	0.52%	0.48%	0.44%	0.38%	0.33%

(Source: Platforum Guide to Pricing, Defaqto, and individual company charges schedule January 2014)

It must be noted that one proposition is highly unlikely to be appropriate for all of our clients; depending on the complexities and circumstances there will be cases where we will look to other companies. Therefore our research goes beyond the scope of the criteria above and we hold thorough research that complements our holistic financial planning service.



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Economic Commentary

A train bought with freshly printed money is gathering apace around a large mountain whilst politicians and bankers are partying in first class, refusing to acknowledge the gap in the track which lies ahead. This tongue-in-cheek image is, in our opinion, a glimpse of what lies ahead.

National debts in developed economies remain high and talk of a recovery is, in our opinion, premature. Some gaps have been plugged and whilst politicians try to paint a rosy picture of a future with a reducing deficit in advance of an election, the problem has not even begun to be tackled.

Some scientists are speculating that, within a generation, life expectancy in the developed world could feasibly reach 120 with the continuing developments in biotechnology opening doors that previously nobody thought were even slightly ajar. Whilst these predictions seem optimistic, it is irrefutable that people are living longer and with this brings extra pressure upon governments already burdened by increasing debts. We ask ourselves, how does a government under pressure feed and house an aging population? The simple answer is; more tax and smaller hand outs.

One thing which is for certain is that future generations will need to pick up the tab and therefore preserving the real value of assets to reduce their future dependence upon the state is vital, as is encouraging early saving towards their retirement so that they, in turn, can leave similar legacies for their heirs.

Debts; As ever, we continue to prioritise the repayment of debt before anything else. Even whilst being serviced relatively cheaply as may be the case at the moment, lower debt means less reliance upon banks.

Verdict: Repay debts!

Cash; Returns from cash remain in a very depressed state. Nonetheless, our rather pessimistic view on the short to mid-term prospects of most other traditional 'low risk' investments means that we are comparatively happy with a heavy cash position at this time. With the increase in average earnings and interest rates lagging behind inflation and government debt continuing to be serviced cheaply by the current status quo, a rise in rates is clearly inevitable at some stage as governments cannot continue expecting investors to lend them money at a loss in real terms! The question is when.

Verdict: Overweight. Cash remains our preferred home for the defensive aspect of client portfolios. With inflation currently under control it should be possible to at least preserve the real value of cash by tying monies down for 12-18 months.

Low Risk assets (i.e. corporate bonds and gilts): We have for some time been concerned over the prospects of a bubble forming within this space in general. Making calls upon the merits of the various sub-classes within this space has been difficult and, therefore, our stance has been to hand over control of these decisions to strategic bond managers who have the flexibility to move between these sub-classes as the economic landscape changes.

We are at a stage now where we believe short dated gilts and bonds are a relatively safe home for other low risk assets, although with yields likely to be low and the risk to capital values higher than from cash, we do have to ask ourselves whether the risk premium is sufficiently high to justify investing.

Verdict: Remain underweight in other low risk investments. Where exposure is required, opt for strategic bond funds to provide flexibility and/or short dated bonds to minimise the risk of interest rate rises impacting upon capital values.

Property: We are relatively bullish on the prospects for commercial property in the short to medium term. The recovery in the UK has been steady and constant and we are beginning to see this reflected in returns from physical commercial property funds which have been largely positive over the past 12 months, and generally in the bracket of 4-6%.

We believe this trend could continue; with interest rates likely to remain relatively low and tapering in the US now underway, large institutional investors concerned over the prospect of capital losses from their traditional bond holdings could view the commercial property market as a relative flight to income safety. Capital values remain well below their peaks of 2007 and the attractiveness of the yield makes this sector appealing in our view.

Verdict: Overweight, particularly for the income investor. Yields from commercial property and physically backed infrastructure investments continue to attract our attention and we continue to believe in the long term story of property as an alternative asset class.

Alternative Investments; This space covers an array of sectors, most of which are dissimilar in strategy, content and returns. At present we are favouring absolute return funds for knowledgeable investors; we believe that the uninhibited investment approach that can be adopted by the managers affords them the opportunity to generate excess returns in a globally fragmented market. In spite of a mooted global recovery, uncertainty most certainly still exists and whilst uncertainty brings risk it also creates opportunity.

Verdict: Neutral. Concentrate on regulated, reputable funds in the mixed investment (20-60% shares) and absolute return spaces in an attempt to provide stability and opportunity respectively.

UK Equity: At the time of writing, the FTSE 100 stands at 6,550 as at close of play on 27th January.

We do remain optimistic on the long term prospects for large-capitalised companies and prefer to focus our attention on this area for the immediate future. With interest rates likely to remain low inflows into large cap companies, in our opinion, are likely to remain high with investors seeking returns and with the general consensus in the press being one of economic recovery, we see no immediate reason why the markets will be spooked. Rising inflation is a risk to all equities however, and therefore we feel that the larger more mature companies are likely to offer higher protection in the event of a correction arising from rising inflation.

As far as smaller companies are concerned, we anticipate continuing volatility but believe that the prospects for this space are strong. History suggests that economic recovery should benefit the smaller company arena and in the UK we have a reputation for running smaller companies well and a government which is looking to encourage entrepreneurial spirit.

Verdict: Neutral – Concentrate on large-capitalised companies for the bulk of a portfolio (unless there are tax considerations), whilst retaining an exposure to smaller companies for those prepared to accept volatility.

Overseas Equity: The overseas equity asset class covers a broad range of regions and sectors, all of which will not perform in perfect tandem with each other.

Our belief is that commodities continue to offer excellent long term growth potential in a world with a rising population, rapidly expanding emerging economies and only finite supply of resources. These investments have suffered in recent times as China's GDP growth falls and demand for emerging markets in general has fallen; however, at current valuations the long term prospects are clearly appealing and whilst growth may be indifferent in the short term, we do believe that prices at present are attractive when taking a long term view.

Similarly, we believe that emerging market investments offer excellent long term growth potential having lagged behind the recovery in the developed world significantly over the past three years. Whilst some may say that falling economic growth and further tapering in the US could inadvertently impact on prices short term, the fact remains that in the aggregate current accounts in emerging economies are in surplus and debt levels are low in comparison to the developed world. Again, whilst short term prospects are difficult to predict, we believe that as a long term investment valuations in this area are very attractive.

Of course, these types of high risk investments are not suitable for everybody! In the developed world we are positive on Japan. With the Japanese government deliberately weakening the Yen to boost exports and Japan's fantastic technology history and innovation, we believe that this sector could see strong growth in the short to medium term, assuming their plan succeeds.

We are less optimistic on the US; quite simply, the level of growth enjoyed in recent times, which has pushed the S&P 500 to record levels (albeit without adjusting for inflation), is unlikely to be sustained in our opinion. Many investors, particularly overseas, may look to realise profits which in turn could impact on prices. Certainly we feel that the index growth over one year of over 18% is unlikely to be repeated, and we therefore will be encouraging clients to reduce weightings to this area.

Verdict: Neutral – however, look to reduce exposure to the US where these shares are accounting for a large proportion of your holdings. Look to increase exposure to Japan, and possibly Developed Europe, in turn. For those investors prepared to see volatility with smaller parts of their portfolio, emerging markets and commodities are a good long term play in our opinion.

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