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What Might We Expect From Investments in 2018?

After ending 2017 on a high, following a succession of closing record highs, as I write, the FTSE 100 remarkably stands above 7,700. The question is whether this momentum can be maintained.

The type of companies making up the index will, as ever, have the main influence on how it performs this year and beyond. There are really just three groupings of stocks that dominate the index; consumer stocks (both discretionary and staples), financials (which are the banks and insurance companies) and oil and gas producers. Many analysts' forecasts show these sectors are expected to generate roughly two-thirds of the index's total profits and dividend payments in 2018 – and perhaps more importantly, they are forecast to provide nearly 90% of the predicted growth in earnings and almost 80% of the growth in dividends.

For the moment, most of these sectors can be seen in a reasonably positive light. The banks passed the latest "stress tests" and profits may improve if the fines and misconduct charges subside. Another positive is the fact that rising crude oil prices are helping to reassure fund managers that the dividends offered by the oil majors (Shell and BP) are relatively safe.

Of greater concern is the contribution consumer discretionary spending may (or may not) make. Any expectation of increased earnings from stocks such as retailers or travel and leisure firms is questionable, though any unexpected strength in Sterling could help several stocks here, by dampening inflation, boosting consumers' real spending power and making overseas holidays more affordable for good measure. That said, the earnings recovery currently forecast by analysts for 2018 overall does look reassuring.

The projected dividend pay-out figures also represent an increase of around 7%, which should please income-seekers, as it leaves the index offering a prospective yield for 2018 of around 4.3%.

Looked at in these terms, the FTSE 100 may not be getting overheated after all, although a slide in oil prices, a weak pound and poor bonds yields (perhaps if Brexit talks or some other factor weighs on sentiment and the UK economy) could between them quickly unravel the promising picture so there does remain some uncertainty.

Looking at the international picture, the outlook for global equities remains reasonably positive despite the fact many markets are standing at record highs following stellar increases in 2017.

Although rising interest rates and bond yields are likely to provide a headwind for share prices, it should be remembered that central banks' assistance is being withdrawn for a reason, which is the stronger economic growth. Since that should feed through into higher profits, it ought to support share prices.

The prospects for European equities now looks positive given the improved economic performance across the region, and what we perceive to be reduced political risk. And another positive is the fact that the European market's price-earnings ratio earnings ratio doesn't seem at all excessive.

Elsewhere, the positive economic outlook should also benefit emerging market shares. Although their valuations have risen sharply, they remain at a roughly 30% discount to those in developed markets, and this level of discount looks quite excessive. However, one word of caution is that the rally in emerging market equities has been driven largely by China, specifically some of its largest technology companies, which has given some commentators a little cause for concern..

The picture is more mixed for the US. Although corporate earnings have been growing strongly, share valuations look high relative to other regions. Nevertheless, US stocks are likely to be supported at the start of the year by the prospect of tax cuts, so we do remain reasonably positive on this area as well.

Turning briefly to the position for fixed interest securities, we feel that although total returns may remain positive, 2018 will almost certainly be another challenging year for this asset class.

Encouragingly, despite the continued uncertainty caused not least by the Brexit negotiations, Edward Hutchings, senior UK sovereign debt portfolio manager at Aviva Investors, believes 2018 is unlikely to see a drastic change in market conditions.

Apart from a few noteworthy episodes in recent years, volatility has been noticeable by its absence in the fixed income markets. This may change but of course with volatility comes buying opportunities for fund managers.

So, although this will remain a difficult sector, if held selectively, it remains an asset that is essential for some diversity in portfolios.

An Update on Impending Tax Changes and Rates

The Budget that took place in November brought little at all in the way of significant changes that will have any impact on most people's affairs. The key points for the 2018/19 tax year for England are:

Income Tax

The personal allowance – the amount below which no income tax is payable will increase to £11,850. The higher rate tax threshold will also increase to £46,350. As expected, the dividend allowance will be cut to £2,000, which had already been announced. This is the amount that an individual can receive in dividends with no tax payable. We believe this will have the biggest impact on small and medium sized business owners who take their profits as a dividend. This is likely to mean that employer pension contributions will become an even more attractive way of extracting profits from a business.

Capital Gains Tax

The CGT allowance will increase by £400 to £11,700 but there are no other changes planned to this tax.

Inheritance Tax

As planned, the IHT Nil Rate Band will remain at £325,000 until April 2021, but we do see the Residence Nil Rate Band increase from £100,000 to £125,000. In total that will mean that, from April, couples can leave assets up to £900,000 to future generation free of IHT. The Residence Nil Rate Band is a relatively complex area with a number of peculiar rules that can cause confusion. If you require more information about this we have covered it in detail in previous newsletters – so please ask for a copy if you would like one.

Pensions

The pension lifetime allowance will increase to £1,030,000 (from £1M). This provides a little additional leeway but will not make a significant difference in most cases. The maximum tax saving from this increase could be £16,500.

Reassuringly there are no changes to the pensions funding limits, despite the fact there was wide speculation again about the withdrawal of higher rate tax relief. This means that the tax relief rules remain unchanged and the annual allowance remains at £40,000 and will not be tapered until "adjusted income" exceeds £150,000.

ISAs

The standard annual ISA limit stays at £20,000 – this should really not be wasted if at all possible, so we must also take this opportunity to remind you that time is becoming short to use this year's allowance.

Trusts

There will be a consultation published in 2018 to consider the simplification and fairness of trust taxation – we will update you if there are changes of any significance,

Please note that the above applies to England and rates of tax in Wales and Ireland may vary.

Making the Most of Your Family's Allowances

The UK tax system is based on independent taxation, which means that all individuals are taxed on their own income and gains, and also means that they have their own set of tax allowances. For families, if these aren't all used it can lead to allowances being wasted and overall tax bills being higher than they need to be. While tax allowances can't actually be passed on to partners, tax relief and taxable income and gains can.

Most people know they can use both ISA allowances to allow them to save tax free, and this allows a couple to save up to £40,000 a year into ISAs. But many don't know that they can also use the pension annual allowance, which can double to £80,000 (depending on circumstances).

Higher-earring individuals have had the scope for pension funding eroded by cuts in the lifetime allowance as well as the tapering of the annual allowance. They may now need an alternative home for their retirement savings, but it could be possible to maximise tax breaks by topping up their spouse or partner's pension. This may also be a sensible planning opportunity for people if one spouse pays tax at a lower rate than the other. Or to reduce income assessable for loss of child benefit or personal allowance.

Not only can a family benefit by sharing allowances, but it can mean that the couple will be using both sets of allowances when accessing savings or pensions, which may well reduce the tax payable on income in retirement.

Another opportunity is that everyone has their own annual Capital Gains Tax (CGT) allowance. A disposal of a jointly owned asset means that two allowances could be used to offset any capital gains. So transferring a sole asset to joint spouse's names (which is not in itself a taxable transaction) means tax on over £11,000 is saved – and depending on circumstances, tax may be paid at lower rates as well.

Changing who is taxable and the ability to control when tax becomes payable offer valuable planning options. And transferring assets into a spouses name shortly before surrender to reduce the tax payable on the proceeds is not deemed to be contentious. In HMRCs eyes, it is acceptable planning and is simply taking advantage of accepted and established practice.

Building & Contents Insurance

We are often asked whether or not can provide Buildings and Contents Insurance and the answer is yes. Having the right insurance in place is vital when it comes to your home and finances, but it can be easy to find yourself either under insured or paying more than you need. If you would like us to review your existing home insurance, or if you have none and would like to put some in place, please contact Mandy Clements-Hunt, who will research the market and source the best available products to match your criteria. If this is of interest please telephone Mandy on 01242 604066.

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