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RT FINANCIAL PLANNERS LTD

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Bonds – What Are They

(and what is all the fuss about them now?)

We have included this in our newsletter as the word Bond can be one of the most over-used in financial services. As a result, many people can, understandably, be misled into thinking they are holding one type of investment when in fact they may have something completely different. To clarify this, we cover the differences in the type of investments commonly referred to under the term Bonds.

Firstly, ***Building Society Bonds*** are, strictly speaking, not Bonds at all! This is usually the name that is used for a fixed-term savings account. For example, if you see “XYZ Bank 2-year Bond paying 2.5%” (yes, rates have risen recently), you can simply consider this as a fixed, two-year savings account, treated for all purposes - including tax and the Financial Services Compensation Scheme - as any other bank or building society account.

A second type of investment known as a Bond is an ***Investment Bond*** and this is an entirely different product. They are offered by insurance and investment companies and although they are assessed for income tax (rather than capital gains tax) on the gains made, this is only on encashment, and they are treated quite differently from a savings account. They are essentially written under life assurance rules which means the tax treatment is different and they can be effectively used for tax planning and deferral for long time periods.

Investment Bonds are usually a “wrapper” that can hold a wide range of different assets and investments within them – ranging from cash to shares. Depending on the investor’s circumstances, the Bonds can be held onshore or offshore – once again making them appropriate for effective, long-term tax planning. These are very often suitable investments for Trustees to hold in their Trusts, due to the simplicity of ongoing tax reporting.

The third type of investment is often referred to as a Bond is the **Fixed Interest Security**, including **Corporate Bonds** and **Government Bonds**. This group of assets is wide ranging and can cover UK and Overseas Government Bonds as well. A Bond in this term is basically a loan to a Company (Corporate Bond) or a Government (e.g. Gilts in the UK).

In some ways, this type of Bond is not unlike a shareholding, but in preference to the shares giving you ownership of a company, this is a loan to the company. The Company or Government pays a fixed rate of interest on the loan until the set maturity date, when the capital is returned.

The interest rate is fixed at the outset, but the bonds are traded daily on exchanges, very much like shares. This trading determines ongoing rates, influenced by a combination of current market interest rates, expectations for changes in future interest rates, and how risky the issuer of the security is deemed to be. If the bond has another 5 years to run before the capital is repaid, the buyer will want to consider what interest they could earn elsewhere during the 5-year term, rather than just what they could earn now.

You would usually expect to receive a higher interest rate from a company than you would from the UK Government. This is because if the issuer of the Bond became insolvent the loan would obviously not be repaid, but it is generally perceived to be unlikely that the UK Government would default on paying its interest or repaying the capital.

Currently it is apparent that many investors have a lack of faith in our Government’s policies, so the interest rates on UK Government borrowing have increased sharply to reflect the perceived heightened risk. The original fixed rate on the Gilt does not increase, so the price an investor will pay for the Gilt has dropped heavily, meaning that the actual interest the new owner receives is proportional to both the perceived risk and expected interest rates.

This works in the same way for a Corporate Bond, but in the case of these, the current interest rates (and expectations of future rates) must also be considered along with the ability of the company to continue to service the debt and repay the capital at the end of the term. A high level of scrutiny is required when looking into the company finances and accounts. In recent years, we have seen a number of high-profile household names become insolvent (e.g. Debenhams) so debt from a corporate bond is in no way guaranteed to be repaid, and the risk of this is always factored in to the rate you would expect for lending to the company.

These Bonds are traded on the market in a similar way to shares, and the most common way for induvial investors to hold these assets is through funds rather than directly. This tends to offer a wider spread, with more diversity to lower the risk. In addition, fund managers can carry out more detailed research into a company than an individual can do.

Bonds are almost always included in portfolios to diversify and lower the risk of just holding shares. However, due to heightened insecurity and rising inflation (and consequently interest rates) they are not currently providing the protection we would usually hope to see.

The Emergency Mini Budget (version 1 and 2!)

The news has been full of talk about the new, and now ex Chancellor, Kwasi Kwarteng's mini budget, and the backlash that created such a lot of turmoil in markets. I had intended to provide some details that look past the hype to clarify the changes announced. However, astonishingly just a week later, in what has been called in some headlines the biggest U-turn in economic history, almost all of the measures have been reversed by the latest Chancellor, Jeremy Hunt.

Last week, the planned cut to the basic rate of income tax was brought forward a year to April 2023. This cut has now been scrapped altogether, with the rate for both non-savings and savings income to remain at 20% indefinitely.

Jeremy Hunt said a Treasury-led review will take place into how households and businesses are helped with energy bills. It had previously been announced that all households would receive the support for two years. This is now set to be reviewed from April next year and Mr Hunt said that support beyond that date will need to be subject to changes. It appears that the objective is to design a new approach to target support to those most in need. We believe this change will be welcome by markets and the public generally.

It appears that one of the few changes remaining intact is the pledge to reverse the National Insurance increases that were implemented to help fund social care reforms.

As I write (and clearly, this could all change very rapidly) the measures designed to 'get the housing market moving', which doubled the threshold for Stamp Duty Land Tax on residential property purchases in England and Northern Ireland, look as if they will remain in place. This extended the relief available to first time buyers who will pay no tax on purchases less than £425,000 (up from £300,000) on properties up to a maximum value of £625,000. The question now is whether this will be effective given the sudden and sharp rises in interest rates since the budget.

There was a rise planned in rates of corporation tax. Rishi Sunak had announced an increase in the rate from 19% to 25% which was due to be implemented in April 2023. This was scrapped last week and has since been reinstated. So, currently this means rates will rise as planned (we think!).

It would be impossible not to mention the fallout since this announcement, which continues at the time of writing. The sharp increase in Gilt rates seen after the Kwarteng mini-budget appear, at first glance, to be reversing and the value of the pound tentatively strengthening against the dollar and euro.

It does not matter what your political persuasion is these about-turns, sharp increases in Gilt yields and slumps in the value of Sterling are clear signs of the market's lack of trust in the Government's plans. It would, therefore, appear that today's news has been well-received. We continue to watch this space.

When Can I Claim My State Pension?

In November 2018, State Pension age was 65 for all men and women, having gradually been equalised from the days when it was 60 for women. This age is gradually increasing and now depends on when you were born.

It will increase in stages and the State Pension age will reach 67 by 2028. It will be kept under review, so it could change again in the future depending on different factors, such as changes in life expectancy, which has an impact on affordability. You can check the age that your State Pension is currently due at www.gov.uk/state-pension-age.

These changes emphasise the need to have your own retirement provision in place to ensure that you are able to meet your future plans without being completely reliant on the State Pension. Whether you wish to retire early or to retire at your state retirement age, you will need additional income running alongside your State Pension. The earlier you plan, the better your chances of achieving your goals.

The recent global market turmoil has put pensions under the spotlight. However, one thing has not changed and that is the pressure the public finances are under. Governments therefore recognise the growing need to continue to incentivise the population to save for their retirement and to be less dependent on the state pension, whenever that may pay-out.

Update and Final Reminder About Trust Registration

We have provided reminders about this in a few previous newsletters. The date by which trustees need to register any trusts on the new Trust Register (via www.gov.uk) has now passed, so we wanted to just give one final prompt to register this if it hasn't already been done.

If required, we do have a document outlining how to do this, so please ask for a copy if you would like one. If we arranged your trust investment, we will be able to provide the details you will need to complete the register.

In a change to previous advice, the Irish Revenue have acknowledged the difficulties in CRBOT registration for UK Trustees and have announced that they are working on a new streamlined process to help with this. Until it is ready, UK trustees do not need to register their Irish domiciled investments in trusts, and there will be no sanctions as a result of non-registration during this period. There is no timescale as to when the streamlined process will be available at this stage.

Christmas Office Opening Hours

Although a little early, there will not be another newsletter issued ahead of the festive period, So we will take the opportunity to confirm that our offices will be closed after Friday 23rd December and will re-open on Tuesday 3rd January. As we have done for the last few years, we will donate to charities rather than sending Christmas cards to our clients – we will select local charities again this year a little closer to the time.