Quarter of the unexpected – the markets' story

The first quarter of 2020 was a traumatic one for investors.

Index	2020 Q1 Change
FTSE 100	-24.8%
FTSE All-Share	-26.0%
Dow Jones Industrial	-23.2%
Standard & Poor's 500	-20.0%
Nikkei 225	-20.0%
Euro Stoxx 50 (€)	-25.6%
Shanghai Composite	-9.83%
MSCI Emerging Markets (£)	-18.7%

Data calculated from https://uk.investing.com/indices/major-indices

2020 started off well enough. Until the middle of February, most global share markets were flatlining as the year got under way. Then the coronavirus (Covid-19) outbreak suddenly expanded from a localised epidemic in Wuhan into a global issue. The reaction of most major stock markets was reminiscent of a certain Looney Tunes scene where Wile E Coyote races past the Road Runner only to find he has run off the edge of a cliff and his frantically spinning legs are taking him nowhere but straight down.

The quarterly performance of both the UK FTSE 100 and US Dow Jones Index was the worst since the final quarter of 1987 (when the UK experienced the Great Storm). No major markets escaped the impact of the virus, with most entering what the pundits label as bear market territory – a fall of 20% or more. Ironically, one of the best performing markets was China, where the Shanghai Composite fell less than 10%.

In response to the threat to global growth, central banks cut interest rates (where they could), returned to quantitative easing (QE) and promised variations on "whatever it takes", the famous words of a former European Central Bank boss, Mario Draghi. Governments also took action, with many introducing employment support programmes (such as the UK's Coronavirus Job Retention Scheme) and offering cheap finance and cash grants to businesses hit by the widespread lockdown.

It is wise to treat with scepticism any statements which claim to be able to predict what happens next. The form of the recovery – and there will be one at some indeterminate point – will determine how long the effects last. This uncertainty means that any changes to investment portfolios need to be approached with caution and only after taking expert advice.

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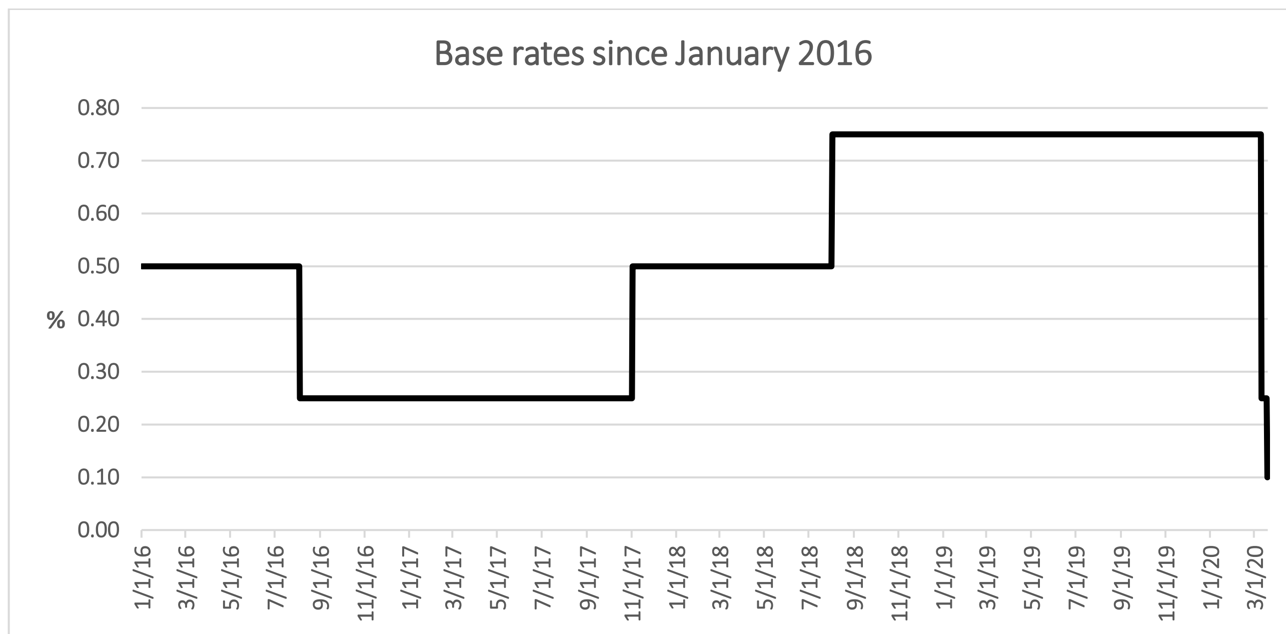
The last cut is the deepest...

The Bank of England's two unscheduled base rate changes in March took interest rates to a new all-time low.



The Bank of England's 0.5% cut in its base rate to 0.25% on Budget Day (11 March) was far from being a complete surprise. The previous week had seen its US counterpart, the Federal Reserve, make its own 0.5% cut in response to worries about the impact of Covid-19 on the global economy. The Bank of England's cut was accompanied by other technical measures to facilitate lending to small and medium enterprises as the Chancellor announced a raft of provisions to deal with the pandemic.

Four days later, on a Sunday evening, the US central bank announced another 1% cut in interest rates, taking them down to 0.00%–0.25%. On 19 March the Bank of England returned with its own interest rate scissors, snipping a further 0.15% off the base rate, taking it down to 0.1%.

As the graph shows, the UK base rate is now below the 0.25% level set in the aftermath of the Brexit referendum result in summer 2016, where it remained for over a year. What happens on this occasion will depend on how long and how deep the economic impact of Covid-19 will be. The former governor of the Bank of England, Mark Carney, had long expressed a view that negative interest rates would not suit the UK and his successor, Andrew Bailey, is unlikely to disagree.

As demonstrated on 11 and 19 March, the Bank of England has other weapons in its armoury alongside interest rates. For example, it has restarted quantitative easing (QE) – often erroneously described as printing money – and relaunched its cheap loan programmes to commercial banks, conditional upon them lending on to businesses rather than using the funds for consumer finance or residential mortgages.

For some while the mantra on interest rates has been 'lower for longer'; now it almost seems 'lowest forever'. That has potential ramifications for many aspects of your financial planning, including retirement income and long term investment.

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A change to the annual allowance taper

One of the more controversial pension tax rules was slightly reformed in the Budget.

The annual allowance effectively sets your tax efficient limit for the total amount of pension contributions that you and your employer can make in a tax year. If the limit is exceeded, then you essentially receive no tax relief on the excess. That can result in a large employer contribution landing the employee with a tax bill.

The annual allowance was originally introduced at the level of £215,000 in 2006, then rose to £255,000 in 2010/11, before being cut to £50,000 in 2011/12. The reductions were meant to limit the cost of tax relief, but in 2014/15 a further reduction was made to £40,000 and tapering was introduced for high earners from 2016/17. The taper process meant that for the highest earners, the annual allowance was reduced to a minimum of £10,000.

As time has passed, the net cast by tapering rules has captured a growing number of people. Among those have been NHS consultants and GPs, whose NHS pension scheme has generous benefits and thus high (but notional) contributions. As a consequence, some senior NHS staff have turned down additional work, refused promotion or even opted for early retirement.

The Chancellor addressed the issue in his Budget by increasing both the thresholds relevant to taper by £90,000. In 2020/21, nobody with total income of up to £200,000 (*after* deducting personally made pension contributions) will be subject to the tapering rules. However, there are some losers from the Budget changes, as the minimum annual allowance has been cut to just £4,000 for the highest earners.

There had been rumours of more radical changes to pension taxation, such as limiting tax relief on contributions to basic rate only. These might still appear in the Budget due in Autumn. In the interim, if you have been affected previously by taper relief, you may now be able to increase your pension contributions.

The inheritance tax dog that didn't bark…

One of the few surprises in March's Budget was that the Chancellor never mentioned inheritance tax (IHT) or expected simplification measures.

Before 11 March there had been much speculation that the Budget would introduce a range of changes to IHT. This was more than just the usual press kite-flying, as the Office of Tax Simplification (OTS) had published two reports on the reform of the tax: the first emerged in 2018, with the second issued last July, in time for the Autumn Budget that never happened.

The OTS made a number of proposals for simplifying IHT including:

- replacing the many lifetime gift exemptions, such as the £3,000 annual exemption, with a single personal gift allowance;
- reforming or replacing the valuable, but little used, exemption for regular gifts made out of income;
- abolishing the taper relief on lifetime gifts tax while simultaneously shortening the seven year look-back period for lifetime gifts to five years; and
- removing the capital gains tax (CGT) exemption on death when 100% IHT business relief applies.

The extent of work done by the OTS and the many issues it flagged up mean that the reform of IHT is unlikely to disappear from the Treasury's agenda. Proposals may therefore emerge in the next Budget, due this Autumn. It is conceivable that, by then, the Chancellor will be looking at IHT as one way of raising extra revenue to help pay down the debts building up in the wake of the Covid-19 pandemic.

In the meantime, for some families, their potential IHT bill falls by up to £20,000 from 6 April as the residence nil rate band increased by £25,000 to £175,000 (subject to taper for estates above £2 million). Taken together with the nil rate band, still frozen at £325,000, that means a couple could now have a combined total nil rate band of £1 million.

The absence of any measures in the Budget has kept open some estate planning opportunities which could have disappeared in March. This stay of execution could prove to be a good time to review your IHT planning.

Out with the old and a boost for the new for children's savings

2020 sees an old plan mature and its replacement given a boost.

Be prepared to feel just a little old: the first Child Trust Funds (CTFs) will mature on 1 September this year, when their owners reach the age of 18.

CTFs were first launched in 2005, when nearly every child born on or after 1 September 2002 became entitled to a government payment of up to £250 (£500 for those from lower income families). At the age of seven a second state payment of £250/£500 was made until August 2010. Additional subscriptions from parents, family and friends were allowed, up to £1,200 a year initially. All government payments stopped on 3 January 2011, after which no new CTFs were created, but existing CTFs have continued to run their course towards their age 18 maturity date.

Earlier this year, regulations were introduced which will mean that when a CTF matures:

- its owner can draw its value; or
- the CTF's value (or part of it) can be invested in an ISA; or
- if the CTF provider receives no response from the CTF owner, the proceeds will be transferred to a 'protected account' where it will continue to enjoy freedom from UK income tax and capital gains tax (CGT).

HMRC set up many CTFs under a default procedure because the initial £250/£500 government vouchers were not redeemed. These and other 'lost' CTFs can now be traced using a form on the HMRC website.

In November 2011, the Junior ISA (JISA) was launched as a CTF replacement, to which no government payments are made. JISAs had a slow start, but their popularity has grown over the years. They were given a boost in the March Budget, when the annual subscription limit – which also applies to CTFs – was more than doubled to £9,000 for 2020/21. All other ISA limits were unchanged.

If you are concerned about university costs for your children or grandchildren, JISAs (and their CTFs predecessors if already subscribed to and not yet at maturity) are worth considering as a tax-efficient way to build up the necessary funds, as some 18 year olds will discover in a few months' time.