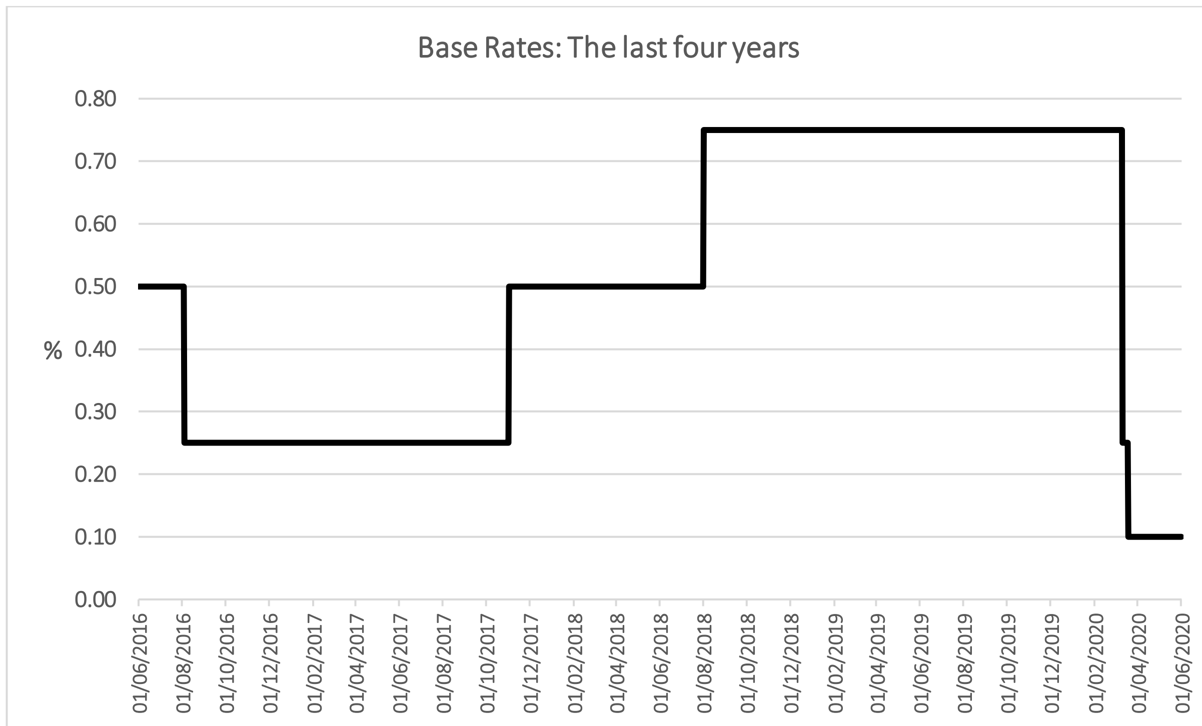
The Investment COACH

Don't be so negative…

Could UK interest rates head into negative figures?



Source: Bank of England

The Bank of England's chief economist, Andy Haldane, suggested in mid-May that negative interest rates were one possible response to the economic fallout from Covid-19. The comment was surprising because in the past the Bank has been opposed to the idea that its base rate could fall below zero. However, shortly after Mr Haldane's comment, the Bank's Governor, Andrew Bailey, said when asked about negative rates "we do not rule things out as a matter of principle".

Negative interest rates – where the lender pays the borrower interest – may sound a bizarre concept, but they are nothing new. The eurozone, Switzerland and Japan have been living with sub-zero rates for some while. The aim behind negative rates is not, as many Germans feel, to punish small savers, but rather to encourage commercial banks to lend. For those banks, negative rates means that leaving reserves in the central bank costs them hard cash – 0.5% a year at the European Central Bank – whereas if they put the money to work in loans to businesses and individuals, the banks can earn interest. With rare exceptions borrowers have not been paid for taking on debt once the lender has added their margin on to the loan.

Where central banks have introduced a base rate, the commercial banks have been reluctant to pass the negative element on to all but the largest of their depositors. Usually deposit rates have been set at zero, avoiding the problem of savers watching the bank gradually reduce their savings. Many deposit rates in the UK are virtually at 0% anyway – it can be an exercise to count the trailing zeros before the figure 1 or 5 is reached.

Ironically, the best instant access account at present comes in the form of National Savings & Investments Income Bonds, which pay 1.16% AER. National Savings announced in February that it would be cutting rates on these bonds by 0.45% from 1 May, but then had a change of heart in mid-April. That might be a reflection on the government's Covid-19 driven borrowing requirement.

If you want an income return of more than 1% from your capital, there are still plenty of options, but your capital will be at risk. For more information, take a positive step and talk to us.

Should you review your pension fund withdrawals?

The fall in world stock markets has cut the value of many pension pots.

Which would you choose as investment performance, assuming a £10,000 investment that would be untouched for 10 years?

1. A steady return of 5% a year throughout the period; or

2. Two years of 20% annual losses followed by eight years of 12.39% a year growth.

The outcome in both instances would be the same: both would produce an overall gain of £6,289. Compound interest can produce many surprises if you are not accustomed to its effects.

Now, try something a little more difficult. Use the same two sets of investment return, but now assume you withdraw 5% of your original investment (£500) at the end of each year. Which would you choose?

1. A 5% return on £10,000 is £500, meaning the growth will be removed at the end of each year, so after ten years there will be £10,000 remaining.

2. With a varying growth pattern, you need a spreadsheet to give a quick answer (or a calculator and paper for the slower version). Either way, at the end of ten years, £7,761 is left.

The £2,239 difference is an illustration of an effect known as 'sequencing risk'. At first sight the gap between the two results appears too large – after all there is no difference when there have been no withdrawals.

However, drill down and what is happening becomes apparent. At the end of two years, taking £500 a year out from a fund that has been falling by 20% a year, leaves you with just £5,500. Suddenly a withdrawal that was 5% of your original investment has become 9.1% of the remaining capital. Even a growth of 12.39% a year thereafter cannot rescue the situation.

These calculations make a point which you should consider if you are taking regular withdrawals from your pension or are planning to do so soon. The recent declines in investment values make it important that you review your level of withdrawals and consider other income options. This is an area that needs expert advice: the wrong decision can leave you with an empty pension pot, but still plenty of life left to live.

Deferring July's income tax payment

The imminent payment on account does not have to be paid.

The last Friday in July is the due date for the second 2019/20 self assessment payment on account. At least, in theory it is…

One of the many measures introduced by the government as part of its Covid-19 programme was the option to defer that second payment. In mid-May HMRC issued guidance on how deferral would operate:

- To be eligible, you need to be registered in the UK for self assessment and "finding it difficult to make your second payment on account by 31 July 2020 due to the impact of coronavirus".
- There is no requirement to be self-employed, although the measure was launched as targeting that sector. For example, you could be a landlord whose cashflow is reduced by tenants withholding rent.
- There is no need to contact HMRC.
- The deferred payment must be settled by 31 January 2021. That is also when any 2019/20 balancing payment and the first payment on account for 2020/21 fall due.
- Provided you pay by 31 January 2021, HMRC will not levy any penalties or interest.

HMRC's guidance says: "You can still make the payment by 31 July 2020 as normal if you're able to do so", which hardly sounds like compulsion for those unaffected by Covid-19.

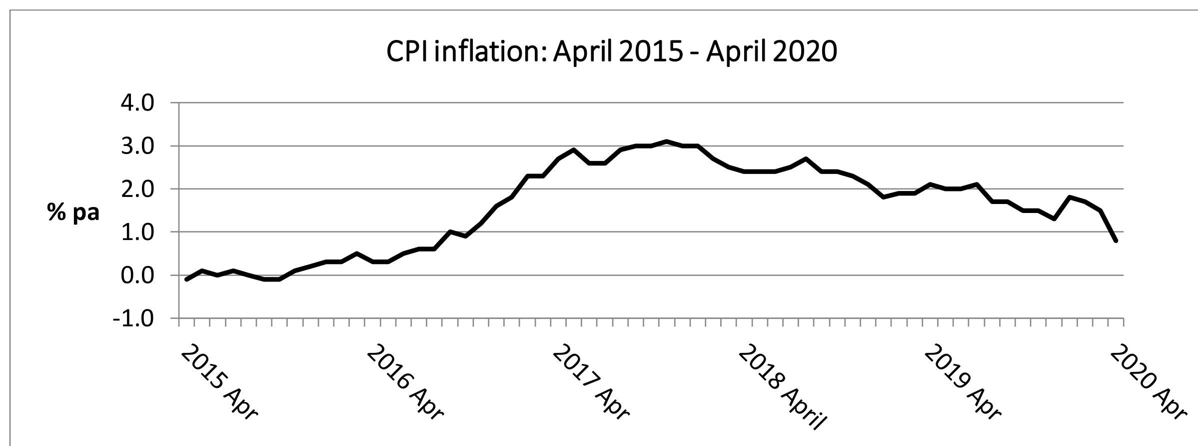
Reductions to income caused by Covid-19 could also affect your tax bill in other ways:

- It could mean that it now makes sense to restart child benefit payments because your drop in income means they will not be taxed away to zero.
- You may find that you have regained some or all of your personal allowance for 2020/21.
- You might become eligible for a higher personal savings allowance.
- That first payment on account for 2020/21 due next January may be too high, as it will be based on your (pre Covid-19) 2019/20 tax return.

If you have suffered a drop in income, it is worth checking with your financial adviser on which actions to take now and which can be left to come out in the final HMRC tax calculation.

Missing in inaction: calculating inflation under lockdown

The Covid-19 pandemic has created problems for the statisticians who calculate the rate of inflation.



Inflation, as measured by the Consumer Prices Index (CPI), fell sharply in April to just 0.9% against 1.5% in the previous month. The main reason for the drop was energy costs:

- Ofgem's new price caps for gas and electricity standard variable rate took effect in April and these were about 10% lower than the rates from April 2019. Even so, the bills set by the caps are generally much higher than those that can be found on any comparison website.
- Petrol and diesel prices were also much reduced year on year – by 15.1p a litre for petrol and 17.0p a litre for diesel.

The sharp moves in energy costs were not the only unusual features of April's inflation statistics. There was also a serious problem with gathering the data. The Office for National Statistics (ONS) has an annually reviewed 'shopping basket' of goods and services which it uses to calculate the various inflation indices. However, for the latest numbers, the ONS discovered about 90 of the items in its basket – about one sixth of the total value – "were unavailable to consumers in the UK". Haircuts, cinema tickets and a pint in a pub are just some of the many examples. Other items were theoretically available, but in such short supply that the ONS's price-tracking task more difficult – self-raising flour being a typical problem item. Ultimately the ONS was forced to "impute" (i.e. estimate) some prices.

There is another twist to the price calculation which you may have noticed personally: the pattern of purchases has changed. The ONS basket contains items which can be bought but are just being ignored in lockdown – many travel services fall into this category. For now, at least, the basket is not representative of spending patterns. We may find that creates problems in the long term-, as inflation indices are widely used by government to adjust benefits, prices and tax allowances.

Inflation may be under 1% and somewhat distorted at present, but it has not gone away. Some economists fear that it could roar back because of all the borrowed money being pumped into the economy by the government. Others think a recession/depression will keep inflation in check. Either way, it still needs to be part of your financial planning: £1 in April 2015 has only 92p of buying power today.

Keep going well…? Shell's historic dividend cut

When a 75-year run is broken, something significant has probably happened.

If you are of a certain age, 'Keep going well…' could have you instantly remembering the rhyming counterpart; 'Keep going Shell'. At the end of April 2020 that 1960s advertising slogan suddenly looked particularly jarring to many investors.

Royal Dutch Shell, to give the company its proper title, announced on 30 April that it would be cutting its quarterly dividend and it was not just any cut: the payment was to fall from $0.47 to $0.16 per share. The near two thirds reduction shocked the market. It was the first time the company had lowered its dividend since 1945. In recent times it had seemed that Shell would do anything – sell assets or even borrow – to make sure the money was there for the quarterly payment.

Shell has regularly been the biggest payer in terms of the total amount of cash it handed out – for each of the last five years it topped Link Asset's list of dividend payers. It has been a core holding of many income funds and individual investors' portfolios for that very reason.

Shell pointed to "…the pace and scale of the societal impact of Covid-19 and the resulting deterioration in the macroeconomic and commodity price outlook" to justify its axe-wielding. However, it also said that it was resetting the dividend, which is corporate-speak for saying 16c a share will be the new base level, not just a temporary adjustment.

The oil sector has been falling out of favour with some institutional investors who see it as increasingly problematic on both ethical and financial grounds. Goals for global carbon reduction are difficult to square with the way in which big oil majors make their money. There is a growing concern that the companies could find themselves holding "stranded assets" – oil reserves that are just not worth extracting.

The Shell story is a good example of the growing relevance of ethical considerations in investment decisions. There is now over £25bn invested in ethical funds according to the Investment Association. To discuss your options, please contact us, as another slogan that has better stood the test of time reminds us: 'it's good to talk'.