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Two weeks that shook the world: reacting to Ukraine

The invasion of Ukraine has shaken emotions and certainties as the world watches a growing humanitarian disaster. The reactions of global markets, which had misread President Putin's strategy as much as many politicians, were similarly sent into crisis mode.

On Thursday 24 February, Europe woke to the news that Russia's forces had entered Ukraine from the north, the east and the south of the country following a substantial military build-up on Ukraine's borders as far back as last October. However, the common assumption – now seen as wishful thinking – was that the growth in troop numbers represented an exercise in ramping up tension, to be followed by a partial wind down a few months later, as happened between March and June 2021. When this hypothesis was proved horribly wrong, there was surprise bordering on shock.

By their very nature, investment markets react to surprises. When a company produces better than expected results, its shares will often rise. When the global economic outlook suddenly becomes uncertain – as happened on 24 February – the markets' reaction is to retreat and reconsider. By the close of business on that day both UK and Eurozone share markets had fallen by more than 3%. Stark headlines appeared highlighting billions wiped off the value of shares. The following day, the falls were largely reversed, but there were no corresponding 'market surges' headlines as the focus moved to the human, rather than simply financial costs.

It is too early to gauge the effects of sanctions and companies withdrawing and divesting from Russian markets. We do know the effects will be felt not only in Russia but more widely. For long-term investors, the market gyrations such as those we have seen since 24 February will seem much less dramatic than they do now – more as 'noise' which will play out. The whipsaw changes are instant reactions to the relentless news flow, influenced by short-term traders. At the time, such moves can feel significant, but look at market graphs covering five years or more and they can be almost impossible to spot.

A standard investment warning is that past performance is not a guide to the future. That is all the more the case when the investment horizon is measured in years, but the past experience in weeks. It's easy and tempting to sell out and hope to get back in at the bottom. But actually timing the return is very tricky. Market timing is very hard – almost impossible – and the benefits of long-term investing come from time in the market. If you are a long-term investor with a diversified portfolio, the cliché of 'Keep calm and carry on' is as good a maxim as any even in these far from normal times.

Repayment of student loans: another freeze… and worse

The government is turning the financial screws on student loans and is set to claw back £2.3 billion under the guise of high inflation. **These changes pose a significant, and potentially expensive, dilemma for those with student debt.**

'Fiscal drag' is an unpleasant sounding economic term which you will probably experience first-hand in 2022 and beyond. It describes a Treasury tactic to raise more revenue without announcing an explicit tax increase. Instead, the Chancellor does nothing (or applies a freeze to prevent statutory rises) and lets inflation do the work for him.

A good example is this year's freezing of the personal allowance. Had Mr Sunak not frozen the allowance, it would have risen by about £390 in April 2022. Unless your income exceeds about £125,000, you would benefit from a tax saving of £156 if you are a higher rate taxpayer (£160 in Scotland, where the higher rate is 1% greater than elsewhere). For 2022/23, it looks like nothing has happened as the personal allowance has remained the same, but in inflation adjusted terms, you are worse off. The same stealth tax rise appears elsewhere – in the inheritance tax nil rate band and the higher rate tax threshold, both also frozen.

A new twist of the fiscal drag theme has appeared in 2022. For graduate students in England and Wales whose courses started in September 2012 or later, the level of income at which they must begin repaying their outstanding student loans has been frozen for 2022/23. In theory it should have risen by 4.6%, from £27,295 to £28,550, but the government overruled the legislated increase.

The extra £1,255 would have saved graduates with enough earnings about £113 a year in loan repayments at the standard rate of 9%. At the current margin, the freeze will mean a few more graduates eventually repay all their loans. For Scottish and Northern Irish students, the repayment thresholds are rising, but only by a mere 1.5%.

For students in England starting their course in the coming academic year, the screw is set to be further tightened. In late February, the government proposed that the repayment threshold for new students should be fixed at £25,000 until at least 2025/26 and their loan repayment period should be extended to 40 years rather than the current 30 years, ensuring more students repay their loan in full, potentially by aged 60.

Student finance, whether for your children's or grandchildren's future education or your own studies, is now an important area of personal financial planning. Advice tailored to your circumstances is important: counter-intuitively, a goal to clear off the debt as soon as possible may *not* be the right approach.

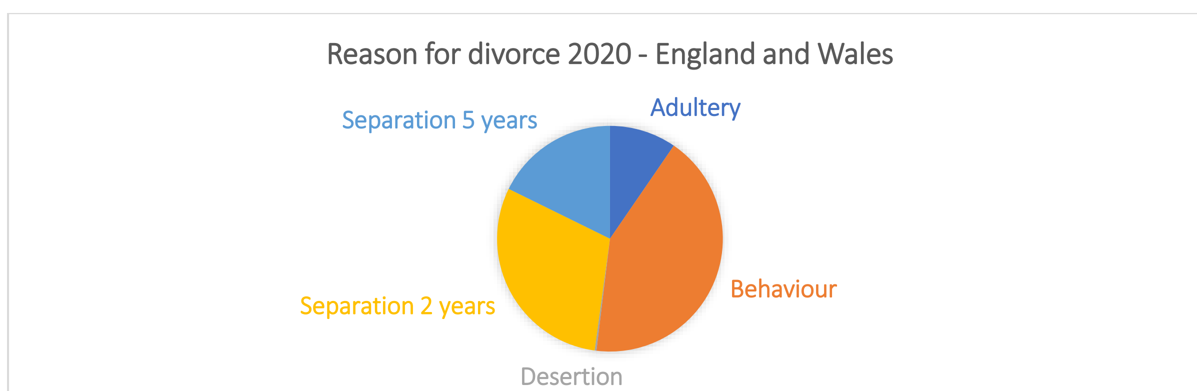
New reforms set to simplify divorce in England and Wales

Divorce will become easier thanks to a change in the law from 6 April, but even with a more amicable split, financial advice is still vital.

Divorce rules in England and Wales will soon undergo their most radical reform since the introduction of the Matrimonial Causes Act 1973. The Divorce, Dissolution and Separation Act became law in June 2020 and was due to be implemented last autumn. However, in June 2021, the Ministry of Justice announced a delay to ensure its systems were fully functional from day one.

The new divorce law will scrap the requirement for one spouse to make accusations about the other's conduct, such as 'unreasonable behaviour' or adultery, or for couples to otherwise face years of separation of up to five years (without consent) before a divorce can be granted – regardless of whether the couple has made a mutual decision to separate. The conduct requirement encouraged a blame game if the object was to achieve a quick divorce.

In 2020, the most common reason for divorce among opposite-sex couples was 'unreasonable behaviour', which accounted for nearly half of petitions from wives and about a third from husbands.



Source: Office for National Statistics.

The new regime replaces questions of behaviour and separation with a single requirement that one (or both) parties to a marriage make a statement of 'irretrievable breakdown' of the marriage. If only one spouse makes the petition to the court, the other cannot contest it – the statement alone is sufficient evidence. In practice, very few divorces – less than 2% – have been contested, but those where couples argue in court tend to grab the headlines.

The new law sets a 20-week period between the commencement of proceedings and the court granting a provisional decree of divorce (*decree nisi*) which becomes final six weeks later. To quote the Ministry of Justice, the 20-week gap '…will provide a meaningful period of reflection and the chance to turn back, or where divorce is inevitable, it will better enable couples to cooperate and make arrangements for the future."

While the new law makes divorce easier and potentially less confrontational, it says nothing about the financial structure of the divorce settlement. This will remain an area where professional advice is vital, particularly when the complexities of pension rights are involved.

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Whatever happened to the wealth tax?

A new wealth tax to counter the cost of the Covid-19 pandemic was the talk of the financial pages not so long ago. Now it has disappeared… or has it?

By the end of 2020, as the huge cost of the Covid-19 pandemic became clear, there was much discussion about the introduction of a wealth tax. It was given added impetus by the publication of a 126-page report from the Wealth Tax Commission, an independent think tank launched in 2020.

Although the Commission did not recommend a specific level of tax, it focused heavily on a one-off tax that:

- Applied on an individual basis;
- Was at a flat rate of 5% on wealth above £500,000;
- Would normally be payable as five annual instalments of 1% (plus interest); and, crucially;
- Would cover *all* wealth including the value of your home and your pension.

The Commission thought that this format would lead to about 8.25 million people paying the new tax, raising a net £260 billion for the Exchequer – at the time broadly in line with the estimated cost of the pandemic.

A wealth tax generally polls well with the public, but that is often thought to be because those in favour think it will not affect them. As soon as the home, savings and/or pension are included in the definition of wealth, enthusiasm starts to fade. The 8.25 million people within the Commission's proposals is close to double the current number of higher and additional rate taxpayers. To make matters worse, the National Audit Office's latest estimate (to July 2021) for the total cost of the pandemic is £370 billion.

The Chancellor has said he is against a wealth tax. However, his two 2021 Budgets will eventually raise tax revenue by nearly £50 billion *a year*, so in the long term the Treasury will be collecting more than the Commission's one-off proposal would have delivered. Other than on the fringes, the Labour Party has not backed the Commission's proposals. Instead, it has spoken about increasing taxes *on* wealth – for example, by bringing capital gains tax rates in line with income tax.

The spectre of a wealth tax seems to have evaporated for now, but tax increases (by stealth or otherwise) – and the consequent need for tax planning – have not.

Quantitative tightening: a reversal of fortunes?

One of the defining financial strategies of the last 13 years – quantitative easing – is about to go into reverse. The Bank of England will slowly trim its £9 trillion portfolio throughout 2022, but only time will tell when it comes to the impact on personal investments.

Source: Bank of England.

What happens when the biggest buyer in a multi-billion-pound investment market stops buying… and then starts selling?

We are all about to find out, and the answer could have surprising ramifications for your investments and the UK economy in general. The buyer in question is the Bank of England and the market concerned is the £2.134 billion gilts market, where the bulk of the government's borrowing is undertaken.

As long ago as March 2009, in the backwash from the global financial crisis, the Bank of England started to buy gilts (government bonds), financing its purchase by a process known as quantitative easing (QE). To many outsiders and some experts, the whole operation looked suspiciously like money-printing as the Bank electronically 'created' the cash which paid for its gilt purchases.

The rationale behind QE was that by injecting money into the economy and buying up bonds, QE would help boost spending in the economy and push down interest rates. The UK has not been alone in using QE with these goals in mind – the central banks of the US, Eurozone and Japan have all done the same.

The extent to which QE worked is the subject of much learned debate. Unsurprisingly, the Bank believes it has – it could hardly say otherwise given that it has run seven separate rounds of QE. On the other side of

the fence are those economists who say that all the money – nearly £900 billion – that QE pumped into UK plc has inflated asset prices – such as house values – and distorted investment markets.

Which view is right may become clearer during 2022 because the Bank of England has announced that QE will be going into reverse and becoming quantitative tightening (QT). Instead of buying gilts, which was especially helpful for the government during the pandemic, the Bank is now going to begin *selling* its portfolio and destroying that electronically created cash. It will be a gradual process – after all the Bank currently owns about 40% of the entire gilts market.

As the Bank of England moves from QE to QT, now would be a good time to review your investments in preparation for a world where the demand for government bonds is shrinking, just as supply is increasing.