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SPRING 2019

COMPOUND RETURNS & THE RULE OF 72
MONEY PURCHASE ANNUAL ALLOWANCE
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OFFICE NEWS

BOOLERS

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THE UK ECONOMY HAS NOT JUST SURVIVED THIS PERIOD OF GOVERNMENT INACTIVITY BUT HAS CONTINUED TO GROW

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ANDREW WHITE

Well, not a lot has occurred in ‘Brexitland’ since our Winter newsletter, apart from many days of debate, argument and indeed posturing. The purpose in mentioning it is not to add any angst to that which I am sure nearly all of us already have, but to highlight that the UK economy has not just survived this period of government inactivity but has continued to grow. Growth of 0.5% in the first quarter of 2019 contrasts with weak numbers for China and many parts of Europe, together with an expected weakening position in the US. We also have record employment.

Whilst we have much to be positive about in the UK, in the short term Brexit and the very uncertain political situation generally here will not result in overseas investors (and even some UK ones) flocking back to UK equities. However, for long term investors, current valuations, especially versus cash and bonds, are of some comfort despite the uncertainties.

Although we have had no new pension legislation for some time, in her article Sian Kent details complications that still surround many aspects of pensions and, if nothing else, emphasises the need to continue to take advice in what remains a complicated area.

Simon Watts’ article on the compounding of investment returns contrasts nicely with John Allen’s which details the risks of drawing on a pot of money and the influence of the sequence of returns. Volatility seems to have returned to investment markets (which is really the ‘norm’) and therefore we firmly believe that ongoing advice is a requirement here also.

We hope that you enjoy reading our latest Newsletter and that the good weather we are enjoying at the time of compiling it continues for the next few months.

Andrew White

COMPOUND RETURNS & THE RULE OF 72

Simon Watts
Senior Investment Manager

In Douglas Adams' novel The Hitchhiker's Guide to the Galaxy it took the supercomputer Deep Thought seven and a half million years to devise an answer to "the ultimate question of life, the universe, and everything". It concluded the answer was, in fact, the number 42. Within the more modest world of compound investment returns there exists the Rule of 72.

What is the Rule of 72?

The Rule of 72 is a mathematical shortcut used to estimate the number of years it would take for your money to double in value, based on a constant growth rate. It can be a useful shortcut because the full-length investment equation is long and complicated. You can use this simple rule of thumb as a base estimate for investments. The Rule of 72 formula is as follows:

$$\frac{72}{\text{Assumed Annual Growth Rate}} = \text{Number of Years to Double Money}$$

The formula can also be rearranged to calculate the growth rate required to double your money given a fixed period of years:

$$\frac{72}{\text{Number of Years to Double Money}} = \text{Annual Growth Rate Required}$$

How it works

Let's say for example you have an Investment that returns 5% per annum. Using the Rule of 72 we take 72 and divide it by 5. The result is 14.4. This means that it would take 14.4 years for this money to double in value. If the investment returned 10% per annum, it would take 7.2 years to double in value, and so on.

Alternatively, if you wished to double your money over a period of 15 years, an average growth rate of around 4.8% per annum would be required (72 ÷ 15).

Even if you are not looking to double the value of your monies, knowing the period of time it would take or having an idea of the growth rate required to do so can help you to understand when you might reach your investment goals, or for comparing two interest rates.

What's Good About It

In a word, simplicity. It doesn't require a scientific calculator to determine a rough estimate of when your money will double. The actual formula for calculating the time required for doubling your investments involves logarithms!

Accuracy

The Rule of 72 is an approximation that is more reliable for growth rates of between 4% and 15%, and is best applied to annually compounding growth or average rates of return. This is fine when using the formula for an estimated growth rate (for example with an equity-based portfolio) within these parameters, but when using it for lower cash deposit interest rates which compound more frequently a more accurate result can be achieved by substituting 72 with 69.31 (though Rule of 69.31 is not as catchy a title!)

Limitations

The Rule of 72 formula is based on a typical (or average) rate of growth. John Allen's article in this Newsletter powerfully illustrates the different routes a sequence of annual investment returns can take to achieve the same average annualised result. Please remember that past performances or averages are no guarantee of future returns.

The formula also takes no account of investment risk. An average return of 8% per annum may be more desirable than 4% per annum, but the additional risk required to potentially generate the additional return may not fit with your risk tolerance or capacity for loss.

Conclusion

As a quick rule of thumb the Rule of 72 can be a useful, uncomplicated tool for long term growth investors. If your portfolio growth has averaged 6.5% per annum it tells you that it would take roughly 11 years to double in value if that rate of return was to continue each year. However, the future sequence of returns is a major factor, particularly if income withdrawals are to be taken, hence a more nuanced approach should be taken if investing for income, as is highlighted in our following article.

Siân Kent
Chartered
Financial Planner

MONEY PURCHASE ANNUAL ALLOWANCE (MPAA)

The Money Purchase Annual Allowance (MPAA) was introduced in 2015 alongside Pension Freedoms. Whilst it is a variation of the Annual Allowance (AA), you will still need to test all of your pension savings against the AA as normal. This is in addition to testing the value of any Money Purchase Pension Contributions if the MPAA has been triggered. Before you start taking pension benefits, it's important to consider when and how you draw them, given the potential impact of triggering the MPAA, especially if you want to continue saving into pensions.

How it works

The MPAA limits future Money Purchase Pension contributions from ALL sources to £4,000 in 2019/2020 once triggered. This includes contributions made by you, your employer and any third party. Transfers are ignored. Once you have triggered the MPAA, you cannot use Carry Forward of any previous unused allowances. If exceeded a tax charge will apply, effectively clawing back the tax relief given.

Once the MPAA is triggered it applies for the remainder of your lifetime.

What triggers the MPAA?

Triggering the MPAA

- Taking your pension as a lump sum - Uncrystallised Funds Pension Lump Sum (UFPLS)
- Taking income within Flexi Access Drawdown
- Taking income above the Capped Drawdown Income Limits (established pre 6 April 2015)
- Taking income through a Flexible Annuity
- Existing Flexible Drawdown – before 5 April 2015, became Flexi Access on 6 April 2015.
- Where a person has Primary Protection with protected lump sum rights i.e. lump sum rights in excess of £375,000 at 5 April 2006, the MPAA will apply if they are paid a standalone lump sum
- A payment of a Money Purchase Scheme Pension where the scheme has fewer than 11 other pensioner members and they became entitled to the scheme pension on or after 6 April 2015

How can I take benefits and avoid triggering the MPAA?

Avoiding the MPAA

- Taking only Tax-Free Cash
- Taking benefits from a DB Pension
- Taking a Non-Flexible Annuity
- Remaining within Capped Drawdown limits (started before 5 April 2015)
- Using the Small pots rule to take benefits – 3 pots up to £10,000
- Designation of pension death benefits for Flexi-Access Drawdown
- Any income taken wholly from a Disqualifying Pension Credit will not trigger the MPAA.

What should I think about if I am about to trigger the MPAA?

It is worth bearing in mind making pension contributions before triggering the MPAA. This would allow the opportunity of making contributions up to £40,000, before any reduction comes into effect. It is only contributions paid to a Money Purchase arrangement AFTER the date of the trigger that are measured against the MPAA.

For example – if the MPPA is triggered on 10 June 2019, contributions of up to £4,000 can be paid between 11 June 2019 – 5 April 2020.

Contributions made before MPAA is triggered, are ignored for MPAA. However, you will need to remember the AA of £40,000 which still limits overall contributions for 2019/2020 (assuming no Tapered Annual Allowance).

What if I have triggered the MPAA and have a Define Benefit (DB) pension?

The MPAA may have an impact on benefits you continue to accrue within DB arrangements. All of your pensions are subject to the AA of £40,000 and contributions of more than £4,000 to any Money Purchase Pension could reduce the amount available for the DB scheme. You can still accrue benefits within the DB arrangement using the “alternative annual allowance” which is £36,000 (£40,000 less the MPAA) for 2019/2020.

Case Study – What happens if I exceed the MPAA?

There are two possible scenarios to consider:

1. **You exceed the MPAA but not the AA.**
2. **You exceed both the MPAA and AA.**

It’s also possible to exceed the AA without exceeding the MPAA, in which case normal AA rules apply.

If you exceed the MPAA only, you will pay the annual allowance charge on this amount. If you exceed both, you will pay the annual allowance charge on the larger of the two amounts.

Example: You pay £2,000 per month into a Money Purchase Pension on the 1st of the month. You also have DB benefits with an accrual of £16,000. You trigger the MPAA on 4th July 2019.

The Defined Benefit accrual is £16,000 with 3 additional monthly contributions of £2,000 before the MPAA is triggered. This total of £22,000 is tested against the “alternative annual allowance” of £36,000 and is below – therefore no excess.

Monthly payments of £2,000 from 1st August 2018 to 5th April 2020 total £18,000. This exceeds the MPAA by £14,000 for which there is a charge to pay. Remember, the DB accrual does not count toward the MPAA.

Note: You are personally responsible for monitoring if the MPAA is exceeded and notifying HMRC if an annual allowance charge is due.

Please do not hesitate to contact us for help and assistance in this area, if this affects you or anyone you know.

John Allen
Financial Planner

SEQUENCE OF RETURNS

Amongst the many considerations when reaching retirement, a key question if you hold a Defined Contribution or Personal Pension plan is "how long will my money last?"

The question is often answered with the aid of charts and graphs that produce a time line based on several average assumptions and commonly show a future date when the pot will run dry.

The purpose of this article is to illustrate that straight-line investment returns do not reflect the reality of markets. Here we introduce the real-life factors that can affect your drawdown plan.

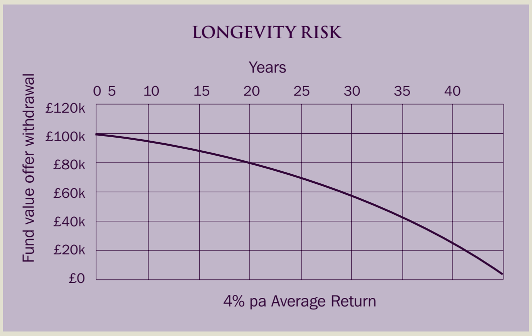
1. Longevity - How long will my money last?

We can plot a simple chart for a person based on some basic assumptions at retirement.

Let's assume we have a person with:

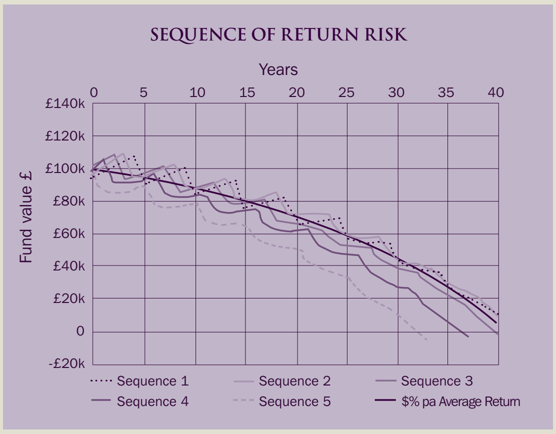
- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- Achieves average 4% p.a. growth after charges

- **Pension fund will last 40+ years.**
- **A person can 'out live' their fund and run out of money.**
- **Defined timeline to build a strategy around.**
- **Beware! Investment markets do not move in straight lines.**



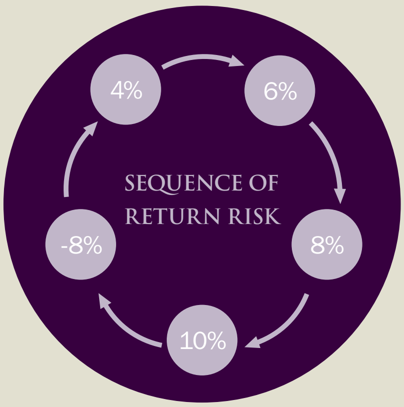
2. Sequencing - Not all averages are created equally

The sequence of returns can significantly impact the longevity of the pension fund. People with identical pension pots and the same withdrawal rate can have entirely different financial outcomes depending on the sequence of returns with the same long-term average.



Now let's assume we have 5 people all with:

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- All achieve an average return of 4% p.a. after charges
- Sequence of the average is different for each
- Sequence of returns for person 1 is 4%, 6%, 8%, 10%, -8%.
- For person 2 is 6%, 8%, 10%, -8%, 4% and so on.
- **Same average. Different outcomes.**

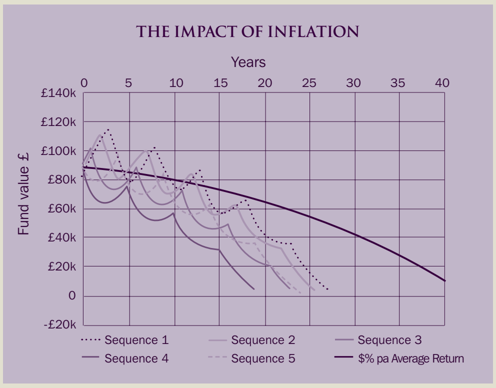


3. Inflation - cost of living increases

A person's starting point for the rate of withdrawal is unlikely to remain static. The price of goods and services increase with time and a person is likely to require more money each year to maintain their spending power.

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- Withdrawal rate increases by 2% p.a.
- Year 1 £5,000, Year 2 £5,100 etc.
- SEQUENCE & VOLATILITY as above
- All achieve an average return of 4% p.a. after charges

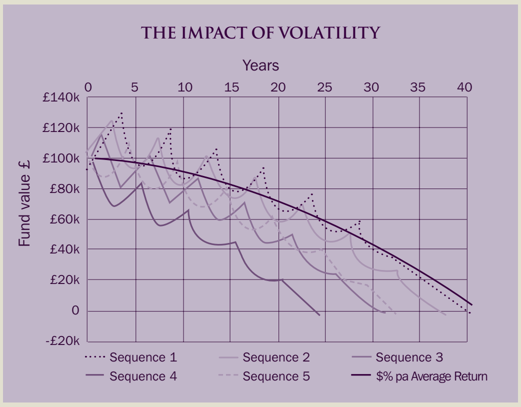
- Sequence 4 reduces the lifetime of the pension fund down to under half the time of where we started in only 19 years.

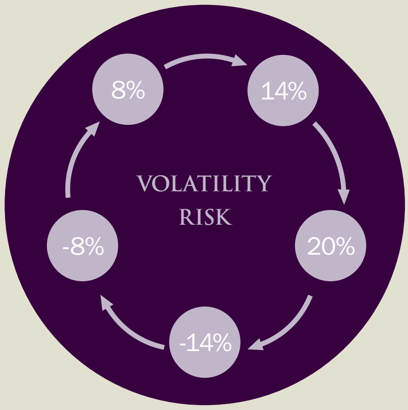


4. Volatility - higher highs and lower lows

The volatility of returns combined with the sequencing can have an even bigger impact on the longevity of the pension fund.

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- Same SEQUENCE of returns as before
- All achieve an average return of 4% p.a. after charges
- Returns more volatile
- Sequence 4 reduces the lifetime of the pension fund down to only 23 years from our original 40+ years.





Key points

Drawdown can offer many benefits when accessing pension benefits:

- Tax-free cash
- Flexibility of income
- Favourable inheritance rules

However, these benefits also come with risks of running out of money through:

- Mismanagement of withdrawals
- Unfavourable market returns

All the more focus should be placed on these uncertainties when considering transferring out of the certainties of a Defined Benefit environment.

Ultimately the choices will be specific to the individual and a Financial Planner will be able to support the process to ensure you have the best possibility of making the money last.

Jo Clamp
HR Manager

OFFICE NEWS

The early part of this year proved to be a very difficult time for all of us. Traci Law, who had worked as a secretary for the Business since September 2000, sadly and very unexpectedly passed away in February. Traci was the sort of person who was always there in the background quietly and busily typing meeting notes and ordering all manner of supplies for us making sure we never ran out of anything. She will be very sadly missed by us all.

Over the course of the coming months we will be looking to arrange a fundraising event in her memory. This will be done in aid of two charities of her family's choice – Leicester Dogs Trust and Leicester Hospitals Charity.

New Recruits

Since our last newsletter we have continued to recruit new staff to the Business. These include:

Claire Potter who joined the Business Support team in January 2019. Claire came to us with many years' experience of working as a secretary/receptionist in the manufacturing field. She provides secretarial and reception support to the Business and spends much of her time typing client meeting notes.

Kate Fisher joined the SSAS Team in April 2019. Prior to taking a break from pensions to look after her children and work for the family business, Kate had worked within the Wealth Management and pensions field for over 5 years so brings with her a significant knowledge of pensions.

Charlie Garner joined the SIPP Team at the beginning of June. He has been working as a Client Relationship Manager in pensions and Wealth Management for the last 3 years so also brings with him significant experience within the pensions field.

SIPP News

Amy Wood, part of the SIPP Team had a beautiful baby girl, Emily, in February and is currently on maternity leave, returning in early 2020.

Leicester Mercury Business Awards.

After undergoing a comprehensive selection process, the Business was one of only three businesses nominated for the Leicester Mercury 'Employer of the Year' Award. A wide variety of criteria were considered including not only terms and benefits but also staff retention and professional development as well as the overall culture of the Business.

We are therefore delighted to be recognised in this way and hope by having such a positive and stable working environment that this in turn is reflected in the service we strive to continually provide to clients.

Charity Support

Since our last newsletter we have again participated, sponsored and supported a range of fundraising events and charities. Here are a selection of just a few of them:

- Football shirt Friday raised £100 for the Bobby Moore Fund and Cancer Research
- Rainbows Hospice – golf day sponsorship - £310.
- Treats – golf day sponsorship - £360.
- Leicester Twilight walk raised £2374 for LOROS

Impressive individual achievements were:

- Alex Williams from our SSAS team who walked an amazing 400,000 steps during February to raise money for Heart Link Children's charity.
- Blake Beardsley and Chris Ball completed the 2019 London Marathon, both of them raising remarkable amounts of money for their respective charities… Blake for The Christie, a Cancer Specialist Hospital in Manchester, and Chris for The Children's Society, who work for under privileged children.

We are delighted to support so many different charities and are very proud of all involved.

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