FINANCIAL FOCUS

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Appetite for risk

Striking the right balance is important to avoid losses

While diversification is important, you should keep in mind how much risk you are prepared to accept on your money. If it is important to you to avoid losses, you may want a portfolio that has less in shares and more in cash and fixed interest securities held to maturity, for example.

Know your risk appetite

Saving and investing involves a variety of risks, for example, the risk your money will not keep up with rising prices (inflation risk), the risk that comes with share prices going up and down (volatility risk), the risk that an institution will fail (default risk), and the risk that you could have earned better returns elsewhere (interest-rate risk).

The aim is to strike a balance between these different risks. What is a good balance for you will depend on:

- Your personal circumstances – how much you can afford to lose (your capacity for loss)
- Your investment goals, time frame and need for returns
- Your personal attitude to risk

Taken together, these make up what's called your 'risk appetite'. Of these three things, your capacity for loss and your investment goals are most important. Personal attitude to risk is hard to measure and can be changeable; what feels comfortable one day may not the next.

How to assess your risk appetite

The following steps should be considered when deciding your risk appetite:

- Know what you can afford to lose
- Ask yourself what would happen if you lost some or all of the money you're putting into investments. This will depend on your circumstances and how much of your money you're investing
- Think about people who depend on you financially and any other important financial commitments you need to be sure of meeting

Work out your goals and timings

Your saving and investing choices will depend on your goals and timescales. The bigger your goal in relation to the assets or income you wish to invest, the greater the rate of return required to beat inflation and hit your goal. Taking no volatility risk at all may make your goals impossible to achieve; taking too much may lose you your investment.

Short-term goals – under five years – such as a car or a house deposit are best saved for in cash. If you have a short-term goal, your appetite for volatility risk would usually be low and cash products will be the best place to invest. You don't want to be worrying about the state of the financial markets when you need your money to be readily accessible. However, cash savings run the risk of not keeping up with rising prices (inflation risk)

Inflation-beating returns

With longer-term goals, it's more usual to put your money into investments that have a better chance of giving you inflation-beating returns, such as shares, but which carry the risk of prices going down. A longer time frame gives your investment more time to recover if it falls in value. So if you have a long-term goal, it makes sense to be prepared to take on volatility risk for the opportunity of higher returns.

However, as a long-term goal moves closer, the risk balance should change. For example, you may want to start moving into less volatile assets a few years before the goal date, to start 'locking-in' gains and to protect your investment against events like market falls. At any one time, you may have a mixture of short-term or critical goals for which you want low volatility (such as saving up to move house), and some non-critical or long-term goals for which you have a higher appetite for volatility (for example, saving towards retirement).

Understand your personal risk attitude

A good way to manage risk is to spread your money across a range of different investment types. Risk attitude is subjective and is likely to be influenced by current events or recent experiences. When stock markets are rising, we tend to feel comfortable with market risk; when they are falling, we do not.

Most people are not comfortable with the idea of losing money. On the other hand, we may regret it if we've been very cautious and our long-term investments don't produce the returns we need. You can keep risks in line with your risk appetite by spreading your money across a range of different investments. ■

IS TIME TO DISCUSS YOUR REQUIREMENTS OR REVIEW YOUR CURRENT PORTFOLIO?

It's important to evaluate and adjust your investment strategy regularly. The products you use and the percentage of your portfolio they comprise will change over time as a result of market conditions, investment performance and other factors. We provide the professional advice and ongoing service needed to help you achieve your financial goals and keep your investments on track. To discuss your requirements or to review your current portfolio, please contact us.

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Securing more of your wealth

You don't have to be wealthy for your estate to be liable for Inheritance Tax

Protecting your estate is ultimately about securing more of your wealth for your loved ones and planning for what will happen after your death to make the lives of your loved ones much easier.

Peace of mind

Making sure that you've made plans for after you're gone will give you peace of mind. It's not nice to think about but it means that your loved ones can carry out your wishes and be protected from Inheritance Tax (IHT).

You don't have to be wealthy for your estate to be liable for IHT, and it isn't something that is paid only on death – it may also have to be paid on gifts made during someone's lifetime. Your estate will be liable if it is valued over the current IHT threshold on your death. The IHT threshold, or Nil Rate Band (NRB), is fixed until 2020/21 at £325,000.

Your estate includes any gifts you may have made within seven years of your death. Anything under the IHT threshold is not taxed (the 'Nil Rate Band') and everything above it is taxed, currently at 40%. Where a person dies and leaves at least 10% of their net estate to a qualifying charity, a reduced rate of 36% IHT can be payable.

Any unused proportion of the NRB belonging to the first spouse or registered civil partner to die can be passed to the surviving spouse or registered civil partner.

Additional Nil Rate Band

From 6 April 2017, the Government will be introducing an Additional Nil Rate Band (ANRB). This will start at £100,000 and increase by £25,000 each tax year until it reaches £175,000 in 2020/21, when it will increase each tax year by the Consumer Price Index (CPI).

The ANRB will be available where you pass your house to your children, grandchildren or great grandchildren. It will also be available if you downsize or cease to own a home as long as the replacement is passed to your children, grandchildren or great grandchildren. It will start to reduce if your net estate is more than £2 million and will reduce by £1 for ever £2 it is over. As with the NRB, the ANRB is transferable between spouses and registered civil partnerships if unused on first death.

Exemptions

Moving ownership of assets to your spouse or registered civil partner may help reduce the IHT liability on your estate. However, don't forget that this can cause an increased IHT liability when they die. There are also exemptions if you make a donation to a charity.

Making gifts

If you can afford to make gifts during your lifetime, this will also reduce the value of your estate, and so your ultimate IHT liability. You can make a gift of up to £3,000 a year without any IHT liability, and if you don't use this whole allowance it can be carried forward to the next tax year. You can also give gifts of up to £250 a year to any number of people with no IHT liability.

There are two types of gift which currently have tax implications. The first is Chargeable Lifetime Transfers (CLTs). The most common chargeable transfers are lifetime gifts into Discretionary Trusts. A transfer will be charged if (together with any chargeable transfers made in the previous seven years) it exceeds the IHT NRB (currently £325,000). Tax is paid at 20% on excess over the NRB.

The other type of gift to be aware of is Potentially Exempt Transfers (PETs). Gifts between individuals or into a bare trust arrangement are examples of PETs. These gifts are free from IHT provided you survive more than seven years beyond the date of the gift. The other area to be aware of is that if you are making a gift but try to reserve any of the benefit for yourself, for example, retaining dividend income from shares you have gifted, or living rent-free in a property you have.

Life insurance policy

Taking out a life insurance policy written under an appropriate trust could be used towards paying any IHT liability. Under normal circumstances, the payout from a life insurance policy will form part of your legal estate and may therefore be subject to IHT. By writing a life insurance policy in an appropriate trust, the proceeds from the policy can be paid directly to the beneficiaries rather than to your legal estate and will therefore not be taken into account when IHT is calculated. It also means payment to your beneficiaries will probably be quicker, as the money will not go through probate.

Setting up a trust

The structures into which you can transfer your assets can have lasting consequences for you and your family, and it is crucial that you choose the right ones. The right structures can protect assets and give your family lasting benefits. A trust can be used to reduce how much IHT your estate will have to pay on your death.

A trust, in principle, is a very simple concept. It is a legal arrangement where the ownership of someone's assets (such as property, shares or cash) is transferred to someone else (usually a small group of people or a trust company) to manage and use to benefit a third person (or group of people). An appropriate trust can be used to reduce how much IHT your estate will have to pay on your death.

Broadly speaking, there are two types of trust to choose from: a Discretionary Trust and Bare Trust.

Discretionary Trusts

A discretionary trust offers flexibility when it comes to deciding who you would like to be the beneficiaries. The appointer can appoint benefits to the beneficiaries of the discretionary trust. With a discretionary trust, there are possible tax liabilities to be aware of. On creation of the trust, IHT might be payable. IHT may also become payable if you die within seven years of the creation of the trust. Depending on the value of assets in the trust, there could be further charges to consider during the lifetime of the trust.

Bare Trusts

A bare trust ensures that, once named, the beneficiaries cannot be changed or added to in the future. Once a beneficiary has reached the age of 18, they can ask for the trust to pay their share to them directly. The major advantage of bare trusts over discretionary trusts is that they are classed as potentially exempt transfers (PETs) with no immediate or ongoing IHT charges, provided the creator of the trust survives more than seven years from the date of the transfer.

Make a Will

By making a Will, you are detailing what you want to happen to your assets after you die. A Will also nominates someone to be in charge of carrying out your wishes. If you die without making a Will, the Government could keep everything if a suitable heir is not found. The rules of intestacy (dying without making a valid Will) can be very complicated, and it should be noted that only your spouse or registered civil partner is assured of any inheritance. ■

THE SOONER YOU START PLANNING, THE MORE YOU CAN DO

Whether you want to provide for the next generation or leave a charitable legacy when you die – or simply want to minimise an IHT bill – whatever your priorities are, the sooner you start thinking about this the more you can do. If you would like to discuss your situation or to find out more, please contact us – we look forward to hearing from you.

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