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WEALTH MANAGEMENT

GUIDE TO HOW

BREXIT COULD AFFECT YOUR FINANCES

LOOKING THROUGH THIS PERIOD OF UNCERTAINTY AND FOCUSING ON THE LONGER-TERM OPPORTUNITIES

FINANCIAL GUIDE

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Welcome

UK's exit from the European Union after 43 years

Welcome to our Guide to how Brexit could affect your finances. *The UK's exit from the European Union after 43 years is now set to happen. The vote by a majority of British people to leave the European Union on Thursday 23 June represents a very significant decision for the UK, for the European Union and indeed for the wider global economy. The UK voted to leave the EU by 52% to 48%.*

HIGHEST TURNOUT

The Leave campaign won the majority of votes in England and Wales, while every council in Scotland saw Remain majorities. The referendum turnout was 71.8%, with more than 30 million people voting. It was the highest turnout in a UK-wide vote since the 1992 general election.

UNSETTLED INVESTORS

But what could this mean to our finances? It goes without saying that investors are going to have to hold on to their nerves through the coming days, months and even years. The markets have clearly been shocked by the decision, and, although unsettled, investors should look through this period of uncertainty and focus on longer-term opportunities.

ECONOMICALLY STRONG

There will be challenges in the near term, and there is likely to be a period of uncertainty as the exact terms of Britain's exit from Europe are negotiated. There needs to be a period of managing political uncertainty, uniting a deeply divided population and ensuring the UK enters negotiations feeling economically strong rather than weak. The instability that we've experienced once it starts to settle down will mean that investors can focus on the UK's future outside Europe and how it will affect their finances. ◂

PROFESSIONAL ADVICE

There will be opportunities – as well as pitfalls – and steps you can take to protect your finances. During any period of uncertainty, expert professional financial advice is at its most important. If you are concerned about any aspects of Brexit on your finances and how this may have affected your financial position, please contact us.

Brexit

UK ready to face the future 'from a position of strength'

For the UK to leave the European Union, it has to invoke an agreement called Article 50 of the Lisbon Treaty.

The Prime Minister, David Cameron, announced on Friday 24 June he would be stepping down as prime minister by October, and he or his successor will need to decide when to invoke Article 50 which sets in motion the formal legal process of withdrawing from the European Union and gives the UK a period of two years to negotiate its withdrawal.

ADJUSTMENT IN THE UK ECONOMY

On Monday 27 June, the Chancellor of the Exchequer, George Osborne, said that the UK is ready to face the future 'from a position of strength' and indicated there will be no immediate emergency Budget. He also said there would still need to be an 'adjustment' in the UK economy.

PROCESS OF LEAVING THE EU

However, Mr Osborne said it was 'perfectly sensible to wait for a new prime minister' before taking any such action. He also said that only the UK could begin the process of leaving the EU by triggering Article 50 of the Lisbon Treaty.

EU TREATIES AND LAWS

European Union law will still remain in the UK until it ceases being a member, and the UK will continue to abide by EU treaties but not take part in any decision-making as it negotiates a withdrawal agreement and the terms of its relationship with the now 27-nation bloc. ◂

Sterling

Buffer for the economy

The value of sterling on Monday 28 June fell to a 31-year low as the effects of Brexit unfolded. Sterling dropped past $1.32 to $1.3192, its lowest since mid-1985, taking losses to 11.8% since the 23 June vote.

QUANTITATIVE EASING

Given all the uncertainty, investors are pricing in a rate cut this year, with some analysts expecting the Bank of England to consider quantitative easing to provide a buffer for the economy. Within days of the Brexit result, gilt yields hit record lows with the 10-year benchmark dropping below 1%.

WEAKER POUND

Many analysts expect the value of the pound to fall significantly in the medium term. A weaker pound means that buying goods or services from other countries will become more expensive, inflation will therefore be higher and goods being sold to other countries will become cheaper for the buyers. ◂

Wages

Point of maximum impact

The economic effects of leaving the EU could cause unemployment to rise in the UK which would reduce the pressure for wage growth. The Treasury estimated that wages will be between 2.8% and 4% lower at the point of maximum impact.

However, if the UK remains a member of the EU for at least another two years, much will depend on economic performance during this period.

BENEFIT PAYMENTS

In the event that economic growth is slower outside the EU in the short term, the Government's income could fall, leaving it with less money to spend. There have been estimates of the size of that possible shortfall varying between £28bn and £44bn by 2019/20.

Since the welfare budget amounts to approximately 28% of all government spending, there could also be cuts that reduce tax credits and benefit payments.

BUDGET SHORTFALLS

Ultimately, the UK's economic growth and potential budget shortfalls will very much depend on the precise nature of trade agreements and whether the UK will be a member of the European Economic Area (EEA).

One further option the Government may consider is not to keep its earlier target to balance the books by 2020, known as the 'fiscal mandate'. This would enable decisions to be made as whether to maintain benefit payments at current levels. ◂

MORTGAGES

Will the Bank of England cut interest rates?

Before the EU referendum vote, the Treasury predicted a vote for Brexit would mean a rise of between 0.7% and 1.1% in borrowing costs. The Prime Minister, David Cameron, claimed the average cost of a mortgage could increase by up to £1,000 a year.

CALMING THE MARKETS

The governor of the Bank of England, Mark Carney, speaking soon after David Cameron on Friday 24 June, stopped short of announcing an increase in interest rates to defend the pound, which would have affected millions of households on tracker-style mortgages. Mr Carney has promised £259bn to calm the markets.

Each half-point change in rates adds or subtracts approximately £25 a month to most people's repayment mortgages. Those with interest-only mortgages would see steeper changes – around £42 a month for every 0.5% rate change.

FIXED-RATE MORTGAGES

Already post-Brexit there have been signs that new fixed-rate mortgage deals could drop – with many more coming in below 2% – in response to changes in the bond markets. A rise in interest rates could also affect those in rented accommodation, as costs for landlords would go up.

But if the vote for Brexit brings a period of low growth, some economists are suggesting the Bank of England will cut interest rates, in which case the cost of lending could actually fall.

PROPERTY PRICES

Some uncertainty and concerns from consumers could lead to a stalling in the housing market, although it will take a longer period to see the full economic effects of Brexit.

The International Monetary Fund (IMF) announced that Brexit could result in the fall in house prices, and this was on the expectation that the cost of mortgages may rise.

FIRST-TIME BUYERS

The Treasury also said house prices could fall by between 10% and 18% over the next two years, compared to where they otherwise would have been, which for first-time buyers is good news.

The National Association of Estate Agents (NAEA) believes house prices in London could see the biggest downward change over the next three years, compared to where they otherwise would have been.

Elsewhere, the NAEA said values could fall, but since it expects prices to continue rising anyway this means a slower rate of increase rather than a fall in real values. ◂

Taxation

No laws have changed

A week before the EU referendum, the Chancellor of the Exchequer, George Osborne, warned that a vote to leave the EU might result in tax increases too. He spoke about a 2p rise on the basic tax rate (currently 20p in the pound) and a 3p rise in the higher rate (currently 40p). He also said Inheritance Tax (IHT) might rise by 5p from its current 40p in the pound. But to do so would go against the Conservative Government's promises at the last general election, making this decision to implement difficult politically.

EXTENDED AUSTERITY

Many commentators believe the Government would be much more likely to extend the period of austerity beyond 2020. The Institute for Fiscal Studies (IFS) said that spending might need to be curbed for two further years.

During the referendum, the Vote Leave campaign said it wanted to remove the 5% VAT charge on domestic fuel that is currently required by the EU – but it is not clear how or when this could be achieved.

TAX AUTHORITY

The UK's tax authority is stressing that 'no laws have changed' and that tax rules remain the same following the EU referendum. 'Everything is continuing as normal. No laws have changed. There is no need to contact HM Revenue & Customs as a result of the EU referendum.'

Changes to financial regulations will inevitably change in time following the UK's vote to leave the EU. However, a recorded message on the HM Revenue and Customs (HMRC) helpline stated that nothing has changed in the immediate aftermath of the vote. ◂

Investments

Maintaining a long-term perspective is the key to investment success

As was widely predicted, a vote to leave the EU wiped billions off companies' share prices. Low interest rates and volatile stock markets are likely to be the order of the day for the foreseeable future, and any rise in interest rates would be good news for savers.

However, it's important to keep this event in context. This is far from the global financial crisis of 2008, but the decision to leave the European Union sparked volatility across asset classes. In terms of specific sectors, banking, airlines and construction experienced the biggest falls in share prices.

IMPULSE DECISIONS

For investors that have no immediate need to withdraw money, they should remain invested, especially if they are genuinely investing and not speculating. Making impulse decisions, such as selling much too low out of fear, can be very costly in the long run. Even though there have been falls in the FTSE 100, and more significantly to the FTSE 250 since the EU referendum result, it's also important not to lose sight of buying opportunities.

The golden rule when investing is to buy low and sell high. With the massive amount of uncertainty surrounding Brexit and its potential long-term effects, now may be a good time for adventurous investors to add appropriate stocks selling at all-time lows to their portfolios. For people years from retirement, they have lots of time for these securities to rebound and need to keep calm and carry on.

INVESTMENT SUCCESS

While the knee-jerk reactions will continue to make headlines, history has shown that maintaining a long-term perspective is the key to investment success.

Although there has been a significant slide downwards in sterling, it's worth remembering that the UK has previously endured sharp devaluations before, notably following the ejection of the pound from the European Exchange Rate mechanism (ERM) and in the aftermath of the banking crisis, resulting in periods of economic expansion.

LARGEST ECONOMY

The UK is the fifth largest economy in the world, and, looking at the fundamentals, more than 70% of FTSE 100 earnings are international in nature and so are little affected by any weakness in the UK domestic economy stemming from the vote.

It is important that investors' portfolios are well diversified and a long-term perspective is maintained, and investors should be careful not to be drawn into any hysteria – a multi-asset approach will enable investors to protect capital and drive long-term returns in the future. ◂

Pensions

Existing commitments re-examined in post-Brexit climate

During the referendum campaign, the Prime Minister, David Cameron, said the so-called 'triple lock' for state pensions would be threatened by a UK Brexit. In their 2015 election manifesto, the Conservatives promised to extend the triple lock on state pensions – a guarantee that they rise every year until 2020 by at least 2.5%, the rate of inflation or growth in earnings if it is higher.

NATIONAL INCOME

While pensioner benefits were a 'policy priority' and he was committed to honouring manifesto promises, the Prime Minister said £90bn was spent on it every year and it was among many existing commitments that might have to be re-examined in a post-Brexit climate. Again, this assumes a poorer economy and lower national income going forward.

If economic performance deteriorates, the Bank of England could decide on a further programme of quantitative easing as an alternative to cutting interest rates, which would lower bond yields and, with them, annuity rates. So anyone taking out a pension annuity could receive less income for their money.

> "In the longer term, there is a possibility that some of the stringent EU rules on the amount of capital that insurers have to hold to support their annuity may be relaxed ever so slightly, and this should be good for annuities."

WHAT COULD THE FUTURE HOLD FOR PENSIONS OUTSIDE THE EU?

DRAWDOWN

For many people with money invested in 'income drawdown', they should do nothing unless they have to. Income drawdown is a way of using a pension pot to provide a regular retirement income by reinvesting it in funds specifically designed and managed for this purpose. The income received depends on the fund's performance and isn't guaranteed for life.

Up to 25% (a quarter) can be taken from the pension pot as a tax-free lump sum. The rest is moved into one or more funds that allows for an income to be taken at a time when it suits. Most people use it to take a regular income. The income received may be adjusted periodically depending on the performance of the investments.

There are two main types of income drawdown:

- Flexi-access drawdown – introduced from April 2015, where there is no limit on how much income can be taken from drawdown funds
- Capped drawdown – only available before 6 April 2015 and has limits on the income that can be taken out; if someone is already in capped drawdown, there are new rules about tax relief on future pension savings if they exceed their income cap

WIDER ECONOMY

As we have seen post the Brexit result, there is likely to be a period of volatility in the markets and uncertainty in the wider economy. In these conditions, acting in haste is unlikely to serve well for many people unless there are good reasons for doing so.

For people many years away from retirement and making regular savings, unless Brexit has impacted on a change in their current circumstances it will be prudent to keep saving. It's also worth remembering that when markets fall, investments are acquired at a lower price, resulting in the opportunity to gain when markets rise.

ANNUITY RATES

It is likely that for the foreseeable future, annuity rates will continue to remain at their current low levels. An annuity is a product available for retirees and offers an income for life, bought at retirement with all or part of a person's pension savings.

The current returns available reflect movements in interest rates, and since Brexit the money markets have signalled further lower long-term rates. Gilt yields and annuity rates have been falling steadily over the past year and could reduce even further.

NEWLY RETIRING

Cuts have already taken place following falls in the yields on bonds issued by the Government in the wake of the EU vote, and more falls in annuity rates are likely to follow. On Monday 27 June, some pension companies began to cut the amount they will pay people who are newly retiring.

If someone is considering using their pension to purchase an annuity to fund their retirement, they should obtain professional advice sooner rather than later.

“For people many years away from retirement and making regular savings, unless Brexit has impacted on a change in their current circumstances it will be prudent to keep saving.”

PENSION SAVINGS

For those wanting to delay purchasing an annuity but needing to draw on their pension savings, if appropriate they could draw an income from their funds using a drawdown arrangement.

In the longer term, there is a possibility that some of the stringent EU rules on the amount of capital that insurers have to hold to support their annuity may be relaxed ever so slightly, and this should be good for annuities.

FINAL SALARY PENSIONS

There are currently over 11m people that have defined benefit pensions (final salary schemes). Many people may have one if they currently work or have worked for a large employer or in the public sector.

A defined benefit pension scheme is one where the amount paid is based on how many years a member works for an employer and their salary earned. These schemes pay out a secure income for life which increases each year.

SUFFICIENT MONEY

An employer contributes to the scheme and is responsible for ensuring there's sufficient money at the time of retirement to pay a pension income to the member, and there is no reason to expect any instant effects of the Brexit vote on such schemes. Once earned, the benefits due from a defined benefit pension scheme cannot be changed without members' approval unless the company concerned goes out of business.

ECONOMIC GROWTH

However, if interest rates stay lower for longer and economic growth is weak, some schemes' funding could be put under more pressure.

It is possible that some defined benefit pension schemes may think about passing more of the cost on to members by increasing their contributions. But any change is unlikely until each scheme's next official valuation, which happens once every three years.

STATE PENSION

As the state pension is 'unfunded', it's not backed by an investment fund, which means it is not affected directly by movements in the financial markets. Any potential effects of Brexit on the state pension is likely to occur in the longer term. However, a severe post-Brexit recession could put pressure on the tax revenues that are needed to pay the state pension.

ALREADY RETIRED

Any changes to the state pension are more likely to affect those who have not yet retired rather than those that have already retired. One significant state pension change in the future could be an impact on the 'triple-lock', which now looks more uncertain following the EU vote.

The triple-lock guarantees that the state pension will rise by the higher of prices, average earnings or 2.5%. Before the referendum, David Cameron warned this 'special protection' would be under threat if there were a 'big black hole' in the economy following a Brexit vote.

Pension saving should still remain a priority, especially given that the tax relief currently available on contributions may not be here forever. ◂

MAKE SURE YOUR PLANS REMAIN ON TRACK

The UK's exit from the European Union after 43 years surprised markets. It is important to keep this event in context – this is far from the global financial crisis of 2008. This is a time for investors to concentrate on long-term fundamentals and to remain focused on meeting their investment goals. If you want to discuss your particular situation post-Brexit to ensure that your plans remain on track, please contact us.

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