

Reviews of the latest products, advice and forecasting

# MM2

## SIDEWAYS GLANCE

Julian Gibbs



### Team effort

Most major markets this year are likely to have little or no growth mainly because there may well be a worldwide recession. This does not mean, however, that some of the emerging markets will not continue to prosper.

Many stocks in some of these markets are under-researched and a specialist team should be able to select well. My tip of the year is an emerging market's fund with an experienced team and a good past record and one which is small enough to take advantage of special situations so I am choosing Resolution's Hexam global emerging markets fund.

The fund was launched in November 2006 and as at December 3, 2007 had increased in value by 46.9 per cent and was fourth last year out of nearly 200 emerging market funds.

The management team, headed by Bryan Collings, are all ex-Barings and have shares in the business. I have never seen such a detailed presentation as Bryan has produced for IFAs and I believe that his investment process together with the past record of the team justifies my choice.

At present, Collings is particularly keen on Brazil, Russia and Turkey. He invests mainly for the medium to long term and has a concentrated portfolio of 41 stocks. He chooses countries in which to invest in with a high savings ratio, favourable demographics with currencies which are undervalued and have scope for revaluation.

He also looks for growth shares at reasonable prices which have the scope for paying out higher dividends, many of which are outside the MCSI emerging markets index.

At present, his biggest stocks are OAO Gazprom, Petrobras, China Mobile, CVRD and Localisa.

I like Hexam because the team is likely to remain together for a long time and because they are all totally dedicated to making their fund successful.

The proposals for transfers of unused nil-rate band will make IHT planning much simpler

## Band aid

### THE EXPERT

Brian Murphy



Last October, the pre-Budget report contained proposals to allow a transfer of any unused inheritance tax nil-rate band on an individual's death to the estate of the surviving spouse and aims to give an update on how they affect the IHT mitigation strategies available.

It should be noted that all references to surviving spouses apply equally to surviving registered civil partners.

The proposals allow the personal representatives of a surviving spouse who died on or after October 9, 2007 to claim any unused NRB that existed on the death of the first spouse. The claim

is based on the proportion of the unused NRB available on the death of the first spouse, not the cash amount, therefore effectively index-linking the NRB.

The new rules also allow any unused NRB to be transferred from more than one deceased spouse up to a limit of one additional NRB. So, if someone has survived more than one spouse, on their death, it may be possible to claim unused NRBs from more than one estate.

However, the unused NRB accumulated for this purpose is limited to a maximum of the NRB in force at the relevant time (that is, the survivor's death).

Here is an example. Greg died in June 1992 when the NRB was £150,000. His will left £60,000 to a discretionary will trust, with the balance passing to his wife Alison. Greg thus used 40 per cent of his NRB, leaving 60 per cent unused.

His wife Alison later married Derek, who died in June 2007, also leaving 60 per cent of his NRB unused.

If Alison dies in February 2008 (assuming she made no lifetime transfers in the preceding seven years) then, although a combined total of 120 per cent of Greg and Derek's NRBs are unused, her personal representatives will only be able to claim an additional £300,000 in respect of both Greg and Derek's unused NRBs (limited to a maximum of the NRB), bringing the total NRB available to £600,000.

The proposals do not require married couples to take immediate action but they will make IHT planning much simpler, as leaving assets to a surviving spouse will no longer mean that the deceased's NRB is wasted. The proposals are likely to be of most use to those couples whose main asset is the private residence and are

therefore unable to undertake any lifetime planning.

Where couples have included an NRB trust in their wills, there is no need to make any changes as there may still be good reasons to have such a trust such as to avoid the spouse having total access and control of the assets, especially where children from a previous marriage are involved.

In addition, it is important to bear in mind that if an NRB discretionary will trust is used, any growth in the value of the assets will be kept outside the surviving spouse's estate and if it is felt that the potential growth on the assets will outstrip the increases in the NRB, this will produce an IHT saving.

Another important point to note is that where couples make provision in their wills for a life interest trust for the surviving spouse, this will continue to be treated as an absolute interest to him/her

for IHT purposes, covered by the spousal exemption. Thus no liability to IHT arises on the first death and the NRB remains fully transferable. This means that assets do not have to be left outright to the surviving spouse and allows for control over the eventual destination of these assets.

These new rules are welcome and will be particularly beneficial for smaller estates where perhaps the majority of the estate is comprised of the private residence, as they will mean that, in many instances, complex will planning involving IOU/debt schemes will no longer be necessary.

For bigger or more complex estates, however, it is envisaged that the use of discretionary will trusts will continue to remain popular, as will the use of IHT mitigation schemes using insurance policies such as loan trusts and discounted gift schemes.

**Brian Murphy is financial planning manager at Axia Life**

Investors should be looking for firms with strong defensive earnings and good dividend records

## Dividend tips

### MARKET VIEW

Michael Gifford



The cold winds of economic downturn are sweeping through the UK equity market and investors are faced with difficult decisions about the best place for their money.

Asset classes that performed well in 2007 are now suffering from the credit crunch and lower liquidity.

The outlook for commercial property continues to be uncertain. Property values are forecast to fall further as the prospect of rent increases have diminished with yields rising to 5.25 per cent from 4.5 per cent already since the middle of 2007.

Commodities may continue to benefit from Chinese demand but

the asset class is hardly cheap and, with the possible exceptions of gold and oil, further price rises appear muted. Meanwhile, last year's price rises in commodities led to fears of rising inflation, making the outlook for bonds appear less certain.

With 10-year gilts offering 4.4 per cent against the expected level of inflation at 2.1 per cent in 2008, a real yield of 2.3 per cent does not look particularly compelling.

And finally, cash. Considered as a safe haven but it is not going to offer significant returns as the Bank of England is expected to cut rates from the current 5.5 per cent to 4.75 per cent by the end of the year.

In contrast, equities do not seem as bad as could be expected.

Certain parts of the market appear constrained, such as consumer-related stocks and banks, but UK equity valuations are starting to look compelling with a market price/earnings ratio

of around 13.

We do not necessarily agree with all the optimistic forecasts for earnings' upgrades but profit growth for the market as a whole is not going to disappear altogether. Corporate activity will continue, particularly as last year was marked by the strength of the private equity market until the credit crunch. Companies have strong balance sheets so we expect UK equities to benefit from trade buyers. The market should also be supported by overseas investors, flush with oil money, and sovereign wealth funds allocating assets to UK equities.

A key issue for investors will be the return of cash to shareholders. We expect traditional, non-cyclical or secular growth stocks to be valued at a premium in a weaker growth environment. These include technology companies with strong franchises, together with the pharmaceutical, telecoms

and utility sectors, which are also well placed to deliver reasonably secure earnings' growth and can, importantly, protect against inflation, growing concern with investors and central banks alike.

Two stocks with very defensive earnings are BAE and Rolls-Royce, which both have strong visibility of earnings as their order books are long term by definition. Earnings' prospects look good as BAE has recently won significant orders while Rolls-Royce continues to win new engine orders.

Another strong candidate for any income portfolio is National Grid. With shares yielding 3.75 per cent, the company has very secure earnings profile. Its position in the US has been cemented by the recent acquisition of Keyspan. Coupled with visible earnings from the regulated UK business, this move will ensure it can continue to maintain and grow its dividends.

In contrast, BP has just

gone through what could only be described as an *annus horribilis* but we believe that BP's fortunes are set to improve this year.

With shares yielding 3.5 per cent, with strong earnings' upgrade potential and strong cashflow to fund dividend payments, BP looks to remain in many income portfolios this year.

In uncertain times, investors have focused on shares paying good dividends. We do not expect it to be much different this time, particularly if the dividends are secure, visible, growing and are offered by firms with defensible market positions.

This is the natural hunting ground for equity income investors and they will gravitate towards companies with strong earnings' prospects and growing dividends. Equity income funds should do well in this environment.

**Michael Gifford is manager of the Old Mutual equity income fund**