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Edition
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Caves Quarterly

Spring 2024 newsletter

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CAVES WEALTH

CEO Welcome

Simon Harvey, CEO

The days are getting lighter as we move into the time of year for regeneration and uplift. Certainly, the government will be hoping that positive news on the downward trend of inflation will lift voters' spirits in this election year. With the Bank of England expected to nudge interest rates down as well over the next few months, there may well be an 'air of spring' for many.

The Chancellor seemed to be hoping his additional National Insurance cuts announced in the Spring Budget would boost that feeling. Although most of the measures that appeared were thoroughly teased, there were still a few surprises to affect your new tax year planning. There was an element of swings and roundabouts: for example, the increased threshold for the introduction of the high-income child benefit charge from £50,000 to £60,000 came with an increase to the size of the band to which it applies from £60,000 to £80,000.

We explore this and other key takeaways from the Budget in the feature for the Spring edition of our newsletter. We also look at the probable lowering of interest rates in 2024 and the potential effects on your savings. If you've been holding cash deposits, either directly or in money market funds, the benefit you've seen from the accumulated rise in rates will begin to dissipate.

Our other stories in this edition include:

1

The renewed case for ISAs – The combination of the erosion of personal tax allowances and improved terms mean that ISAs are coming back into fashion for the new tax year.

2

Succession – have you got a plan? – It's not just fictional warring families and multinational empires that need to face up to managing future ownership and control. Private company shareholder/directors or partners need to ensure they have planned for transition and the unforeseen.

3

Tax charge trap for pension withdrawals – With the pension freedom rules giving people more flexible and earlier access to their retirement savings, many are finding themselves penalised with higher tax payments on initial withdrawals.

The full list of topics in this edition include:

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There may be more clarity on the path to an election by the summer when we'll share our next edition with you. Please do get in touch if we can continue to help or provide you with more information on any of the topics covered.

Best wishes, Simon.

It has been a positive start to the year in financial markets, with strong returns witnessed across Japan, Europe, and the United States. Meanwhile, China continues to hold the emerging markets sector back, hampered by concerns over its growth prospects and property market challenges.

The end of 2023 saw the US Federal Reserve (Fed) pivot towards an easier monetary policy stance. As it has become clear that interest rates have likely peaked across the developed world, traditional risk assets have performed well, with positive momentum across stocks pushing several of the leading equity market indices close to record high levels by the end of the first quarter.

Economic growth has proved resilient over recent months, buoyed by a pickup in global manufacturing activity and corporate profit growth, particularly for the mega-cap stocks listed in the US. With inflation falling rapidly from post-pandemic highs (and without the associated global recession that many economists said was needed to restore price stability), investors who were fearful of a global downturn last year are now being drawn back into the market.

It was a more challenging period for fixed income investors as robust economic activity and sticky inflation data combined to drive negative returns for bonds. The Fed kept interest rates on hold at 5.25-5.5% as US inflation ticked up slightly in February. The pace of monetary policy easing in the States now looks set to be slower than previously expected after chair, Jerome Powell, said that the central bank will be “careful” about the decision on when to start cutting rates. Across the pond, the Bank of England (BoE) and the European Central Bank (ECB) have hinted that initial rate cuts are likely to commence as early as this summer following the downward trend in core inflation data.

1 Global Equities

US markets trended higher off the back of a robust domestic economy and continued excitement surrounding artificial intelligence (AI). A bumper earnings season was boosted by the "Magnificent Seven" stocks (Amazon, Apple, Alphabet, Meta, Microsoft, Tesla, and Nvidia), whose aggregate market cap share makes up around 30% of the S&P500; the remaining 493 participants make up the other 70%.

With all of the "Magnificent Seven" harnessing new AI technology, demand for their products and services continues to rise, and this was reflected in strong earnings, especially for Nvidia, as it manufactures the chips that make this AI drive possible. The S&P500 index ended the first quarter 10.2% higher, with the NASDAQ index slightly behind at 8.5%.

Eurozone economic activity is benefitting from falling energy prices, real wage gains for households and a rebound in global manufacturing activity. European bourses enjoyed a strong quarter, with information technology stocks faring best in line with strong momentum seen in sectors linked to the AI megatrend. The lack of true tech powerhouses in the Eurozone and sticky regional inflation did little to deter markets, with the Eurostoxx50 index gaining 12.4% over the 3-month period.

It was energy, industrials, and financials that outperformed in the UK, albeit with a headwind of higher oil prices and interest rates. There was also a fairly subdued market reaction to the Spring budget, which investors had anticipated to be much bolder ahead of this year's General Election. The FTSE All-Share ended the quarter up just 2.5%. Despite the UK falling into a technical recession, the Bank of England continues to hold interest rates at 5.25%. Continued lower than expected inflation data indicates we may however see the first rate cut in June, sooner than previously expected.

China continues to face headwinds as geopolitical tensions with the US, a general slowdown in growth and a property market crisis discourages investment into the world's 2nd largest economy. Although the market showed signs of life with a brief rally during the quarter, investors remained cautious amid the uncertain outlook and the Hang Seng ended the 3-month period -3.0% lower.

Foreign investors' increased optimism surrounding Japan's positive economic cycle of mild inflation and wage growth saw the Japanese equity market post very strong performance over recent months.

The Nikkei index closed out the quarter 20.6% higher, having reached an all-time high by surpassing the 40,000 level during the period.

Emerging markets posted positive performance but lagged their developed market counterparts. Countries most exposed to tech, such as Taiwan, strongly out performed, again fuelled by the excitement and demand surrounding AI, as companies start to diversify their supply chains away from a seemingly unstable China.

2 Fixed Interest

We have seen some movement in market interest rate forecasts and bond yields over this first quarter of the year, although perhaps not in the direction that would have been expected following the strong shift in sentiment seen in Q4 of 2023.

Market forecasts for interest rate cuts, particularly in the US, have been tempered as US economic data has remained remarkably robust and also due to sticky inflation, with the annual rate of inflation unexpectedly rising to 3.2% in February, from 3.1% the month before. These factors have seen the US 10-year government bond yield increase from 3.9% to 4.2% over the quarter.

In the UK, the 10-year government bond yield also rose, from 3.5% up to almost 4%, with the year-end position now proving to be a very marked low for this reference data over the short-term. The UK Consumer Prices Index (CPI) has continued to moderate however, with the annual rate falling to 3.4% for February 2024, the lowest level since September 2021.

Within credit markets, as prospects for aggressive rate cuts have faded somewhat, high yield bonds outperformed investment grade bonds thanks to their lower interest rate sensitivity and easier financial conditions. On aggregate, investment grade returns were slightly negative over the quarter.

While most of the major central banks are adopting a 'wait-and-see' approach on interest rates for the time being, markets are still currently pricing in a series of rate cuts in the US, UK and Europe, most likely weighted towards the second half of 2024. Much would seem to depend on a continued fall in inflation towards the 2% target of the respective central banks.

3 Commercial Property

In the UK, corporate activity within the REIT space continued to pick up.

This reflects the deep discounts to net-asset-value that many of them trade on, as well as a realisation that some of the smaller companies in the sector perhaps need to consolidate with each other to remain competitive and increase their appeal to a broader range of retail and institutional investors. As a result, discounts broadly tightened over the period.

Whilst capital performance is important, investors are drawn to the sector for the consistent income received through dividends. With rent collection now back above pre-COVID levels in many cases, these look well supported in the period ahead.

4 Alternatives

The first quarter of 2024 saw gold break out of its recent trading range, with prices more than 10% higher over the period. Investors generally consider the asset a "safe haven" in times of economic or geopolitical uncertainty.

The precious metal, however, offers no investment yield, making it less attractive when interest rates rise and higher yields can be found from other asset classes. As interest rate expectations have fallen back in the last six months, the opportunity cost of holding the yellow metal has reduced. This coupled with rising geo-political risk has been cited for the increased investor demand and corresponding price rises seen over recent months.

With little sign of a breakthrough in the Middle East or Ukraine, this uncertainty, combined with elections looming in the States, could well see gold continue to reach new highs as the year progresses.

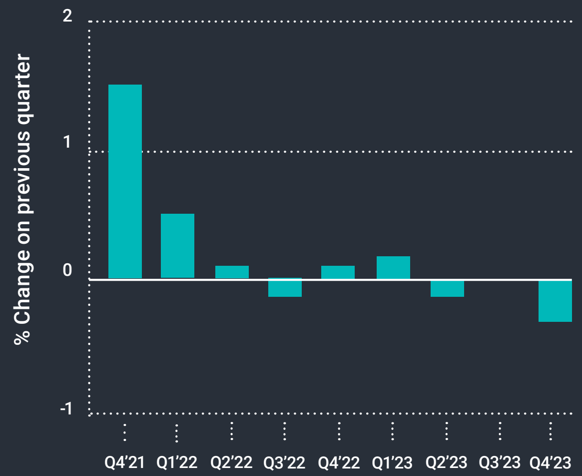
5 Outlook

Despite concerns over potential exuberance in markets since the turn of the year, an environment of moderating growth, slowing inflation, policy rate cuts by the major central banks and continued low volatility broadly supports a 'risk-on' stance going forward.

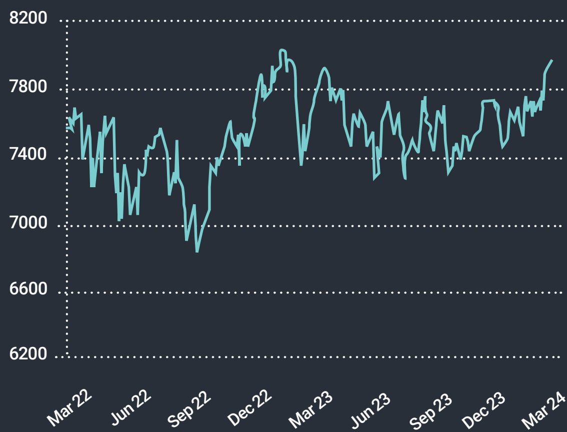
When determining asset allocation, we continue to believe that maintaining a well-diversified portfolio is prudent to absorb any adverse shocks. As ever, markets remain vulnerable to a multitude of environmental, geopolitical, and economic risks, which could lead to heightened volatility in the coming period. Whilst certain areas of financial markets may seem 'priced for perfection' after a strong first quarter, we believe there is ample opportunity for investors to continue to generate positive returns by diversifying across asset classes and increasing the resilience of portfolios for the remainder of the year.

UK Consumer Prices Index (CPI)

UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index

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Protecting your health

Private healthcare options are on the rise as more people are looking at alternatives to the NHS through personal or workplace provision.

Protection and insurance products can provide access to some primary healthcare options, such as GP and dental services, and often contribute towards the cost.

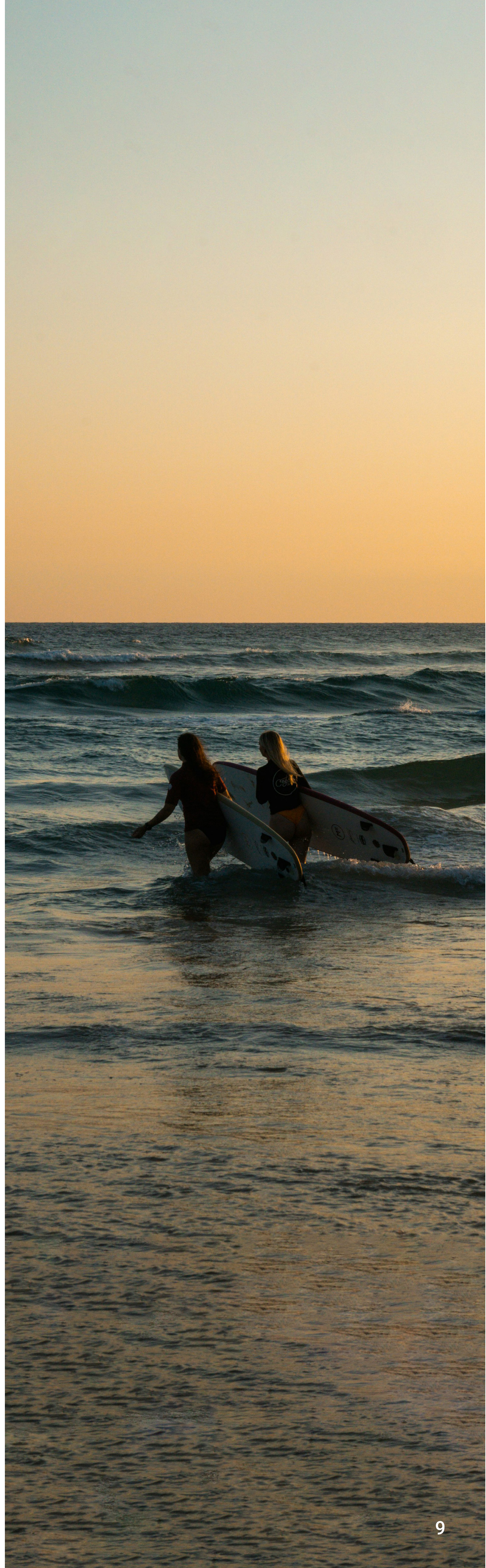
There are significant differences between providers and products in price, coverage and exclusions, although none replicates the range of services available via the NHS. Understanding the details of each policy is key to finding the right option.

1. **Cash plan policies:** Pay out a fixed contribution towards routine healthcare costs, such as dental and optician fees.
2. **Income protection:** An insurance policy that pays a fixed monthly income if you are signed off work through ill health. It can ensure essential bills are paid during a period of illness.
3. **Critical illness:** Pays a lump sum on the diagnosis of one of the serious illnesses listed on the insurance policy. The conditions will include most cancers, heart disease and stroke.
4. **Private medical insurance:** Typically covers the cost of private diagnostic tests, consultations and hospital treatment. Emergency cover is not included, nor is treatment for existing or ongoing problems such as asthma and diabetes, nor pregnancy-related complications.

Many of these products now also offer a range of additional services, often at no extra cost. This can include virtual GP services, mindfulness apps and online counselling, plus information on lifestyle issues – for example diet, smoking or exercise.

While these products can of course be bought individually, employers are increasingly offering some form of health benefit to their staff to improve staff retention and reduce long-term sickness absence.

If you need to access health insurance at any point, or are looking to improve your health, it is worth checking what benefits may be available through your workplace, including access to healthy lifestyle services.



Top takeaways from the Spring Budget

Teasers for the 2024 Budget had been dropped across the preceding fortnight but nevertheless, Budget Day still contained a few surprises.

Chancellor Jeremy Hunt was under great political pressure to add to the tax cuts announced in his Autumn Statement 2023 and, if possible, steal a march on Labour's tax plans. However the Office for Budget Responsibility (OBR) had made clear his scope for generosity was minimal. Mr Hunt managed to square the circle, but only by bringing his margin of error down to just £9 billion in 2028/29, a figure which the OBR described as "a tiny fraction of the risks around any forecast".

What's new?

Some of the Chancellor's Budget measures likely to affect you include:

1. **National insurance contributions (NICs)** The main rates of employee (class 1) and self-employed (class 4) NICs will be reduced by two percentage points to 8% and 6% respectively from 6 April 2024. The 2% rate on earnings/profits above £50,270 is unchanged. These reductions once again alter the mathematics around the wisdom of incorporation and whether to draw bonuses or dividends.
2. **High income child benefit charge (HICBC)** The income threshold at which this charge starts to bite will rise from £50,000 to £60,000 for 2024/25. Simultaneously the rate of charge will halve, to 1% for each £200 over the threshold. Consequently, the size of the income band in which the HICBC can apply will double to £20,000 (£60,000 to £80,000). By 2026, the income threshold is expected to move from an individual to a household basis.
3. **Residential property** The maximum capital gains tax (CGT) rate on residential property gains will be cut from 28% to 24% in 2024/25, while all other CGT rates remain unchanged. Some second homeowners will be stung, however, as the favourable tax rules for furnished holiday lets will be scrapped from April 2025.
4. **UK ISA** The Chancellor issued a consultation paper on a 'UK ISA', with domestically-focused investment options. This new variant will have a contribution limit of £5,000, which will be in addition to the existing overall £20,000 ISA limit (unchanged since 2017/18).
5. **Non-domicile rules** The arcane tax rules which offer favourable tax treatment to some UK residents with a foreign domicile will be scrapped from 2025/26. The new regime will be based solely on tax residence, although transitional rules will apply for those already claiming the status.

If any of these changes could affect you or your business, or you would like further information on the Budget's contents, please do not hesitate to contact us.

The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Investments do not offer the same level of capital security as deposit accounts. Investing in shares should be regarded as a long-term investment and should fit with your overall attitude to risk and financial circumstances. Past performance is not a reliable indicator of future performance.

The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.

Coming down: the year of interest rate cuts?

Interest rates have risen for two years straight, but the outlook indicates a change of direction in 2024.

The Bank of England raised its bank rate at fourteen consecutive meetings between December 2021 and August 2023, taking it from 0.10% to 5.25%. There is now an expectation, not disputed by the Bank's Governor, that the next move will be downwards. The pattern of rise-and-stall has been mirrored by two other major central banks: the US Federal Reserve and the European Central Bank (ECB).

Markets anticipate cuts

The yields on 10-year government bonds have fallen since last autumn in the UK, US and Europe and the knock-on effects are visible in the UK mortgage market, where new, fixed-term rates have started to drop. NS&I has also reacted, making a range of rate cuts, including 0.25% off the Premium Bond prize rate.

If you have been holding cash deposits, either directly or via money market funds, you should have benefited from the rise in rates. However, unless your deposits were earning on average within 0.7% of bank rate net, they will have lagged behind inflation. In fact, in the last 15 years it has been rare for the bank rate to be higher than the CPI inflation rate.

That devaluation, combined with the likely fall in rates, means that the amount of cash you hold on deposit needs a review. Talk to us about your options now: deposits may be less attractive once rates begin to fall.

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The renewed case for ISAs

The significant erosion of tax allowances is making ISAs a favourable option for the new tax year.

Since their launch, successive Chancellors have made revisions to Individual Savings Accounts (ISAs). Before his Budget proposal of an extra £5,000 for a 'UK ISA', the current Chancellor made arguably his biggest hitting pro-ISA changes in the Autumn Statement 2022:

1. Halving the dividend allowance to £1,000 for 2023/24 and again to £500 for 2024/25.
2. The capital gains tax (CGT) annual exempt amount was cut from £12,300 to £6,000 for 2023/24, then to £3,000 for 2024/25.
3. Almost £25,000 was cut from the additional rate threshold leaving many more taxpayers with a zero personal savings allowance (PSA) from 2023/24.

The dramatic reductions in the dividend allowance and the CGT annual exempt amount alone mean you could be paying up to £2,450 more tax on the returns from your investments in 2024/25 than 2022/23. Even a basic rate taxpayer could be over £1,050 worse off.

ISAs offer a way to sidestep these tax increases.
A reminder:

- Dividend income within an ISA is free of UK income tax, although withholding tax may apply to foreign dividends.
- Interest from deposits or fixed interest securities is also free of UK income tax.
- Gains on investments held within ISAs are free of CGT.
- There is nothing to report regarding ISAs on your tax return.

As we move into a new tax year, now is the time to consider your ISA contributions for 2024/25 and review the investments holdings in existing ISAs to maximise those potential tax savings.

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It is not only fictional multinational media empires that need to consider future ownership and control.

In 2023, the question of how to transfer control of a large, high profile family organisation gripped attention. First the Sky Atlantic series, Succession, drew us in, followed by its inspiration, the transfer of the Fox and News Corporation reins by Rupert Murdoch to his son, Lachlan.

What happens when ownership changes is not only a concern for the likes of multinational empires, real or otherwise. If you are a private company shareholder/director or a partner in a partnership, business succession is something that should matter to you. For example, what would happen if one of the fellow shareholders in your company or partners in your partnership suddenly died or suffered a disabling accident?

The way to deal with such potential business threats is to have a plan in place before disaster strikes and, equally important, to ensure the money is there to execute it; one without the other can be a minefield. Take the example of a suddenly disabled partner.

Your agreement may require the partner to retire in such a situation, but unless the remaining partners have the resources to buy out their colleague, a new partner may need to be found or the business might even have to be sold.

What you and your business associates need to protect against such situations are:

- appropriate, tax-efficient agreements to deal with the sale of interests on death and serious illness; and
- life and health insurance cover to fund the purchase costs those remaining in the business will face.

For advice on both aspects, talk to us today – as Succession showed – you never know what tomorrow might bring.

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Tax charge trap for pension withdrawals

Pension freedom rules have given people earlier and more flexible access to their retirement savings. However, many are paying too much tax when they first make a withdrawal, due to the way HMRC's computer systems operate.

Latest HMRC data shows it processed 12,000 reclaim forms in the last three months of 2023 relating specifically to this issue. In total it paid back nearly £39m to savers who have been overtaxed on pension withdrawals, making the average rebate £3,216.

The problem occurs when savers first make a withdrawal from a drawdown plan (rather than just taking their tax-free lump sum payment). HMRC software assumes that this payment will be a regular monthly withdrawal, and taxes it accordingly, via an emergency tax code.

Tax rebate

In many cases, however, people aren't taking a regular payment but are using the pension freedom rules to make one or more ad-hoc withdrawals – perhaps to pay for a holiday, home improvements or reduce debts – and so end up with a smaller sum due to this taxation issue.

If you've been overtaxed, you can claim this money back via an HMRC form. Complete either a P55, P53Z or P50Z depending on your circumstances. Those who don't complete a form should have this tax readjusted in the following year, via the self-assessment process.

Staged payments

If you are planning to make a flexible withdrawal from your pension plan in the near future, there are steps you can take to try to avoid this problem. The best way is to make a very small initial withdrawal. The temporary tax code is then imposed on this smaller sum, and will be reapplied to the second, larger withdrawal. There may still be some adjustments to make but it is unlikely to result in such a large overpayment.

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Costs of living in retirement increase

Savers need to build up more funds if they want to secure a decent standard of living in retirement.

An independent pensions body has updated its calculations on how much money people need to fund a basic, moderate or comfortable lifestyle in retirement. Rising food and energy costs, plus the fact more people want to socialise with family and friends post pandemic, has pushed up the cost of a 'moderate' retirement by £8,000, to £31,300 a year – with couples looking at a combined cost of £43,100 a year. As the name suggests, this is not funding a life of luxury. The Pensions and Lifetime Savings Association (PLSA) says this covers one week-long holiday in Europe each year, running a small car and modest amounts for socialising, alongside essential bills.

Moderate retirement costs increase most

The costs of 'minimum' and 'comfortable' lifestyles have also increased – although not by as much in percentage terms. The PLSA estimates an individual needs £14,400 a year to fund a basic lifestyle and £43,100 for a more 'comfortable' retirement.

These are ballpark figures, and individuals' spending requirements will vary. But the numbers can be useful as part of a wider pension planning process.

Remember, not all this cost needs to be met by private pensions, as from April this year those qualifying for the full state pension will get £11,502 a year, although that alone is not enough to meet basic living requirements according to these calculations.

Don’t discount inflation

Despite slowing down considerably, inflation has not gone away yet.

Source: ONS

The fact that annual price rises have dropped to under half their October 2022 11.1% peak does not mean you can now ignore inflation’s impact. As some of those who grew up in the 2010 –2020 era of low inflation are now realising, a falling inflation rate (disinflation) is not the same as a general falling in prices (deflation). Prices are still rising, albeit at a slower rate.

In the three years since the start of 2021, inflation added over a fifth to average prices, only 2.2% less than the increase across the entire decade from 2010. You could now need to review your financial plans if they are more than a couple of years old. The level of life and health cover that looked more than adequate in 2020 may no longer be enough. Similarly, the pension pot that looked sufficient for a comfortable retirement may now be at the just-getting-by level.

News Round Up

New online trading data sharing rules

If you sell things online using sites such as Ebay or Vinted, or rent out your home via Airbnb or similar sites, those platforms will now automatically share data with HMRC. The rules are designed to ensure that those earning via digital platforms are fully declaring their correct income and tax. There is an 'occasional seller' exclusion for those making less than 30 sales under the value of around £1,700. The rules came in from 1 January 2024, but the relevant platforms will start reporting data from 1 January 2025, so there's time to understand if you could be affected.

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Student loans hit by marginal tax rates

Last December's Scottish Budget introduced a new 'advanced' 45% income tax rate covering taxable income between £62,430 and £125,140. One unfortunate consequence of the change was to create a potential marginal 'tax' rate of 78.5% on earnings between £100,000 and £125,140 for graduates still repaying their student loans (67.5% effective income tax rate + 9% graduate repayment + 2% national insurance). If you think you have escaped this by living outside Scotland, be warned – the equivalent elsewhere in the UK is 71%.

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Entitled to a bigger State pension?

HMRC is contacting thousands of people by post, mainly women, to highlight that they may be eligible for a higher State pension than they realise. An error in national insurance records has meant those eligible may have missed out on a provision called 'home responsibilities protection' between 1978 and 2010.

The letters are going out in phases and explain how to check for eligibility and then claim, potentially adding thousands of pounds to State pension entitlement. It's not a scam, but you can check and confirm with HMRC if you receive a letter.

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