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Election 2015: an unexpected outcome

Financial markets reacted positively to the news the Conservative Party had won a slim majority in 2015's General Election. A clear majority, however slender, should allow the elected party to enact government policy, while preventing a period of ambiguity while the terms of a coalition are negotiated.

Investors had generally been expecting another hung parliament and therefore financial markets had not really factored in the possibility of an outright majority. As a result, share prices rose on relief that an element of uncertainty – which markets hate – had been removed. In particular, the news provided a boost for share prices in the banking, energy and housebuilding sectors, which had all been expected to come under pressure from a Labour government. Labour had promised to enforce further regulation on the banking sector and to impose new regulation on the energy and property markets.

Gains were especially pronounced among medium-sized companies – which tend to be more exposed to the domestic UK economy than the global multinationals in the FTSE 100 index – and the FTSE 250 index reached a new high following the election result. Meanwhile, sterling surged against the euro on the news of the Conservative victory and, having risen sharply in the run-up to polling day, the yield on the benchmark 10-year UK gilt subsided.

For now, at least, the election result has provided a certain amount of clarity amid hopes that current government policy will remain in place. This clarity is expected to deliver a short-term confidence boost for investors and is also likely to provide support for business investment in the longer term.

With the General Election now out of the way, investors' attention is likely to revert to the timing and scale of an interest-rate rise while, looking further into the future, political uncertainties will be kept alive by doubt over the UK's role within the European Union (EU).

Prime minister David Cameron's past promise of a referendum on the UK's EU membership by 2017 is likely to trigger fresh speculation over the UK's future within the EU, leading to anxiety over the potential implications for the UK economy and for the pound. Meanwhile, strong gains by the Scottish National Party could reignite the thorny issue of Scottish independence. Elsewhere, having pledged not to raise income tax until 2020, the government still has to meet its deficit reduction targets.

ISAsâ€™ appeal expanded again

The 2015 Budget confirmed ISAs as the savings product of choice for the coalition government. Not only did George Osborne introduce the ‘Help-to-buy’ ISA, he also allowed greater flexibility to move money in and out of ISAs without affecting the annual allowance. The Chancellor did however introduce changes to the way interest is paid on savings, which may dent the appeal of cash ISAs.

The new ‘Help-to-buy’ ISA will see the Government contribute £50 for every £200 paid towards a house deposit by first-time buyers, up to a maximum of £3,000. Treasury estimates suggest as many as 285,000 could use the scheme every year.

The Chancellor also announced greater flexibility in taking money out of ISAs and then reinvesting it. Previously, if an investor took money out of an ISA in a tax year, they would automatically lose that part of their annual allowance. Any reinvestment would count towards the annual limit. Osborne has now promised “complete freedom” on moving money in and out of ISAs. Investors will now have the flexibility to withdraw and reinvest into ISAs without losing their tax-free allowance.

This was all positive for ISAs. However, the Chancellor may have dealt an unintentional blow to cash ISAs by announcing the first £1,000 of all savings will now be tax-free. With an ISA paying 1.5% say, this means investors could save almost £67,000 before hitting the limit and, as such, many conventional savings accounts may look just as attractive as cash ISAs.

2015/16 limits for ISAs

Individual Savings Accounts (ISAs) are tax-efficient vehicles that allow individuals to save without paying tax on income or capital gains. The introduction of the ‘New ISA’ (NISA) from July 2014 substantially reformed the ISA system, boosting flexibility and choice for investors. Under the new system, savers can invest their entire £15,240 allowance for the 2015/16 tax year into cash, stocks and shares, or any combination of the two. Moreover, investors can transfer their ISAs between providers freely (subject to their providers’ rules). Please note levels and bases of, and reliefs from, taxation are subject to change.

What is auto-enrolment?

One of the largest-ever shake-ups in the history of UK pensions, automatic enrolment (auto-enrolment) was introduced in 2012 to provide wider access to pension savings. A changing demographic backdrop means that, while people in the UK are living longer, they are not saving enough to finance their increasingly long retirements. Before the advent of auto-enrolment, only 46% of UK employees were enrolled in a qualifying workplace pension scheme.

According to the Department of Work & Pensions , individuals working in sectors such as hotels, construction, and agriculture were the least likely to save into a workplace pension. However, since auto-enrolment was introduced in October 2012 , two million people have started saving into workplace pension schemes. It is estimated that, by 2018, between six and nine million people will have increased the amount they are saving into a pension scheme, or will have joined a scheme for the first time. Auto-enrolment is designed to provide every worker with the opportunity to amass some savings for their old age, while helping to shift the onus away from the state and on to the individual. Employers are now obliged to enrol all their employees in a qualifying workplace pension scheme, unless the individual makes an active decision to opt out.

In order to be eligible for auto-enrolment, an individual must live in the UK, must be aged between 22 and state pensionable age, must earn over £9,440 a year and should not already be signed up to a workplace pension scheme. The employee will be able to decide the level of investment risk they are willing to take with their pension savings although, in the absence of an active decision from the individual, the default option will be relatively conservative. The pension provider will impose an annual management charge, to be deducted from the pension pot.

A minimum percentage of each worker's "qualifying earnings" have to be paid into their pension pot. Employers have to make contributions, and the government also makes a contribution through tax relief. Each individual will pay in a minimum of 0.8% of their qualifying earnings, rising to 4% by 2018. Their employer will contribute a minimum of 1% of the employee's qualifying earnings, rising to 3% by 2018. Finally, the UK government will pay 0.2% of the employee's qualifying earnings, rising to 1% by 2018.

Tax efficient options

As life expectancy in the UK continues to rise, you may be considering how best to save for your retirement. Pensions are often considered the principal solution; yet ISAs can be a useful additional tool. Pensions and ISAs are taxed differently – pension payments qualify for up-front tax rebates at your highest rate of income tax, but the income you receive is taxable. ISA contributions come from taxed income but withdrawals are tax-free. The question is not whether an ISA or pension is better, but how to plan your finances using both. Your financial adviser can offer further help.

Funding a decent income

Whenever you start thinking about retirement planning, it is worth beginning by working out how much income you think you are going to need. Generally, few people need as much income in retirement as they did when working; nevertheless, with more leisure time available, you may have some ambitious plans for travel or family. All these expectations need to be considered carefully so you can set some realistic targets. Once your target figure has been determined, you can then begin to decide how much money needs to come from a pension and how much can come from other sources. For example, the basic state pension is £113.10 per week (for 2014/15), plus you may have money in Individual Savings Accounts (ISAs) or from rental income from second properties. You may also decide to take some other type of temporary paid employment. Pension plan savings are the first step in working out how to make up the difference; however, unless you already have a significant work or personal pension arrangement in place, some form of additional saving is likely to be necessary for you to meet your target. Just to give you an idea, a pension fund valued at £100,000 will buy a 65-year-old individual an annual income of about £6,116 , with no built-in guarantees. If you wish to retire earlier than that, the cost will be even higher. The amount you need to save could, therefore, be considerable.

Building a core investment

It is important to think long term when considering your investment strategy. A core investment is a range of relatively lower-risk holdings around which the rest of your portfolio can be constructed. This approach is based on the assumption you will keep these investments for the longer term, while tailoring other parts of your portfolio to pursue medium-term or higher-risk strategies, such as smaller companies or exposure to overseas markets. Above all, always remember investment is for the long term and you should consider taking professional advice to ensure you achieve the right mix for your individual circumstances.

Q: How much tax do I really pay on ISA investments?

A: Income or capital gains generated by any ISA investment will not incur tax after they have been paid to you. Similarly, no tax is paid on interest earned within your cash ISA or on interest payments from corporate bonds or gilts held within stocks and shares ISAs. You do not even have to declare the existence of your ISA on your annual tax return. However, tax of 10% will be deducted from all dividends and 20% from any interest earned on uninvested cash within a stocks and shares ISA before either is paid out, and this cannot be reclaimed.