thesis

asset management

Thesis Market Commentary

Who Wants to be an ISA Millionaire?

In 1986 the then Chancellor of the Exchequer Nigel Lawson announced the launch of Personal Equity Plans (PEPs) which were followed in 1990 by John Major's Tax-Exempt Special Savings Accounts (TESSAs). These were forerunners to today's Stocks and Shares and Cash ISAs respectively. As well as marking the start of a new tax year, 6th April 2019 will also mark the 20th anniversary of the launch of Individual Savings Accounts (ISAs). Like their predecessors these were vehicles designed to encourage mass market saving and investment by providing tax incentives to those who took them out. In the ensuing period these vehicles have evolved and the annual limits have increased; however the underlying principle remains as it was: investments and savings within these accounts are free from both income and capital gains taxes (CGT).

Our experience is that these vehicles are often misunderstood, so let's explain: think of a Cash ISA as a savings account contained within a tax-free 'wrapper' (the ISA); think of a Stocks & Shares ISA as an investment portfolio or share dealing account which is also contained with a tax-free 'wrapper.' In the past there were confusing rules distinguishing between the two, with different sums available for investment. This has all now been simplified and the two are largely interchangeable. There are other ISAs in the marketplace for very specific purposes (Innovative Finance and Lifetime ISAs) but for the time being we will focus on the more popular variants already mentioned.

It has recently been estimated that there are over 1,000 'ISA millionaires' in the UK ie investors who have built up this milestone sum and for whom that sum is entirely sheltered from income and capital gains taxes. Achieving this feat will undoubtedly have involved taking some risk, as investing does. Almost certainly there will have been more and less successful investments over the years. However what is also almost certain is that most of these investors will have made contributions to their ISAs on a regular basis and over a long period of time.

At present, each UK individual over the age of 18 can subscribe up to £20,000 in an ISA in each tax year. Therefore a couple starting today from scratch, could have £80,000 in tax efficient ISA vehicles on 6th April this year, using each of their annual allowances for the existing and forthcoming tax years. It is easy to see how these sums can build up fairly quickly, even before allowing for the impact of any positive investment returns. The power of frequent investing which 'compounds' over longer periods of time is well known, as is the benefit which can be achieved by the regular investment of smaller sums. In both cases while an investor is in 'build-up phase' the ups and downs in markets can actually be to the investor's advantage as some of these regular investments will inevitably catch some of the 'downs.'

> *"ISAs are also available for children (Junior ISAs). For under 18s the allowance for the current tax year is £4,260, rising to £4,368 on 6th April."*

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ISAs are also available for children (Junior ISAs). For under 18s the allowance for the current tax year is £4,260, rising to £4,368 on 6th April. Contributions can be made by parents, grandparents or any other party. If the annual allowance rises in line with inflation of 2.5%, the full annual subscription is made every year, and the investments earn a return of 5% per year net of fees, a child starting now could have almost £190,000 at the age of 18.

This is powerful. But rather than labouring this analysis we would like to draw our readers' attention to another opportunity to improve tax efficiency overnight by reminding them that Cash ISAs are effectively tax-efficient savings accounts.

In the current low interest rate environment a £20,000 Cash ISA might earn something like £250 per year. Regardless of the investor in question's income tax position, the tax saving offered by the ISA wrapper is unlikely to be meaningful. Furthermore, most investors can earn between £500 and £1,000 of savings interest tax-free in any case.

Take a basic rate taxpayer who is entitled to earn the larger of these interest sums tax-free. By using his ISA allowance for effective cash deposits, this investor is sheltering himself from income tax which is not an issue anyway because:
a) interest earned is so low and
b) he has his tax free interest allowance in any case. This investor would be better off using his tax efficient ISA wrapper to shelter his stocks & shares from income tax and CGT, where both are potentially likely liabilities with investment portfolios. Yes, investors also have tax-free dividend allowances but this does not address the potential for CGT liabilities.

This is not to say that investors should not hold cash for contingencies. They absolutely should, and the scale of this will be driven by their personal preferences and circumstances. However, low interest rates and tax-free interest allowances rather negate the value of using a tax-efficient ISA vehicle for this purpose. Take the investor I mentioned earlier. This basic rate taxpayer would need to have more than £80,000 in cash savings earning 1.25% before income tax would even start to be an issue. For a couple, this might therefore be as much as £160,000.

Food for thought all being well. Next time you are reviewing your finances bear all this in mind. Consider helping younger generations of your family with Junior ISAs and reflect on any simple tax efficiency improvements you can make among your own affairs. Your Thesis Investment Manager is here to discuss your options and help you make sense of it all, as ever.

> *"Consider helping younger generations of your family with Junior ISAs and reflect on any simple tax efficiency improvements you can make among your own affairs."*

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NEWS&VIEWS

Summary

- Equity markets continued to rally
- UK domestic stocks rebound
- Upside surprise in the US
- Concerns in Europe
- Improved outlook for trade negotiations

Indices	Value as at 28/02/2019	% Change on month	% Change year to date	% Change on 12 months
FTSE 100 Share	7074.73	1.52%	5.15%	-2.17%
FTSE All Share	3888.81	1.65%	5.82%	-2.33%
S&P 500	2784.49	2.97%	11.08%	2.60%
Dow Jones	25916.00	3.67%	11.10%	3.54%
Euro Stoxx 50 EUR	3298.26	4.39%	9.89%	-4.09%
Nikkei 225	21385.16	2.94%	6.85%	-3.10%
MSCI Emerging Markets	1050.95	0.10%	8.82%	-12.07%
UK Treasury 4.25% 2027	125.56	-0.65%	-0.57%	0.53%
Sterling/US$	1.33	1.10%	4.08%	-3.76%
Sterling/Euro	1.17	1.69%	4.72%	3.21%

SOURCE: BLOOMBERG

After January's exceptionally strong recovery in global stock markets, stocks finished modestly higher in February and most markets are now back to levels last seen prior to the December sell-off. A dovish tilt from the US Federal Reserve (Fed), credit expansion in China, and more optimism surrounding US-China trade talks all helped to support the equity rally.

UK

The Bank of England served up a surprise with its revised forecasts in February, cutting its growth forecast from 1.7% to 1.2% for the year, citing slowing global economic growth and Brexit related uncertainty. There is no doubt that new orders for both manufacturing and services are weakening and there is a slower pace of hiring but the increased caution from the corporate sector is somewhat in contrast to the consumer, who continues to prove relatively resilient. Domestic stocks such as housebuilders and financials performed particularly well.

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US

Amid a barrage of weak data in the closing months of 2018, including retail sales, industrial production, durable goods orders, home sales and construction, a majority of analysts materially trimmed estimates for US GDP growth. The moderation in growth however proved to be much more benign, as GDP handily topped expectations and rose at an annualised pace of 2.6% during the fourth quarter. This upside surprise appears to have reined in fears of an economic downturn arriving this year. In addition to this the Fed's “patient” approach to future monetary tightening and chairman Powell's remarks that it was a “good time” to watch and wait to gauge how the global outlook evolves, added to market optimism and proved to be positive for risk assets.

Eurozone

The European Central Bank (ECB) revised down its growth forecasts more dramatically than the consensus had expected, given the

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slowdown seen in the second half of 2018 had spilled into this year, particularly for the manufacturing sector. This was most evident in Germany where the Purchasing Managers' Index (PMI) for new orders came in at 47.6, reflecting negative impacts from both the Chinese trade dispute and issues within the auto sector. More concerning was the fact its economy only missed a technical recession by the skin of its teeth, by posting GDP growth of almost exactly zero. Given the current malaise facing the region, the ECB now only expects growth of 1.1% vs. 1.7% previously. Faced with this weaker momentum it has now opted to give the European economy and the banking system extra support by announcing a new long-term liquidity injection, starting in September 2019 and running until March 2021, in addition to delaying interest rate hikes. Whilst it is true that business surveys have deteriorated and growth has slowed in the euro area, we think this reflects a series of country-specific shocks and supports the case that the rate of expansion will pick up as those influences begin to fade.

Emerging Markets

China's economic figures were also showing signs of strain with factory data contracting to a three-year low as export orders fell sharply. Investors were able quickly to shrug off the news however, and focus on an improved outlook for trade negotiations, which lifted sentiment and risk appetite. Equity markets were further encouraged by news that MSCI, a provider of global equity market indices, is set to increase the weighting of China-listed shares in the MSCI Emerging Markets Index. Elsewhere, Latin America took a breather from recent gains but remains the best performing region year to date. Brazil ended lower on profit taking, as investors awaited more clarity on pension reform from the government, while EMEA was weak, losing 2.8%, as Turkey and Russia weighed on performance once again. South Africa was another laggard with the rand falling on an uninspiring Presidential State of the Union address.

Japan

The Japanese market edged upwards as fears continued to ease over the extent of the global slowdown. Most Japanese companies have now announced their third-quarter earnings. The sell-off at the end of 2018 suggested that the market was anticipating bad news and, indeed, current year forecasts have been lowered, but the extent of the reduction was relatively minor.

> *"Latin America took a breather from recent gains but remains the best performing region year to date."*

Economic data released during the month was less pleasing, as industry activity fell 0.4%, core machinery orders fell 0.1%, and PMI data dropped. These numbers reflect signs of a slowing economy and confirmed the lacklustre 0.3% annualised real GDP growth witnessed in the final quarter of 2018.

Fixed Income

Government bond yields rose during the period, meaning prices fell, with sentiment and conditions continuing to favour riskier assets. The US yield curve shifted higher over the course of the month, with the 2- and 10-year US Treasury yields rising six and nine basis points respectively to end the month at 2.51% and 2.72%. Corporate bonds did, however, produce positive total returns and outperformed government bonds with high yield corporate bonds recovering particularly well as credit spreads narrowed further.

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