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theADVISER

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Welcome to the latest edition of our newsletter, our update on developments in the world of financial services. In this issue we take a look at Global Markets, House Markets, Interest Rates and Dividend Tax.

Share Markets Enjoy October Rally

Equity markets generally rallied during October while daily volatility was less pronounced than in recent months. Investor sentiment received a boost from the news that China's central bank had implemented another cut in interest rates although the International Monetary Fund reduced its forecast for global economic growth from 3.3% to 3.1% for this year and from 3.8% to 3.6% for 2016.

European share prices rose strongly during October, buoyed by the news that central bank policymakers intend to re-examine their programme of stimulus measures at their meeting in December. Germany's DAX index rose 12.3% over the month, while France's CAC 40 index was up 9.9%. Data showed consumer price inflation in the eurozone stagnating at zero, although the region's rate of unemployment eased to 10.8% in September – its lowest level since January 2012.

UK share prices also generally rose during October, although share prices in the mining sector remained volatile over the month. Elsewhere, several UK companies, including Home Retail Group, Pearson and William Hill issued profit warnings. Indeed, according to Ernst & Young, profit warnings among UK companies rose during the third quarter of 2015, notching up their largest quarterly increase in almost four years. Meanwhile UK economic growth lost momentum over the third quarter as the economy expanded at a quarterly rate of 0.5% during the period, compared with 0.7% in the second quarter. The FTSE 100 index rose 4.9% over October.

Across the Atlantic and as expected, US interest rates were left unchanged at zero to 0.25% at the Federal Reserve's October meeting. Again, share prices generally rose over October and the Dow Jones Industrial Average index climbed 8.5% over the month, despite some disappointing economic data. In particular, weaker-than-expected third-quarter economic growth and anaemic employment data triggered some concerns over the strength of the economic recovery.

In Japan, central bank policymakers decided to maintain their current programme of monetary stimulus. The decision provided a boost for share prices and the Nikkei 225 index rose to its highest level since August. Over October as a whole, the benchmark index rose by 9.7%. The Bank of Japan reduced its economic growth forecast for the financial year ending in March 2016 from 1.7% to 1.2%, however, and pushed back its 2% inflation objective to the second half of the next fiscal year, citing the effects of lower crude oil prices.

The value of the investment can go down as well as up and you may not get back as much as you put in. Changes in rates of exchange may have an adverse effect on the value, price or income of investments.

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Evaluating Market Sell-offs

Markets may have regained a degree of equilibrium since what has been dubbed 'Black Monday' but sell-offs of the magnitude seen since mid- August undoubtedly unnerve investors. No matter how often they are reminded that investing is a long-term business, it is – to say the least –uncomfortable to see a near 10% drop in the value of shareholdings over such a short period.

As ever with these periods of market dislocation, investors must ask themselves if there is genuinely something to worry about or if it is just markets' so-called 'animal spirits'. The answer to that question affects whether an investor sells out with the aim of avoiding further losses or holds on in the hope of recovery.

In the case of China, we may simply be seeing an unwinding of a stockmarket bubble. Historically vulnerable to the influence of speculators, the Chinese market had risen dramatically over the past 18 months and some measure of readjustment was always likely. The economy is certainly slowing, but did not everyone know that anyway? Certainly plenty of market-watchers had suggested the Chinese economy needed to slow.

There is, though, an alternative view. This has China on the brink of collapse, laid low by the weight of its internal debts and a speculative property bubble. Policymakers' ham-fisted intervention in markets, it is argued, have revealed how scared they are of any disruption, given the state of the economy. Both narratives have some validity and demonstrate how difficult it can be to see clearly until well after the event.

A few general lessons from previous market routs are worth remembering though – not least that there can be significant bounces in the days and weeks that follow. Looking to sell up and then buy back in again is likely to see investors miss such upturns. It also adds trading costs – perhaps the one aspect of investing over which people have some actual control.

August also tends to be a bad time to make big investment decisions as thin trading often produces significant market swings. When traders return to duty after their summer break, market order is usually restored.

It has been said many times but it bears repeating – in most circumstances, it will make sense to stay invested, or even to buy a little bit more. Valuations have been relatively unattractive of late and investors may now just be able to pick up a bargain.

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Housing Market Update

Homeowners are hurrying to make the most of exceptionally low interest rates, according to the Council of Mortgage Lenders (CML), which revealed a 26% increase in remortgaging activity in July compared with June. UK base rate has remained at 0.5% since March 2009 and Bank of England policymakers are widely expected to instigate a rate increase during the first half of next year. Overall, the CML reported that mortgage lending is "enjoying its best spell since 2008" – during the first eight months of 2015, mortgage lending outstripped annual lending during the financial crisis. £138.6bn was borrowed between January and August of this year, exceeding total annual mortgage lending in both 2010 and 2011.

UK house prices rose at an annualised rate of 5.2% in July, according to figures from the Office for National Statistics – a marginal slowdown compared with June's figure of 5.7%. The average price paid for a home in the UK was £282,000. Meanwhile, the Halifax reported house price inflation of 9% over the first eight months of the year. The mortgage lender calculated that prices rose at a monthly rate of 2.7% during August, posting their strongest month-on-month increase since May 2014. For its part, mortgage lender Nationwide reported rather more muted house price inflation of 3.2% over the first eight months of 2015.

The Royal Institution of Chartered Surveyors expects house price inflation to reach 6% during 2015, driven by strong demand, a shortage of supply and accelerating prices. Housebuilder Barratt Developments revealed a strong increase in pre-tax profits that was partly attributable to improving mortgage availability and government support for the new-build market. During September, the government reported that 56,401 mortgages had been completed under its 'Help to Buy' mortgage guarantee scheme since its inception in October 2013.

Citizens Advice warned, however, that 934,000 homeowners who took out interest-only mortgages do not have a strategy in place to pay off their mortgage at the end of the term. Describing the situation as a "financial black hole", Citizens Advice warned that interest-only mortgage holders will have to find the capital to pay off the debt or sell their homes or risk repossession. Elsewhere, the CML's chief economist argued in a blog that the UK's housing market is "dysfunctional" and called for further reforms to the sector, in addition to building more homes.

Your home may be repossessed if you do not keep up repayments on your mortgage.

What if My Bank Goes Bust?

The Financial Services Compensation Scheme (FSCS) was established in 2001 by the Financial Services & Markets Act 2000. The FSCS encompasses all companies regulated by the Financial Conduct Authority and the Prudential Regulatory Authority. The FSCS is an independent body covering investments, deposits and insurance for UK-based customers.

To date, the FSCS has never had to pay compensation for the collapse of a major UK bank. However, the UK government is unlikely ever to stand by and allow the failure of a British retail bank. This was demonstrated in 2008, at the height of the financial crisis, when mortgage lenders Northern Rock and Bradford & Bingley were both nationalised by the government in response to signs that confidence in both institutions was on the threshold of collapse.

If you have an account with an institution that collapses, you will be contacted by the liquidator or by the FSCS. At present, the FSCS pays compensation of up to £85,000 per person, per authorised bank or building society. From 1 January 2016, however, this will be reduced to £75,000.

However, it is important to remember that, if you have several accounts with the same bank or building society, or with different banks or building societies that are subsidiaries of the same institution, you will still only receive the maximum amount of £85,000 per person, per institution (£75,000 from 1 Jan 2016). For more information, go to www.fsa.gov.uk.

Changes to Financial Services Compensation

From 1 January 2016, British savers will receive a lower guarantee on their deposits. At present, in the unlikely event that a UK bank or building society collapses, the Financial Services Compensation Scheme (FSCS) will pay compensation of up to £85,000 per person or small business, per authorised bank or building society. However, from the beginning of 2016, the maximum amount of compensation will be reduced from £85,000 to £75,000.

Under the European Union’s own Deposit Guarantee Schemes Directive, a harmonised limit of 100,000 Euro (currently around £73,000) is fixed across all EU member states. Because the value of the pound has increased against the euro, the sterling limit has been reduced to keep it at the harmonised level, and the Prudential Regulation Authority (PRA) is now required to review the limit every five years.

According to the FSCS, most people have £50,000 or less in savings and therefore the new threshold will protect more than 95% of UK savers. However, those who are affected by the new rule need to take action and consider dividing their money between several banks and building societies in order to ensure their savings are fully covered.

However, consumers who have a high balance in the short term – for example, following a house sale or a ‘life event’ such as an inheritance or a divorce settlement – will receive additional protection up to £1m for a maximum of six months, in order to allow the depositor time to spread the money – and hence the risk – across institutions.

FSCS protection has been expanded to include larger companies and small local authorities, such as parish councils, and their cash deposits will be covered up to £75,000. The PRA has also altered the insurance limits for compensation under the FSCS to increase cover for policyholders in the event that their insurer collapses. The changes have increased the limit to 100% of cover for all long-term policies, for professional indemnity insurance and claims arising from death or incapacity although the limits for all other kinds of insurance remain unchanged.

It is important to remember that, if you have several accounts with the same bank or building society, or with different banks or building societies that are subsidiaries of the same institution, you will still only receive the maximum amount per person, per institution. All the brand names are listed at www.fsa.gov.uk.

Company Earnings Boost US Markets

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US equity markets rose strongly during October, boosted by an encouraging corporate earnings season and continuing merger and acquisition activity. The Dow Jones Industrial Average index rose 8.5% over the month while the broader-based S&P 500 index climbed 8.3%. In comparison, the technology-heavy Nasdaq index was up by 9.2%.

The S&P 500 posted its best monthly performance since October 2011, according to S&P Dow Jones Indices. Every industry sector in the index rose during the month, led by sectors that had performed particularly poorly in September. Materials, energy, information technology and consumer discretionary were particularly strong performers. Three-quarters of the way through the corporate reporting season, 75% of the S&P 500's constituents had released their earnings and 70% of those companies exceeded the most recent forecasts. That said, news from the financials sector was mixed as banks struggled with falling revenues. Goldman Sachs reported a sharp drop in third-quarter net profits, while Morgan Stanley recorded a 42% decline in third-quarter net profits. However, Citigroup revealed a 51% rise in net profits that was driven by cost-cutting measures.

Investor sentiment was rattled by news of a sharp deceleration in economic expansion in the US. The country's economy grew at an annualised rate of 1.5% during the third quarter, compared with 3.9% in the second quarter. However, much of this slowdown was attributed to the temporary effect of companies running down their inventories, and growth is generally expected to pick up during the fourth quarter. Disappointing employment data also fuelled concerns over the strength of the economic recovery. The rate of unemployment in the US remained unchanged at 5.1% during September but the US economy added only 142,000 jobs during the month, while August's figure was revised down to 136,000.

As expected, US interest rates were left unchanged at a level of zero to 0.25% at the Federal Reserve's October meeting. Fed policymakers cited ongoing concerns surrounding inflation and unemployment in their decision-making process, which was not unanimous – one member of the Federal Open Market Committee (FOMC) voted for an increase, while the remaining nine voted in favour of maintaining rates. Looking ahead, policymakers will "assess progress – both realised and expected – towards … maximum employment and 2% inflation". The FOMC "continues to see the risks to the outlook for economic activity and the labour market as nearly balanced but is monitoring global economic and financial developments".

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