

ADVISER Investment

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Number One Southwark Bridge, London SE1 9HL
Tel: 020 7873 3000
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Better times ahead?

At last, a hint of green shoots. According to the IMA, March sales figures for UK-domiciled fund Isas hit £321m this year – up from £47.5m last year.

Investors are returning to the market – as they should. If ever there were bargains to be had, the current depressed market represents a once-in-a-generation opportunity for investors on a three to five-year view.

But let's look at what could go wrong. How could these initial green shoots wither and die, even before we reach summer? First, worries remain over the possibility of a collapse in the sovereign debt markets. Questions still hover: was Iceland a one-off? Will the markets revolt over the possibility of ever-increasing gilt issuance – in the case of the UK government – not finding any buyers?

The current depressed market represents a once-in-a-generation opportunity for investors

Similar stories abound on the global scale, particularly in the Piigs countries of Portugal, Ireland, Italy, Greece and Spain. Swine flu, in this instance, carries a whole new meaning.

And in itself, the possibility of a flu pandemic has already sent the jittery emerging markets further down, suggesting the hesitant recovery is built on shaky foundations. Inflation also remains a concern – particularly its negative sister, deflation, which has become more pressing for the UK.

Yet while none of these – and there are more – should be dismissed, sentiment does appear to be changing. As the days grow longer and the sun shines down, a new mood of optimism – guarded, cautious – has crept in. Now the talk in the Square Mile is of when, not if, the inflection point will come. Any question of the collapse of capitalism is long gone.

They may only be green shoots today, but as every canny investor knows, get in at the very beginning and your acorn Isa will soon prove to be the mighty oak that will prop up a comfortable retirement.

To contact IA staff phone 020 7775 followed by their extension number
Editor Hugo Greenhalgh 6626, hugo.greenhalgh@ft.com
Features Editor Laura Hughes 6625 laura.hughes@ft.com
Deputy Features Editor Anna Lawlor 6642 anna.lawlor@ft.com
Features Writer Stephen Wilmot 6628 stephen.wilmot@ft.com
News Editor Jim Robinson 6624 jim.robinson@ft.com
Chief Reporter Nick Rice 6629 nick.rice@ft.com
Reporters James Kenny 6630 james.kenny@ft.com; Rob Langston 6632 rob.langston@ft.com
Chief Sub-Editor Riaan Wolmarans 6622 riaan.wolmarans@ft.com
Deputy Chief Sub-Editor Obaid Jilani 6623 obaid.jilani@ft.com
Editorial fax 020 7775 6495 Email ia@ft.com

Head of Sales Ben Bonney-James 6614
Advertising Manager Ben Miller 6611
Display Sales Executive Danielle David 6619
Advertisement Production Manager Kay Bowman 6553
Production Executive Emma Regan 6554
Senior Classified Sales Executive Costas Savva 6606
Publishing Director Neil Barwick
Managing Director Caspar de Bono
Advertising fax 020 7873 6499

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Comment

Chancellor's Budget will have nightmarish results while not bringing the deficit down

The dire consequences of Darling's plans

PHILIP
COGGAN



The headlines may be fading from memory, but the ramifications of Britain's dog's breakfast of a Budget will be around for years.

It is not just the 50 per cent tax rate, which will only apply to a limited number of individuals. It is the way the government relentlessly seems to make the tax system more complicated. At the most basic level, this was evident in the increase in the Isa allowance, from October, for the over-50s. So, fund managers will need to check the ages of investors – but only for six months, before everyone gets treated the same again. It is just the kind of trivial gimmick in which the Brown government has specialised.

Even worse is the emergence of kinks in the system, creating higher marginal tax rates. The withdrawal of the personal allowance for those with more than £100,000 means their marginal tax rate rises to 60 per cent. Those earning above £113,000 see their marginal rate fall to 40 per cent again before the 50 per cent band kicks in at £150,000.

And that is where the real nightmare begins. Above £150,000, high earners face not just the new tax band, but also the withdrawal of tax relief on pension contributions, higher taxes on dividends and a tax on the 'benefit-in-kind' represented by employer contributions to their

pension fund. Meanwhile, capital gains tax remains at 18 per cent, a discrepancy that creates every incentive to turn income into capital gains.

The pensions changes are particularly disheartening given it was only in 2006 that the government introduced a simplified regime – one of its few taxation successes. The change in the system of annual age-related limits for contributions was ideal for those whose income was highly variable and might have wanted to use a good year to bump up their pension pot. Now they will have to think twice.

Advisers are likely to spend the next few years grappling with the complexities of the new system. For example, it seems people who earn between £150,000 and £170,000 get effectively 50 per cent relief, provided their contributions stay below £20,000.

Deficit

To add insult to injury, all this tinkering will not make much of a dent in the deficit. Even on Alistair Darling's optimistic forecasts, the government will have to raise £600bn from the markets over the next three years – equal to the size of the existing gilts market. Even if pension funds step up their enthusiasm for matching liabilities by buying more gilts, they will not make much of a difference in that supply (they only have roughly £860bn of

assets, all told). The same goes for insurance companies.

Banks will end up buying a fair amount of gilts, as part of their balance-sheet repair operations. But it creates an uneasy situation in which banks, themselves rescued by the government, are propping up their patrons' finances. The government could appeal to the public, but while Britons were willing to buy 'Victory bonds' during the war as a patriotic duty, 'Brown bonds' will be more of a hard sell.

That leaves foreign investors. People in the currency markets say there has been a loss of confidence in the British economy. This is hardly surprising, but makes the task of getting out of the hole even more difficult. John Wraith of Royal Bank of Canada points out the government is currently paying 3.5 per cent on its £600bn of gilts. Suppose investors demand 5 per cent to fund the new £1.2trn total. That will see the annual financing bill leap from £20bn to £60bn, requiring higher taxes to close the gap, resulting in an economy that will grow even more slowly, reducing overseas confidence further.

I have argued for a while that sterling will weaken and that investors should be shifting money overseas. That argument looks even more compelling now.

Philip Coggan is Buttonwood columnist for The Economist

As the world turns to nuclear energy, there are diversification opportunities for investors

How nuclear power can fuel investment

MARKET WATCH
STEPHEN BARBER



The government has unveiled a list of 11 sites in England and Wales (though not Scotland, where Alex Salmond's administration is against the idea) where new nuclear power stations could be built over the next decade.

In doing so, Britain has firmly thrown its lot behind nuclear power as the solution to the country's – and the world's – energy needs for the next century. As it sees the situation, nuclear is clean, plentiful and a good alternative to carbon. This new generation of nuclear power plants will be built and operated privately, and ministers have indicated there should be no artificial cap on the percentage of national electricity generated by these reactors – currently roughly 20 per cent.

For a country like the United Kingdom, nuclear power is an attractive way of diversifying away from foreign energy sources in the Middle East and Russia on which some suggest Britain is currently overdependent. The downside could well be massive expense, gallons of toxic waste and the fear of catastrophe. Given the history of High Court challenges, “seriously flawed” government analysis (to quote one senior judge) and an intervening

“Nuclear power remains contentious, but its progress is a near certainty”

general election, there is no guarantee this plan will see fruition. And no bad thing either, the many opponents of the scheme would say – especially given Al Gore's argument that nuclear power can hardly be the global solution to the world's energy needs when there are so many corners of the globe where the international community opposes the development of nuclear technology.

Whatever the outcome in Britain, there is growing demand for alternative sources of power as the world population grows. Developing countries playing catch-up is a big driver of energy demand. According to ETF Securities, the non-OECD countries are seeing the strongest growth in energy demand, with these countries and China projected to represent the largest source of demand in absolute terms within a few years. Coal and gas

remain the most significant fuel for electricity generation in the world, with nuclear power representing roughly 16 per cent.

Nevertheless, around the world today there are 439 operating nuclear reactors. Seven are under construction in China and a fivefold increase is planned over the next 10 years. India is building six, Russia is building seven to add to the 32 it already operates and four reactors are under construction in Europe, bringing the total to 154. A new nuclear programme in the US will see a further 32 reactors added to the existing 104. Nuclear power is going to be a significant part of the energy mix for years to come, and billions will be poured into its development.

It is this background that underpins ETF Securities' WNA Global Nuclear Energy fund, which tracks the WNA Nuclear Energy index. This comprises roughly 65 firms engaged in the industry, offering diversified exposure to what remains a specialised sector.

Nuclear power remains contentious, but its progress appears a near certainty, and exposure to its growth potential will interest investors looking to diversify their portfolios.

Stephen Barber is head of research at Selftrade