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Newsletter Summer 2011

***“What’s a Grecian Urn?”
“About three drachmas a week...”
(Morecambe and Wise, c.1977)***

The troubles of Greece, Ireland and Portugal have been well documented over the last 12 – 18 months. Essentially, as international markets have become more and more sceptical about the ability of these economies to service their sovereign debt, their credit ratings have been downgraded and the risk of default (failure to make repayments) have increased.

The after effects of the ‘credit crunch’ which manifested itself in 2008 are being felt very severely in some of the smaller Mediterranean countries. Loose fiscal and monetary policy, heavy reliance on tourism, significant tax avoidance and over-generous public sectors have left some countries heavily indebted. Like a private individual looking to re-finance, the lenders need to be confident that the borrower can afford the repayments after balancing income with expenditure. On this simple basis, it is clear that with their balance of payments deficits growing, these economies are hardly safe bets for would be lenders!

The IMF (International Monetary Fund) has been called on a number of times recently to step in and lend money to troubled economies. However, with the lending come strict conditions, commonly known as ‘Austerity measures’. These measures are politically divisive and very unpopular with voters and have led to protests and riots, the scale of which is usually in line with the severity of the cut backs. It is not hard to see why Greeks would feel unhappy about being told

that they were suddenly expected to pay more tax, earn less money, work for up to 14 years longer and retire on a reduced pension...

Despite feeling slightly divorced from the troubles of mainland Europe, we should not feel too comfortable about our own situation in the UK. We have a sizeable Balance of Payments Deficit, a fractured banking system, over-reliance on imports and diluted political leadership. We have our own currency and have planned our route to balancing the books, which is encouraging, but we are far from insulated from Sovereign Debt issues.

Where all of this leads is anyone’s guess. One thing that seems to be certain is that it is going to take a long time to ease global debt worries. In many ways, this problem is uncharted and Governments around the world are being asked to devise and enforce policies that have not been tried before. In our opinion, Greece will default on its debt. The economy cannot sustain repayments as they are and it is clear that pumping more money into the system to be paid back over longer periods at higher rates is not sustainable. We do however believe that the contagion is centred around a few countries rather than the whole Eurozone and that, over time, the situation can be rectified. Greece, Portugal and Ireland make up just 2.4% of Eurozone market capitalisation*, so it would be unfair to overstate the size of the problem.

What this has meant for us is that investment markets are offering value at a time when the alternatives are not.

Despite all of the issues, the FTSE has been very resilient this year, starting the year at 5900 and currently sitting around the 5800 level. Throughout the period interest rates have remained at 0.5% and in our opinion, bearing in mind the fragile economic situation, look unlikely to increase anytime soon. The threat to interest rate movement is clearly inflation, which remains at around 5% (depending on which figure you believe) although for many, when individual tastes are taken into account, price rises are greater than this.

With this in mind, in order to make a 'real' return, you need to be making 5% per annum (after taxes and charges). With banks unable to provide this, it is important that you at least consider alternatives.

**Daily Telegraph, Saturday June 25th 2011*

Structured Products – the Pros and Cons

Over the last two years, structured products have become very popular with investors, as a way of trying to outperform low rates of growth on deposits without taking significant risks with capital.

As an organisation, we have been careful to recommend structured products on an individual basis only when we feel they suit a client's risk rating, investment term and as part of a wider investment strategy.

A structured product is essentially an investment which aims to produce a certain return over a set period of time. In many cases, the performance is not guaranteed, as the returns are based on the performance of an index, often the FTSE 100. If the index performance meets the target, the product will deliver a return of capital plus a fixed return (usually subject to tax) at the maturity of the product. These products tend to run for 5 – 6 years. If the index falls, the product may return the capital in full (without growth) however, some products will return less than the original capital if the index is down.

This is a popular misconception amongst clients,

as many people believe that the worst case scenario is that they get back their original investment. Many structured products are set up under a SCARP (Structured Capital At Risk) basis, and although the potential gains look very attractive, they do not suit risk-averse investors. It is also very important that the client understands the guarantees underpinning the product, as many are backed by 3rd party custodians. Essentially, if the custodian were to fail, the investment would be at risk.

Structured products come in various forms and are complex, but they do provide significant opportunities for the right client who is aware of the risks involved. Critically, as we are able to research the whole market, we can firstly establish if a structured product suits you, and then exactly which one meets your requirements the best.

In our experience, banks are very pro-active in promoting structured products, particularly with interest rates at just 0.5%. We are very keen to encourage our clients to consult us first, as we are totally independent, before making a decision. We feel that structured products offer very viable alternatives to either cash or unit linked investments in times of uncertainty, but you need to be made aware of their risks and limitations before making a decision.

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Thresholds, percentage rates and tax legislation may change in subsequent finance acts

For further information please ring our office on 01204 366522 or alternatively return the FREEPOST slip below to **Leedham IFA Ltd, FREEPOST BL5244, BOLTON BL1 3YZ:**

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