LOWES

Where personal finances are cared for personally

Summer 2003

"Imagination will often carry us to worlds that never were. But without it we go nowhere."

Carl Sagan

INSIDE – The truth about Precipice Bonds

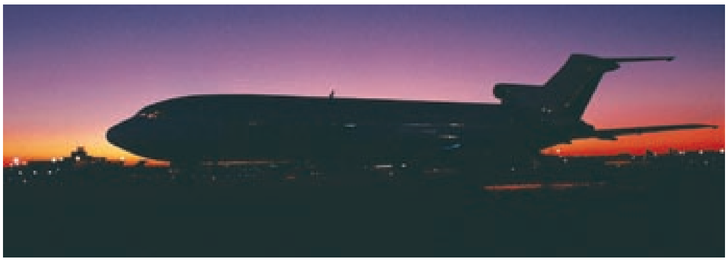
The power to switch off

SIX IN TEN OF DOMESTIC GAS and electricity consumers could pay up to a quarter less if they switched supplier, according to the National Audit Office.

If you want to check out any possible savings then there is a range of information available:

- **Energywatch**
  Independent gas and electricity consumer watchdog which offers pricing comparisons for different gas and electricity suppliers. Call 08459 06 07 08 or visit www.energywatch.org.uk/
- **Blays Guides**
  Calculators to let you check the cheapest energy supplier. Call 01753 880 482 or visit www.blays.co.uk/energy/home.asp
- **Ofgem**
  The Office of Gas and Electricity Markets. Call 0141 331 2678 or visit www.ofgem.gov.uk/ofgem/index.jsp

Treasury creates travel confusion



THE TREASURY HAS EXCLUDED travel insurance sold by tour operators and travel agents from regulation by the Financial Services Authority, despite research suggesting they use high pressure sales tactics to sell inferior and more expensive policies.

However, travel policies sold direct to the public by insurers and brokers will be regulated.

According to industry experts, the Treasury's move means that different standards will apply and is a recipe for confusion.

British consumers spend over £26 billion a year on travel insurance, the majority on policies sold by the travel industry. Numerous surveys have indicated that you get a better deal by buying direct or from a broker. An investigation of 28 travel agents by the Consumers' Association earlier this year found that only one checked for pre-existing medical conditions and explained what the policy did and didn't cover. In contrast, direct insurers, banks and brokers were found to be more thorough.

Jargon attack!

COULD THE END FINALLY BE IN sight for the arcane and impenetrable jargon which characterises most financial products and services?

Don't hold your breath, but the Financial Services Authority is considering getting the providers of financial products to produce what it calls a 'Key Facts' document.

This, an FSA spokesperson told Lowes, will prioritise the information consumers actually need to decide whether a product is right for them, including the impact of charges.

But haven't we been here before? The current product disclosure regime (dating back to 1995) introduced the Key Features document, which firms must give to consumers before they buy a 'packaged product'. It now seems that this is no longer considered adequate. Reports in the media put the cost of introducing Key Facts at around £100 million – which will be passed on to consumers in higher prices.

In the meantime, if you need some help with jargon, we have recently added an extensive glossary to our website **www.lowes.co.uk/glossary** For readers not on the internet, Reuters Financial Glossary by Tony Parry (available from good bookstores) is a comprehensive guide to financial terms, including explanations, illustrations, diagrams, tables and even equations and workings where necessary.

You can also call Lowes on 0845 1 484848 and we'll be delighted to help.

Personal recommendation

Accompanying this issue of the magazine you will find a Personal Recommendation Card. If you believe that a friend or colleague could benefit from our services, then perhaps you would consider passing the card to them. Many thanks.

The photograph used on this issue's cover is of The Grand Canal, Venice

Make your money work

Best bank and building society instant access/no notice accounts

Branch Based

Amount	Provider	Account	Gross Rate	Contact
£1-£4,999	Alliance & Leicester	Easy Saver Card	3%	Branch
£5,000+	Bank of Scotland	Instant Access Savings Account	3.5%	Branch

Postal or Telephone

Amount	Provider	Account	Gross Rate	Contact
£1-£499	Ing Direct	Savings Account	4.3%	0800 376 8844
£500-£999	Ing Direct	Savings Account	4.3%	0800 376 8844
£1,000+	Ing Direct	Savings Account	4.3%	0800 376 8844

Internet

Amount	Provider	Account	Gross Rate	Contact
£1-£4,999	Ing Direct	Savings Account	4.3%	www.ingdirect.co.uk
£5,000+	Ing Direct	Savings Account	4.3%	www.ingdirect.co.uk

Source: Individual providers' websites (1/7/2003). All accounts subject to terms and conditions.

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If you would like to receive further information on any of the subjects featured in this issue of LOWES please call 0845 1 484848, fax 0191 281 8365, e-mail client@lowes.co.uk. Or write to us at: Lowes Group Ltd, FREEPOST NT197, Holmwood House, Clayton Road, Newcastle upon Tyne NE2 1BR

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Pyramid schemes face their nemesis

New law to ban "get rich quick" schemes

THE GOVERNMENT LAST MONTH said it would outlaw 'pyramid selling' schemes – get rich quick ruses which enable a few people to make money at the expense of many others.

The ban was announced by Culture Secretary, Tessa Jowell, and will form part of the new Gambling Bill. When this becomes law in 2005, anyone who sets up or profits from these schemes will face up to six months in jail or fines of £5,000.

The move comes as the latest pyramid selling scam – a scheme called 'Hearts' – is sweeping through British suburbia, targeting middle-aged women. Characterised by touchy-feely language like "supporting other women" and "standing up for ourselves against men", it promises an eightfold return on a £3,000 investment.

Potential scam members are usually invited by a 'friend' to a party and introduced to existing members who talk about the money they've made. To join up, the would-be member must buy a 'Heart' or membership of a scheme and to do this she must sign a declaration that she is making an unconditional gift of £3,000 to an existing member. She then aims to rise up the pyramid of friends by selling Hearts to eight other people in order to get the eightfold return on her investment equal to £24,000.

The catch, of course, is that while the first person in the pyramid needs to get only eight other people to part with £3,000 to realise their £24,000 return, if all eight of these people are to get a similar amount they must involve 64 people. These 64 must in turn involve 512 people who must then involve 4,096 participants. In simple terms, the supply of investors will rapidly dry up, leaving the majority of people in the scheme having paid out a large sum and receiving nothing in return. In other words, many losers pay just a few winners!

PHOTO: PA

"These schemes have a nasty sting in the tail and are preying on vulnerable women"

Patricia Hewitt
Minister for Women

Currently, such schemes are not illegal. Because the investments are technically gifts to other people, they are not covered by the investment regulations. The significance of the £3,000 figure is that it's the maximum that can be gifted each year without incurring any potential tax liability.

Minister for Women, Patricia Hewitt, warned last year: "These schemes have a nasty sting in the tail and are preying on vulnerable women. I want the public to be aware of the risks associated with schemes of this kind and urge them to think long and hard before they get involved and then think again."

If you have become involved in one of these schemes, then call the Department of Culture, Media and Sport on 020 7211 6200.

COMMENT

Can do better

NO COMPANY CAN BE ALL THINGS TO ALL PEOPLE and so all we can do is try and satisfy most of our clients most of the time. Since 1991 we have conducted Client Surveys in which we ask all our advisory clients to complete a questionnaire to help us find ways to continually improve and maintain our service. The latest questionnaire was issued in April and I am indebted to all those clients who completed and returned it; the 32 per cent response rate is the best in 10 years – thank you.

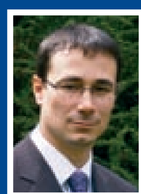
I am absolutely delighted with the results of the latest survey. Recently there have been many reports of financial advisors failing to meet the needs of their clients especially when it comes to levels of service. However, I am pleased to note that over 90 per cent of our clients rated us as "good" or "very good" in each of the areas of client service, level and quality of contact, approachability, professionalism, staff friendliness and helpfulness. Bearing in mind the global stockmarket collapse that commenced at the turn of the new century, it is reassuring to note that, as with the 2001 survey, the 2003 results showed that over 80 per cent of our clients rated us as either "good" or "very good" on investment advice. The ultimate test of any Company is how its clients would describe it to a friend; over 72 per cent of Lowes' clients would describe us "as a Company that has their interests at heart" with a further 22 per cent rating the Company "as good as any other". We believe that we are a Company that has its clients' interests at heart and hope to prove this to every client.

I would also like to convey special thanks to the hundreds of clients who took the time to add a comment to the questionnaire; we are considering using many of the messages of praise in our next Company brochure.

We are, however, by no means complacent and will continue to strive to provide the best service possible to all our clients. I am very conscious of the fact that not every client has indicated satisfaction and I sincerely hope that, over time, we will satisfy the 1.1 per cent who rated us as "poor" on client service and level and quality of contact. Obviously, as the questionnaires were confidential, we are not in a position to respond, but we will be working on your suggestions.

The vast majority of clients rated this magazine as "good" or "very good" and again, we are delighted as this affirms that we are, in the main, getting it right most of the time. We are therefore not planning to make any substantial changes to the format and as such, unlikely to appease the 0.5 per cent who rated it as "poor". If you would like us to add a friend or colleague to the magazine distribution list please contact us on 0845 1 484848.

Kind regards



Ian H Lowes,
Managing Director

Over the precipi

So-called precipice bonds have been roundly attacked by the media in recent months. In this article we examine what they are and investigate Lowes' position ...

NEARLY THREE YEARS AGO, IN August 2000, Lowes published a document titled "The Truth Behind Those High Yield Stock Market Bonds".

Its purpose, according to Ian Lowes, who is now the company's Managing Director, was to explain to potential investors and journalists alike the pitfalls and dangers of some stockmarket-linked income bonds which offer a high level of income and (apparently) a high level of capital security. These products are now commonly – and quite justifiably in many cases – referred to as 'precipice bonds'. This is because although there is usually a safety margin built in, once this is breached the fall in the capital value can be quite rapid.

He says: "Among the key characteristics of many of these bonds were complex and potentially misleading terms and conditions. If structured fairly, these investments are worthy of consideration for most portfolios. However, many of them had 'hidden risks'."

Since Lowes issued this first report, it has maintained a comprehensive and up to date database of all such products on the company website – **www.lowes.co.uk** – and has continued to analyse each new issue giving it an 'Endorsed' or 'Not Endorsed' stamp.

> *"Many of the product providers have tidied up their act following bad publicity and possibly pressure from the FSA ..."*
>
> Ian Lowes
> Managing Director

Seven stockmarket income bonds were covered by the original research paper, but of these only two were endorsed as offering a reasonable return for the risk taken. "The other five," says Ian Lowes, "were rejected because we felt they offered an unacceptable degree of risk to investors or were misleading."

Of these seven, two have now matured and, following the unprecedented stockmarket falls, even the one recommended by Lowes, the Scottish Mutual Income Bond, matured at a loss. However, the losses on the products Lowes chose to reject are significantly higher. Figure 1 illustrates the expected total loss on all seven of the original investments after taking into account all annual income received and assuming the investor was a basic rate tax payer.

Ian Lowes says: "At that time there was no way anyone could have predicted that we were facing one of the deepest and longest bear markets in living memory and, whilst even the products we endorsed have been disappointing, they have in fact performed significantly better than those we rejected."

He adds: "The primary basis of our assessment is a risk versus reward analysis and the effect of this can be seen by comparing the first two products on the leaflet. The first contract from Canada Life rated as 'Not Endorsed' has resulted in an overall loss of 75.43 per cent to a basic rate taxpayer, whereas the second contract, the Scottish Mutual Income Bond, resulted in an overall loss of 32.87 per cent to a basic rate taxpayer after adding back all income received on both accounts. Although these two bonds were linked to different indices, which has a bearing on the risk, the major reason for not endorsing the Canada Life bond was that any falls in the index over 20 per cent were multiplied by a factor of 3.33 making it a true precipice bond."

Figure 1 **Stockmarket Income Bonds issued in 2000**

Product	Offer closing date	Lowes' view	Overall loss
Canada Life High Income Bond Series 3	8/3/2000	Not Endorsed	-75.43%
Scottish Mutual Income Bond	14/4/2000	Endorsed	-32.87%
Scottish Life Int'l Income & Growth Bonus Bond	2/6/2000	Not Endorsed	-63.30% (*)
Canada Life Platinum Income Bond	21/6/2000	Not Endorsed	-74.26% (*)
AIG Stockmarket Income Bond Series 3	23/6/2000	Endorsed	-11.90% (*)
NDF Admin Extra Income & Growth Plan 3	21/7/2000	Not Endorsed	-56.53% (*)
NDF Admin Extra Income & Growth Plan 4	8/9/2000	Not Endorsed	-59.37% (*)

NOTE: Those investments marked (*) had not matured at the time of writing and we have therefore assumed the closing level of the relevant indices on 30 May 2003 as the final index measurement.

ce?

Some of the pitfalls contained within the contract terms of these bonds are difficult to spot even for qualified, experienced advisers. Lowes have had sight of marketing literature from other advisers where it is quite obvious that they had missed a crucial point. It is not therefore unreasonable to assume that many individuals may not have fully understood the terms of the investment, hence the bad publicity.

Apart from taking into account the full implications of the various contract conditions, it is important to consider the tax treatment of each product offering. Seemingly similar investments can be very different from a tax perspective and at the extreme this can mean the difference between no tax or 40 percent tax on the return for the same person. Obviously, this has to be taken into account as it affects the potential reward relative to the risk taken.

Current view on stockmarket bonds

The Lowes database shows that in 2000, 16 products were analysed and only 25 per cent of these were endorsed. Yet at the time of writing there had been 46 analysed in 2003 of which 52 per cent were endorsed.

So why is a larger proportion of them 'Endorsed' now than in the past?

Ian Lowes says: "Many of the product providers have tidied up their act following bad publicity and possibly pressure from the FSA and the industry as a whole. Furthermore, some contracts that we would not have endorsed in previous years offer much better value for money now that the markets have corrected and so are worthy of our endorsement when previously they would have been rejected."

However, notwithstanding the Company's view that markets are on the road to recovery, Ian Lowes stresses that it doesn't mean that all of these products should be deemed as suitable for everyone. He says: "The need for in-depth expert analysis is still as important now as it ever was."

Extra weeks cut annual returns

Sunday Telegraph follows up Lowes' research…

ONE PARTICULARLY DEVIOUS practice Lowes' research has highlighted is the tendency for the companies offering stockmarket income bonds to offer a headline rate of return based on a three, four or five year investment term, when in fact the actual term can be up to two or three months longer. The practical effect of this ploy is to significantly reduce the actual annual return.

In October 2000, the *Sunday Telegraph* followed up Lowes' research into Stockmarket Income Bonds and interviewed a number of companies about this practice.

One was NDF Administration which had launched the Extra Income & Growth Plan 3. This promised an annual income for three years of 10.25 per cent, but Lowes calculated that this was in reality 8.77 per cent a year once the actual term of three years and 11 weeks was taken into account.

An NDF spokesman told the *Sunday Telegraph*: "We do mention to clients that the money is not actually available for three years and two months. There is no extra income during this time but we clearly state that in our Key Features documents."

Subsequently NDF changed their policy on this and Lowes has since endorsed three of their income contracts.

Are performance fees the way ahead?

Lowes' Consultant, Rod Molyneux, takes a look at how performance fees may influence your investment returns…

ON THE FACE OF IT, PAYING YOUR fund manager a fee which depends on how your investment performs may sound like a good idea.

Currently, fund management companies selling UK-based collective investments such as unit trusts are not allowed to charge performance fees. Such fees are only allowed on funds based offshore.

Instead, UK companies impose charges which typically comprise a one-off initial charge of 5 per cent of the amount you invest, and an annual management fee of around 1.5 per cent of the value of your fund. These charges are fixed irrespective of investment performance.

This could change by the end of this year, however. The Financial Services Authority (FSA) recently asked the fund management companies their views on allowing performance-related fees and a spokesman told Lowes Magazine: "We've had a lot of feedback in favour of allowing performance fees so they could be in place by February 2004."

However, the FSA says there are a number of issues which must be resolved first: "One is that the performance fees must be explained to investors before they join the fund."

How will performance fees work?

Probably pretty much in the same way as on existing offshore funds. A good example of this is the curiously named Bedlam Asset Management, a fund manager launched last year which has made much of its adoption of the principle of 'No gain, no fee'.

Bedlam's funds have a progressive quarterly management fee which cuts in only when the quarterly investment return reaches 1.25 per cent, which is just over 5 per cent a year. Once this 'hurdle rate' of growth has been achieved, Bedlam charges a quarterly fee of up to a maximum of 1.4 per cent. This fee is imposed on the excess over the 1.25 per cent quarterly gain.

So, if an investor lost money over successive quarters, Bedlam would charge nothing. And if the investor saw a straight-line investment return of 5 per cent a year, then Bedlam would again charge nothing. But, if the investor made a straight-line return of 10 per cent a year, Bedlam would charge 5 per cent in performance fees giving a net return to the investor of just 5 per cent.

But simply because the market rises by only 5 per cent in a year does not necessarily mean that Bedlam will charge no fees. Figure 1 illustrates the impact of Bedlam's charges assuming a 5 per cent annual growth which was not linear (i.e. not straight-line) enabling Bedlam to take the 1.4 per cent management fee in two quarters.

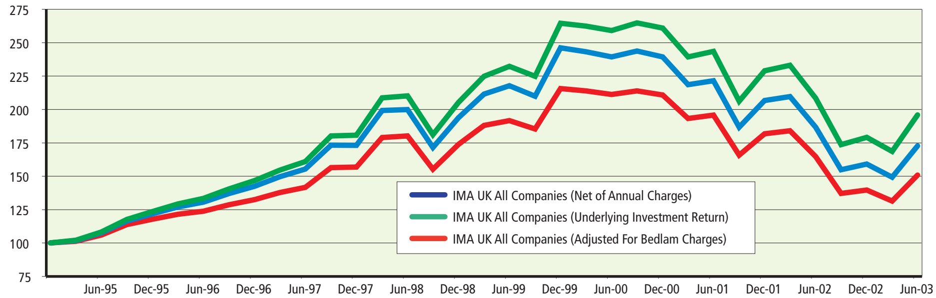
To illustrate that the above is not an unreasonable assumption we have compared the charging structure with a conventionally charged fund over the last eight years (Figure 2).

Surely, the point is that investors invest to make money, not to lose less. Consequently, they are investing in the belief that the market is going to rise. In this type of situation, performance-related fees could severely undermine their expectations.

Obviously, after three years of falling markets, funds that historically would not have charged any fees are likely to attract a lot of attention. However, when markets are rising, funds like Bedlam's are likely to prove very poor value.

Whilst it's likely that the FSA may allow the introduction of performance fees on UK funds, these examples illustrate that their actual level will be critical to them gaining acceptance among investors.

Figure 2 The UK All Companies Sector Average
– Bedlam performance charges versus typical industry 1.5% annual management charges.



This illustrates the relative performance of 3 versions of the average fund in the UK All Companies sector over the last 8 years. The sector average (blue line) grew by 72.72%. We have assumed that the annual charges applied to the sector were 1.5% a year and adding these back in gives us the underlying investment growth (green line). Applying Bedlam's performance charges to the underlying investment growth gives us the red line.

Figure 1 The impact of Bedlam performance-based charges

	Movement in underlying investment assets (%)	Fund movement after deducting standard 1.5% annual management charge (%)	Movement after deducting Bedlam fees (%)
Quarter 1	-1.25	-1.625	-1.25
Quarter 2	+3.5	+3.125	+2.1
Quarter 3	-2	-2.375	-2
Quarter 4	+4.83	+4.455	+3.43
Gain in year	+5	+3.45	+2.20

Equity release popularity on the rise

THE HOME EQUITY RELEASE market is growing rapidly in popularity and, at the same time, is undergoing a major facelift.

According to Safe Home Income Plans (SHIP), the trade body representing most companies in this market, the value of equity release business totalled about £850 million in 2002, a near 50 per cent rise on the previous year.

Against a backdrop of a 'property rich, cash poor' ageing population, and, the growing use of equity release as a tool to release value from a property and so help reduce future inheritance tax liabilities, the potential size of the market over the next few years could be as high as £100 billion.

Increasingly, old style inflexible schemes called Home Reversion Schemes and Home Income Plans aimed at the over 70s are giving way to new style mortgage-based schemes which can be used by people aged 55 and above.

These are in effect loans where the interest is rolled up and repaid together with the capital at a future date, e.g. when the homeowner dies or goes into care. Most arrangements offer a guarantee that the loan together with accumulated interest will not result in any negative equity. Their big advantage is that they allow a substantial amount of the cash value of a property to be withdrawn and, with appropriate financial planning, removed from the potential estate.

The current market

At present there is a noticeable absence of mainstream mortgage lenders from this market. Also, existing mortgage-based equity release schemes require the borrower to decide exactly how much they wish to withdraw at the outset.

But this is set to change. Industry experts predict that over the coming 12 to 24 months most of the big mortgage players will be in this market. The reason they are not there now, the experts say, is because they are perfecting methods of reducing the risks of making these loans. This is crucial as they may see no repayments of interest and capital for 20 years or more.

What's more, work is proceeding on so-called 'hybrid' products. These will enable borrowers to increase the amount they borrow over time if the value of their property rises, and also let them repay some of the loan interest over time if they wish.

Such products will in effect offer the advantages of modern 'offset mortgages' where borrowers can offset the interest they owe on the loan against any interest they may earn on their savings.

However, the use of equity release schemes as an inheritance tax planning tool requires advice carefully tailored to individual circumstances.

■ **For more information call Lowes on 0845 1 484848.**

The end of a bear market is never obvious

THE DECLINE IN GLOBAL stockmarkets since mid-2001 has been one of the deepest and longest in living memory.

However, it seems that the recovery from the low point of 12 March may have marked a change in investor sentiment. Before that date there was a tendency to ignore the good news and seize on the bad, but now there seems to be a willingness to take a more optimistic and upbeat view.

By the end of that month the markets had rallied strongly – recovering most of the losses of the previous six months – despite the initial doubts about the effectiveness of the coalition military operation in Iraq.

But whilst the fighting is over, the rebuilding of Iraq and the relationships between the US/UK and those opposed to military action may take a while longer. What's more, while the prospects for surging oil prices and global economic recession have receded, economic recovery is likely to remain subdued for a while yet and has not been helped by the emergence of unforeseen events like the SARS outbreak.

However, confidence is returning and the rally which began in March has been maintained. For the first time in almost three years, global equity markets are responding favourably to positive news and have risen strongly in recent weeks – although there is still a long way to go before we reach the high points of 2000.

Can the recovery be maintained? The answer lies in the performance of the US which remains the principal driving force in the global economy. This is very much in the balance, although recent indicators point to recovery and with interest rates likely to remain low, even as a recovery picks up, the prospects for equities are brighter than for some considerable time.

Perhaps the most significant indicator of changing sentiment is that while the magnitude of the recovery from the March lows has created opportunities for traders to consolidate profits, many investors are using the corrections associated with the bumpy recovery as buying opportunities, especially if they missed out on the initial rally. The end of a bear market is never obvious – there are always lingering doubts and it is a fact that we will only really know we are in a new bull market a long time after it began.

■ Melvyn Bell, Lowes' Investment Manager.

Innovation produces excellent investment opportunities

STRUCTURED GROWTH PRODUCTS are fixed term contracts that give a defined return relative to the movement in a stockmarket index and usually have a predetermined risk to capital. They come in various guises and are increasingly becoming part of many balanced portfolios as increased innovation by the product designers leads to more and more interesting and attractive investment opportunities.

- **A good example of an innovative product is the Keydata Investment Services Dynamic Growth Plan launched in November last year. This five year plan offered investors double the growth of the FTSE 100 Index subject to a maximum gain of 80 per cent whilst providing a high level of capital protection against the market falling over the term. This particular investment proved extremely popular and variations from virtually all product providers have been launched since.**

- **Another example of great innovation that we have seen recently is the FTSE 100 Growth Plan from Premier Fund Managers which is designed to mature on the first anniversary that the FTSE 100 Index is above the level it was at when the contract began. On maturity investors will receive their original capital plus a bonus of 8 per cent for each year the contract has been held. Even if in the unlikely event the FTSE is not higher on any of the six anniversaries, investors' capital will not be reduced unless the index halves in value during the investment term. Again, this investment has proved very popular and, as a result, Premier have launched an identical follow on contract and have plans to launch a third once the second closes.**

KEYDATA INVESTMENT SERVICES ARE again responsible for some first class innovation in their latest offering, the FTSE Growthbuilder Plan.

This contract has two investment options and we favour the Maximum Growth Option which is designed to provide a maturity bonus equal to the percentage rise in the FTSE 100 Index over the term, subject to a maximum bonus of 100 per cent. What is unique about this particular product is that it locks in growth of the Index for each 20 per cent rise. Therefore, if the Index rises then falls, the maturity bonus will be determined by the highest position the market reaches during the term. The original capital is protected unless the FTSE falls by 50 per cent or more and fails to recover to the investment start level by the maturity date. If this does occur the initial investment will be subject to a 1 per cent reduction for each 1 per cent the final value of the Index is below its start level. However, any bonuses earned as a result of the Index rising will still be payable.

The investment is designed to be held for the full six year term but, as with most structured products, it is possible to transfer a holding to a third party during the term by way of a gift, a sale or through probate following the death of the holder. Any transfer during the term will be at the then current value, which will fluctuate throughout the term.

In our opinion, the Keydata FTSE Growthbuilder Maximum Growth Option is an excellent contract which is very worthy of our endorsement. If you wish to consider investing in this plan, you should read the brochure and Key Features document enclosed with this issue of the magazine to satisfy yourself that the investment is right for you and you understand the risks. If you have any doubts about its suitability, you should contact your Lowes consultant or our office on 0845 1 484848.

Completed application forms should be returned to this office in the envelope provided together with a cheque payable to "Keydata FTSE Growthbuilder Ref (Your Name)".

Please note that the closing date for this investment has been extended to 22 August but it may close sooner if fully subscribed.

Important Notice: This investment is intended to be held for the full six year term. If you need to sell your investment early you may get back less than you invested even if the FTSE 100 Index has risen. Your original capital is not guaranteed and you may get back less than you invested. Those investing outside a PEP or ISA will be subject to Capital Gains Tax if their gains in the year of maturity exceed the personal exemption, which is currently £7,900. Levels and bases of reliefs from taxation are based on our understanding of current tax legislation and are subject to change.