Turbulent Times

The 1980s and 1990s proved to be an exceptional period for stock market investors. During the first few years of this century, we have had to live with more volatile markets and returns for investors in the UK stock market have been extremely poor in capital terms. At the same time, interest rates are at a very low level, having fallen sharply following the terrorist atrocity perpetrated on the World Trade Center in New York in 2001, otherwise known as 9/11.

As interest rates have stayed low for a prolonged period, despite rising inflation, this has caused problems for the elderly and those who rely on savings for income. Low interest rates and poor returns from stock markets have had a major impact on pension funds and insurance companies, resulting in pension benefits coming under pressure and savings policies paying out less than originally envisaged. For many, this gap has been bridged by releasing a chunk of equity through the sale of their homes and the move to smaller houses after retirement. This benefit was the result of the exceptional boom that we saw in house prices over a thirty-year period.

The problem for future generations of pensioners is that they will have less in the way of pension provision and may not have the same amount of equity in their homes. The average age of a first-time buyer in the UK has now risen to 37 years old. Many young people are getting married later and, because of the higher cost of housing, are living at home for longer, making it more difficult for their parents to sell and 'downsize' – live in a smaller place, with lower costs.

At the same time, the generous defined-benefit pensions that young people might have expected when they entered the workplace have, in many cases, simply disappeared. They have often been replaced with defined-contribution pensions. The old schemes gave those who had given 40 years of service two-thirds of their final salary at retirement. Defined-contribution schemes provide the beneficiary with a specific pot, which they get on retirement. The problem is that, if markets are very weak at the time of retirement, they are stuck with a less favourable pension. In other words, companies have shifted the risk that markets will be weak from their balance sheets. The beneficiaries of the pension scheme now assume that risk.

Another major factor putting strain on those retiring is that life expectancy has risen sharply. Many people are now spending the last few years of their lives in a very frail state, requiring high levels of care. The cost of this creates a heavy financial burden, which frequently cannot be met by the immediate family. The result is that the children have to sell the home to cover these costs, and their inheritance is greatly diminished.

Against this background, we all have to plan our financial future more carefully rather than relying on rising house prices or a rising stock market to ensure comfort in old age. As a nation, we need to be more financially literate - that is why I have decided to write this financial guide.

The key point I am making in this guide is that your destiny lies in your hands. An actuary will tell you that if you want to have a decent standard of living during retirement, then you need to set aside at least 25 per cent of your net earnings per annum between the ages of twenty-five and sixty-five. For most people, this is an impossible task, given the cost of housing, travel, food and childcare. Many people rejoiced as the housing market soared, but we are now living with the consequences of over-inflated values, which feed into rental levels and mortgage repayments and take up too big a percentage of most people's incomes. The result is that most women, when they have children, cannot afford to give up work. The cost of nursery care again reflects the high cost of premises and creates a further burden on families.

If you cannot afford to save 25 per cent of your net earnings each year, then it is important that you at least save something and hope that you will be able to save more as the children grow up and move into employment. The government is eager to encourage saving, and has increased the amount that individuals can save through an Individual Savings Account (ISA) – and Innovative Finance ISAs (IFISAs), with effect from the new tax year on 5 April 2016.

An important point: an ISA is just a label that means you get favourable tax treatment. Think of it as heat-proof, cold-proof, weather-proof wrapping paper. You can wrap anything in this paper, and it will stay protected – in financial terms, this means protection from paying tax (see the paragraph below). So the ISA is a wrapper, and the thing that you wrap inside it is the investment – which could be a cash deposit, a share, or one of the many investment funds currently available.

For the tax year 2015/16, each person had an ISA allowance of £15,240. Once the money is in an ISA, there is no tax to pay when you sell something at a profit. There is also no tax on income reinvested. Some of your ISA allowance can be saved via a cash ISA, although the very low level of interest rates does not make this particularly attractive at the time of writing.

Another alternative is to invest in a stocks-and-shares ISA. The investor can either hold individual shares or invest in unit trust funds - with the latter being the better choice for most, as unit trusts provide a diversified portfolio of shares managed by a professional fund manager.

The new option, from April 2016, as mentioned above, will be to commit funds to an IFISA. This will allow you to invest in crowdfunded peer-to-peer (P2P) loans, which often have a high yield, but do carry a degree of risk that you should be fully aware of before committing capital. Reputable P2P websites such as my own, Money&Co., explain those risks clearly – and regularly remind lenders of the risks inherent in lending to a small business.

The sensible approach is to put some money into a savings plan with an ISA wrapper every month from the time that you start working, and then to increase the amount you invest as your earnings rise. By doing this, you should be able to create a decent pot of money in a tax-free environment. That money will then be available to you whenever you need it.

Investing in the stock market may seem forbidding to those who have little experience of it, but it can be fun to follow your investments. Our aim is to equip you with sufficient knowledge in order to make informed investment decisions and to come to enjoy following your portfolio at the same time as ensuring a comfortable retirement.