

## Pre-Budget Report: Will Darling pull a rabbit or a rat out of his hat?



Next week's pre-Budget Report takes place against the backdrop of spiralling public debt and a fast-approaching General Election, prompting fears that Chancellor Alistair Darling may be set to further squeeze high earners until their pips squeak.

In particular, there is anticipation of a potential move against Childcare Vouchers, a hike in Capital Gains Tax and the extension of changes announced at the Budget to taper relief on pension contributions for people earning more than £150,000 down to those earning over £100,000. Such measures, combined with the introduction of a 50% rate of income tax for the highest earners next year, could prove popular even though some forecasters question whether they will make a material impact on the public finances.

"The days of pre-Budget purdah, where absolute silence was maintained on financial policy ahead of such statements, have long since been replaced by 'kite-flying' leaks to test reaction to potential new measures," said Jason Hollands, Director, F&C Investments. "Right now, hitting the wealthy - particularly those working in the City - is a dog whistle to parts of the Government's traditional core voter base who are angered by tales of excessive bonuses.

"However, such kite flying can also be a tactic to manage down expectations so that when actual announcements are made, the surprises are more on the upside," he added. "For example, despite the limited room for manoeuvre and the overall push towards higher taxes in the last Budget, the increase in the ISA allowance was welcome news for savers." Hollands believes that one area which could deliver a surprise is a temporary

restoration of some of the levels of tax relief available on Venture Capital Trusts until a couple of years ago, combined with a relaxation of some of the investment restrictions for such vehicles. VCTs were introduced in 1995 to help bridge the financing gap for small UK companies by offering investors a package of tax incentives to mitigate some of the risks of investing in such firms.

"In 2007, a year before the credit crisis, the level of reliefs on VCTs was slashed and the size of company eligible for VCT investment materially reduced. This has resulted in sharp fall in VCT financing," said Hollands. "Right now the UK needs to encourage entrepreneurs in order to climb its way out of recession. Given the continued tough lending climate for individuals and small businesses, there is a compelling case for providing a boost to VCTs by restoring higher rate relief on new subscriptions and broadening the universe of companies eligible for this form of financing. "With major tax hikes for high earners on the way, restrictions on sheltering this through pension contributions and a possible increase in CGT, enhanced VCT income tax reliefs, combined with their CGT-free status, would be particularly attractive for many high earners and at the same time positive news for small businesses."

### Short-term warning on Asia, but fundamentals remain intact

After impressive gains year-to-date investors in Asia Pacific markets should be mindful of the risk of a near-term pull back, according to Peter Dalgliesh, manager of the F&C-managed Pacific Assets Trust.

Even though Asian markets have been relatively overlooked in recent months as economic growth in most Western nations has turned positive again, the region is now trading above historical average valuations. Dalgliesh says that this, combined with high expectations from investors and analysts, means the risk of disappointment has increased. "A lack of top-line growth due to the easing of government stimulus measures may trigger a correction now that the liquidity-led lift-off phase appears to be nearing an end," said Dalgliesh. "Furthermore, as markets

contend with the prospect of exit strategies by global central banks, easing risk spreads are unlikely to sustain their recent downward trends, challenging the lofty level of investor risk appetite."

Because of Asia's relatively higher-beta status and formidable returns year-to-date, Dalgliesh says the region is now vulnerable to some profit-taking. However, over the medium and longer term he believes the case for investing in Asia Pacific equities is still strong. "The structural growth story inherent across Asia remains compelling and with a banking system that is relatively robust, the prospects for high sustainable GDP growth are good," he concluded.

Pacific Assets Trust has just reported results for the quarter ended 31 October 2009. Net asset value total return was 6% over the three months, compared with 5.3% from the MSCI All Country Far East ex Japan index.

### F&C Monthly Lunchtime Press Briefings – One for your 2010 diary!

F&C's programme of monthly lunchtime press briefings continues in 2010, beginning with the F&C Multi Manager Team on 13<sup>th</sup> January at our offices in Exchange Square. Dean Cheeseman, Head of Multi Management at F&C, along with fund managers Oliver Sonnichler and Paul Carne, will give an overview of likely themes for 2010. Invitations will be sent in the coming weeks, to book your place please contact Jennifer Donohoe on 020 7011 5017 or by email on [jennifer.donohoe@fandc.com](mailto:jennifer.donohoe@fandc.com). Further events in the series will be announced in the New Year.

### Fund Manager Roadshows

F&C is hosting two roadshow events for discretionary advisers in January, firstly in Manchester on 15<sup>th</sup> January followed by London on 21<sup>st</sup> January. Presenters include Peter Lees, Head of UK Equities, who will provide an outlook for 2010, along with Paras Anand, Head of European Equities, Fatima Luis, Director of Retail Funds and Rebecca Seabrook, Director, UK Credit, who will each host interactive break-out sessions. For further details on the events, please contact [dianne.readings@fandc.com](mailto:dianne.readings@fandc.com).

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