

JPMorgan Asset Management  
Investor Insight  
May 2008



## Changing Fortunes:

Essentials for better financial well-being



Better insight + Better process = Better results

**JPMorgan**   
Asset Management

## Do the right thing

We are all being told we each need to take steps to ensure our future financial well-being. But it can be hard to know what this should involve.

In this brief guide, we have looked to provide guidance to some common financial-planning questions - and offer some useful rules of thumb for planning your finances effectively.

We also aim to show how measures such as investing from an early age and using stock market investments can potentially help to enhance your financial prospects.

None of the information here should be taken as advice. Before taking any action, it is strongly recommended that you seek professional financial guidance based on your individual circumstances.

But we hope this guide offers some useful pointers to help you plan your financial future more effectively.

### Contents

- What should my financial priorities be?
- How much should I be saving for retirement?
- When should I start saving and investing?
- Do I need to take investment risk?
- How much debt is too much debt?

*This guide is an abridged version of proposals put forward in a 2008 report by JPMorgan Asset Management, "Changing Fortunes: Setting guidelines for financial well-being in the UK". It is not intended as advice.*

# Part One:

## What should my financial priorities be?

### The Financial 5 Steps

It's easy to feel bombarded by financial guidance and confused as to what you should do first. But by arranging your finances in logical steps you can help to ensure that your capital is working as effectively as possible and you are well prepared for unexpected financial eventualities.

To help we've come up with a Financial 5 Step plan – a simple guide to the five basic principles of financial planning that every saver needs to address. Follow all of these steps and you can be more confident that your financial planning is in good shape.



#### 1. Arrange life/income insurance

If you have dependants such as children, it's essential they are provided for in the event of your death. Life insurance should be the number one financial-planning priority for people in this position. Even if you don't have dependants, you may want to protect your income if you are unable to work through sickness or disability.

#### 2. Build a rainy-day cash fund

Everyone needs capital they can fall back on in emergencies. So it is advisable to keep an amount equal to at least three months' income in an instant access deposit – as well as using deposits for other low-risk savings.

#### 3. Pay off expensive debt

Credit cards and personal loans with high rates of interest can be a huge drain on your financial resources. In fact the interest on unsecured debts like these can instantly wipe out anything you are earning on a savings account or other low-risk investments. So before you use capital for investments and savings, try to pay off expensive debts.

#### 4. Set up ISAs & pensions

Once you have built up a low-risk cash fund and reduced expensive debt, you can start thinking about other longer-term investments. ISAs and pensions should be a priority because they both have attractive tax breaks. Pensions can be used for long-term savings you don't want to touch until retirement. ISAs allow you to get at your money at any time, so they can be used for medium as well as long-term investments.

#### 5. Review your position

The most important step of all. Once you have set up savings, investments and insurance make sure you review all your arrangements regularly (e.g. once a year) to ensure they are appropriate and you are on target to meet your objectives.

## Part Two: How much should I be saving for retirement?

### The 15% rule

When it comes to investing for retirement it is important to invest as much as possible – especially as you may need to generate an income for 20 or 30 years or more after you stop working full-time.

And it's very easy to underestimate how much capital may be required to do this. For example, to 'buy' a pension income of £25,000 a year, you would currently need a pension fund of around £350,000.

### Pension illustrations

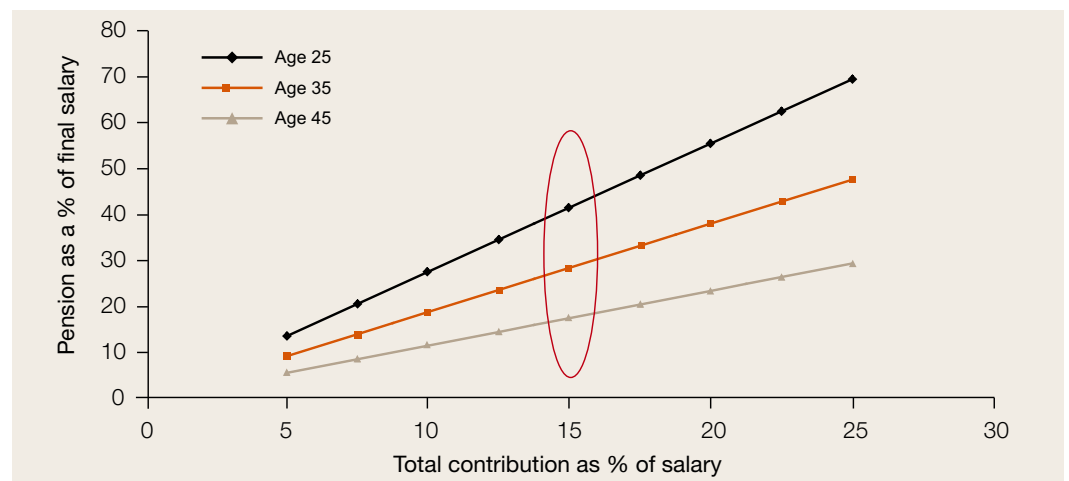
If you have a pension plan, you will be receiving annual illustrations showing what your pension fund might provide as a retirement income, based on certain assumptions. It's important to take careful note of these illustrations to see if your retirement planning is on track to deliver the pension you expect.

### The 15% rule

So what is an ideal pension contribution to be making? Through our calculations, we have concluded that savers at all ages need to be putting aside at least 15% of their gross salary in a pension. At this level, a 25-year old male starting a pension could expect to receive a pension income equal to 40% of his final pre-retirement salary, while a 45-year old would receive around 20% of final salary (see diagram below). Please note, these projections are based on certain assumptions detailed below and are not guaranteed.

The less time you have until retirement, the more you will need to contribute to get the same result as a younger saver. But remember that every pension contribution will attract tax relief at your highest rate of income tax. So every £15 of gross salary will only cost £12 in after-tax salary if you are a 20% taxpayer and £9 if you are a 40% taxpayer. Plus, if you are an employee, you may benefit from additional contributions from your employer.

### 15% - the minimum to be saving in a pension?



Source: JPMorgan. Assumptions: 7% annual investment return; 1% annual investment charges; 4% annual salary increase (based on salary increases of 1.5% above inflation of 2.5%); contributions are paid mid year. No tax effects have been taken into account and assumes full pension fund is used to purchase an annuity.

Annuity rates of 4.48%, 4.42% or 4.37% for a male born on 1/4/63, 1/4/73 or 1/4/83 respectively for an annuity of: single life; 5-year guarantee; monthly in advance; 4% expenses; 0.6% net interest rate, to provide RPI increases; calculated in accordance with FSA projection guidelines for pensions. Annuity rates advised by DST International Pensions & Actuarial Services Limited.

Please remember that past results are not a guide to the future.

## Part Three: When should I start saving and investing?

### Putting time on your side

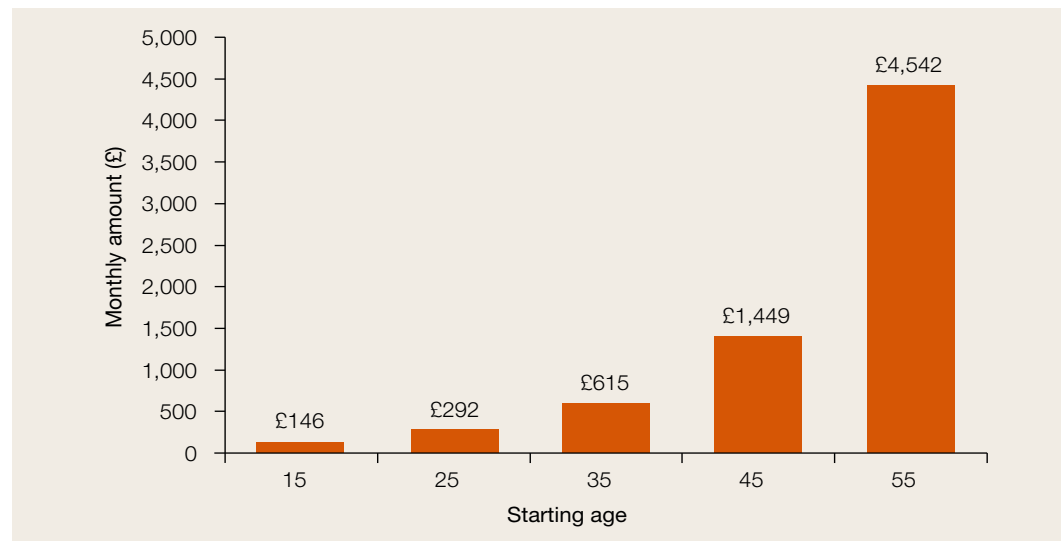
As you may suspect, the answer to the question “When should I start investing?” is “As soon as possible”. But beyond this obvious piece of advice, it is easy to underestimate the positive impact of investing from an early age.

The ability to leave savings and investments to grow for the long term is one of the most important factors in achieving strong returns. This is particularly true where investments are receiving a regular income (e.g. dividends). Compounding (consistently reinvesting income to create a greater capital base on which more income can be earned and reinvested) can be one of the biggest contributors to growth over the longer term.

The younger you are when you start investing, the greater the returns that can potentially be achieved. Or to put it another way: the less you will need to invest to achieve the same result as an older saver. As the diagram shows below, a saver of 15 would need to contribute about a tenth of the monthly amount that a saver aged 45 needs to in order to achieve the same value of fund at age 65 (based on certain assumptions shown below).

### Building a £1 million pension from different ages

Starting monthly pension contribution required to build a £1 million pension fund (in today's terms) by age 65



Source: JPMorgan Asset Management Pension Calculator

Assumptions: Fund growth rate of 7%, annual charges of 1.5% for first 10 years and 1% thereafter.

Monthly contributions assumed to increase by 2.5% a year in line with inflation; real value of capital assumed to be subject to 2.5% annualised inflation

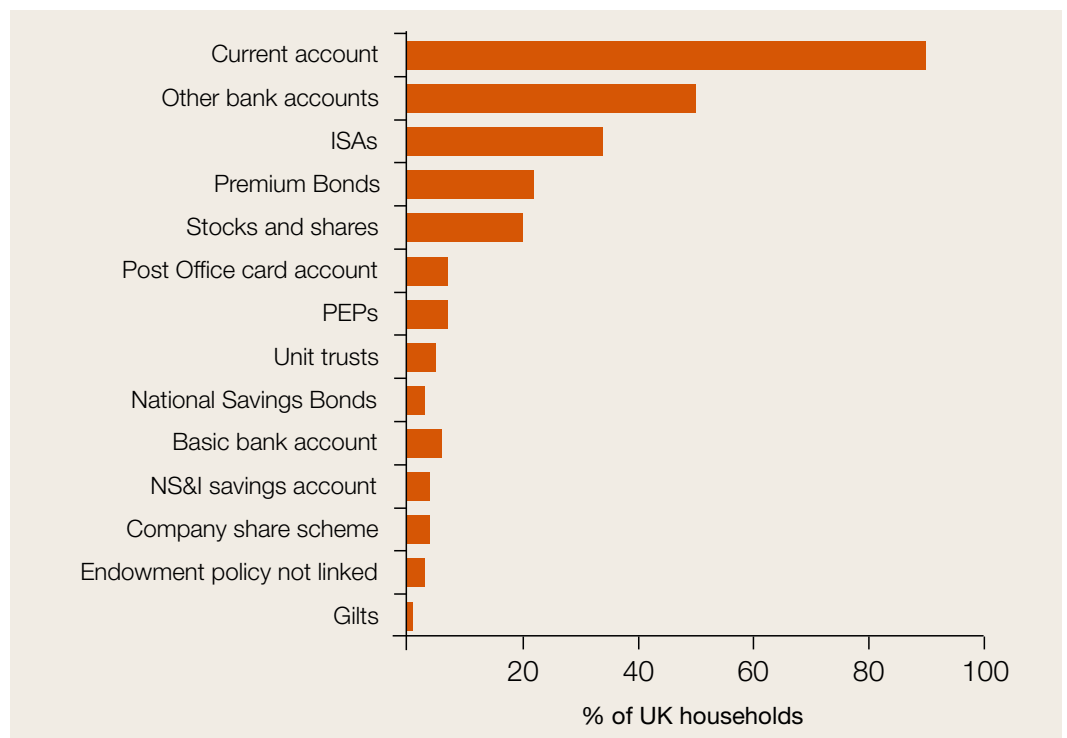
## Part Four: Do I need to take investment risk?

### Harnessing stock market potential

Data suggests that lots of savers in the UK are highly risk-averse. A survey in 2006 revealed that 43% of people say they don't want to take any risk with their money (FSA: Levels of Financial Capability in the UK; baseline survey, March 2006).

Plus, if we look at where people choose to put their money, we see that most people favour low-risk deposit accounts, with far fewer holding stock market investments. Even premium bonds outstrip stocks and shares.

### Household take-up of savings products 2005/06



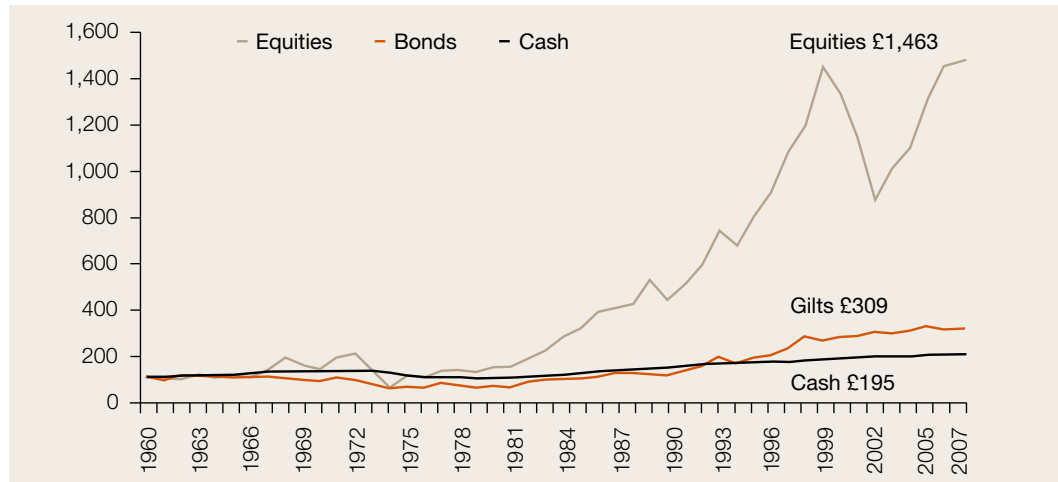
Source: Department of Work & Pensions

This is understandable, particularly given recent market volatility – and it's always important to keep some of your capital in low-risk deposits. But when it comes to investing for the future – for example, retirement, most of us need to consider taking some risk in order to achieve the results we need. That's because low-risk deposits only earn interest; they don't grow the value of your capital as well.

You can see this from the graph. This shows that had you invested the equivalent of £100 in shares ('equities'), government bonds ('gilts') and savings deposits ('cash'), the results by 2007 would have been very different.

In cash, a £100 investment in 1960 would be worth £195 after taking inflation into account. In gilts, it would have tripled to £309. But in equities, it would have grown 14 times in value and would now have the purchasing power of £1,463 – even though equity markets have seen some sharp falls along the way.

**'Real' value of £100 saved/invested 1960-2007**



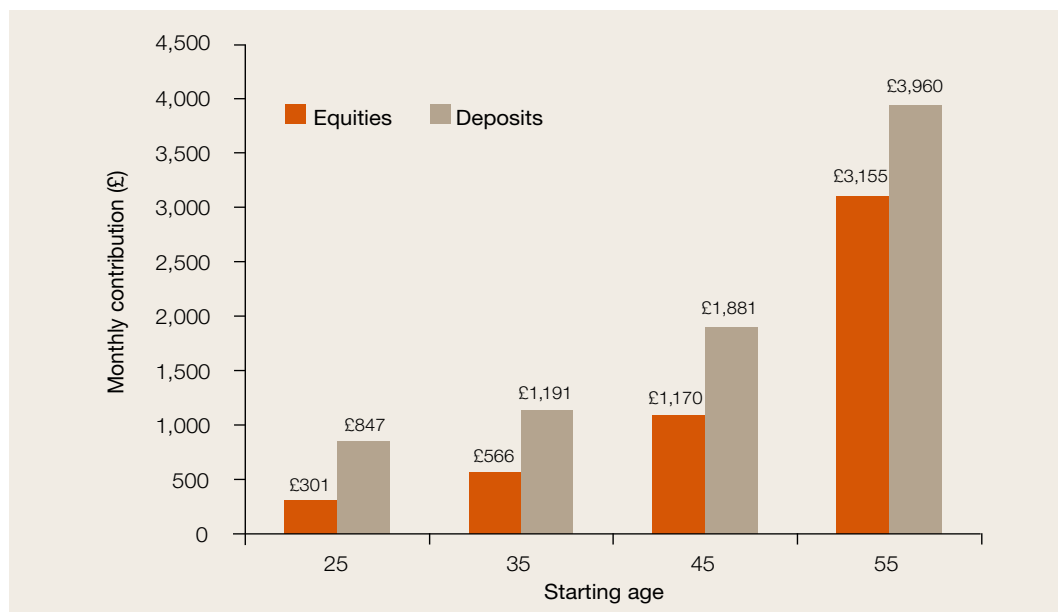
Source: Barclays Capital Equity Gilt Study 2008  
Based on average real (after inflation) rate of return with gross income reinvested.

The higher growth potential of shares, or equities, may mean that lower contributions are required to achieve a particular result.

For example, say you are 35 and you want to build a fund worth £500,000 in today's money by age 65. If you wanted to do this using only low-risk deposits, our calculations suggest you would need to save £1,191 a month. But the growth potential of equities means you stand to achieve the same result investing only £566 a month – less than half the amount need for deposits. (Please remember these calculations are based on historic returns for equities and cash. Future returns may be different and are not guaranteed. Your capital is safe in a deposit account whereas its value can fluctuate in stock market investments and you may not get back what you invest.)

**Building £500,000 with equities ('shares') versus deposits**

Monthly contributions required to build £500,000 in today's terms by age 65



Source: JPMorgan Asset Management  
Assumptions: Contributions made monthly; real (after inflation) annualised rates of return assumed as 5.3% for equities and 1% for deposits (drawn from average annualised real returns 1899-2007 – Barclays Capital Equity Gilt Study 2008); gross income reinvested.

So unless an you can afford to divert a very high proportion of capital to deposits, most savers will want to consider some exposure to riskier investments like equities and other growth assets.

# Part Five: How much debt is too much debt?

## The JPMorgan Debt Obesity Scale™

Until recently, debt has been easy to come by. But maintaining large debts - particularly unsecured credit cards and loans that charge high levels of interest - can have a huge negative impact on your financial planning.

For a start, if you have other savings and investments, the return you are making on them may effectively be wiped out by the interest you have to pay on your debts. So your 'net wealth' is not actually increasing.

Second, if you are opting for minimum payments, you may only be paying off interest and not any capital. As a result, the debts may not be reducing - and it may actually be increasing if unpaid interest is added to the loan.

To guard against these eventualities, there are two important measures to consider:

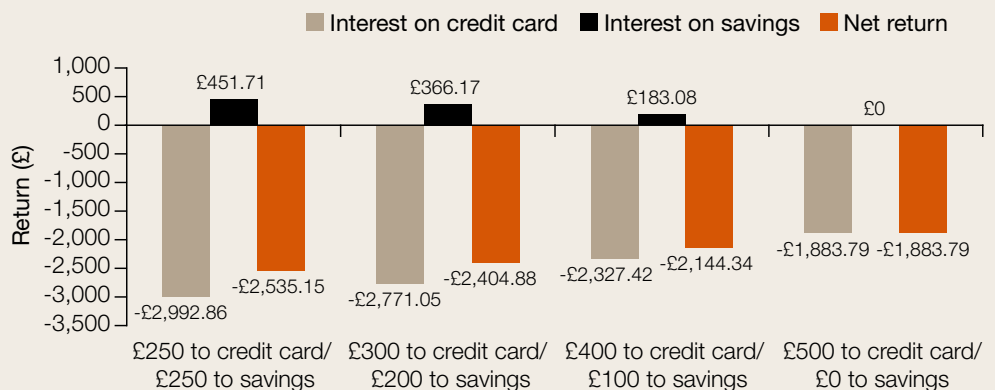
### 1. Take a 'holistic' approach to debts and assets

Think of your debts and savings and investments as two sides of the same coin. See what your net wealth is after you have deducted loans and borrowings. You may be surprised to see what you are actually worth.

Make repayment of expensive debt a priority for any spare income you have. This can even have a more positive impact on your overall financial position than putting the spare cash in a savings account – as the example shows below (although always ensure you have sufficient capital on deposit for emergencies).

### Credit cards v savings

CASE STUDY: John has £10,000 debt on his credit cards. Each month for the next two years, he has £500 spare from his income that he can use to pay off this debt or save in a deposit account. At average rates of interest, the interest paid/earned over two years could look as follows.



If John chooses to divide the £500 a month equally between paying off his credit card and savings – i.e. putting £250 a month in each, his net expenditure on interest payments will be £2,535.15. But if he uses the full £500 a month to pay off his credit card, the net cost in interest over two years will drop to £1,883.79 – a 'cost saving' of £651.36.

Source: Credit Action

Assumptions: Outstanding credit card balance of £10,000; average interest rate on credit cards – 17.31%; savings interest rate of 7% (no deduction made for tax on interest); minimum credit card payment is 2.5% of outstanding balance.

**2. Know how much debt is too much**

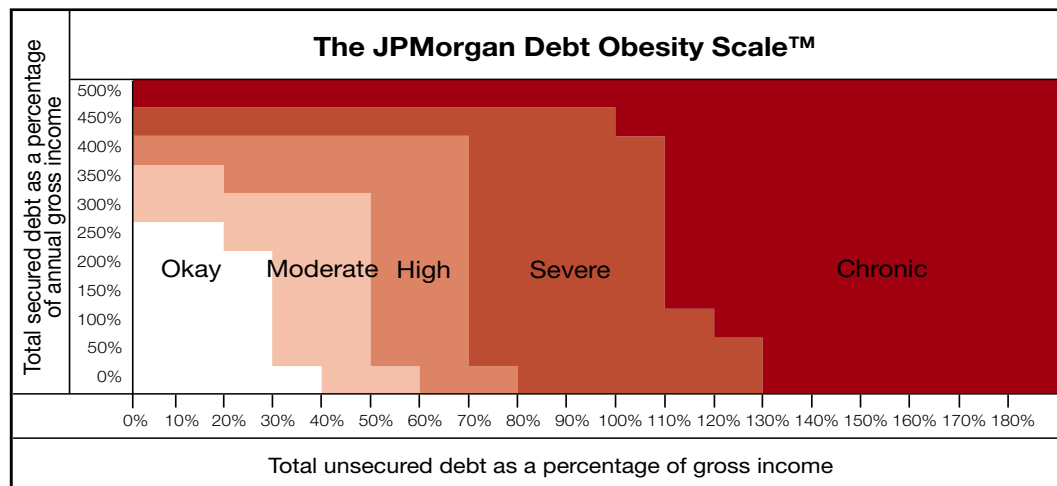
Because debt has been easy to come by, it can be tempting to take up every loan you are offered. But this can mean your debts can far outweigh your ability to pay them off.

So how can you tell when your debts are heading to dangerous levels? To help, we have devised The JPMorgan Debt Obesity Scale™, in conjunction with Credit Action, the money education charity, to help borrowers gauge how manageable their debts may be.

**How the JPMorgan Debt Obesity Scale™ works**

The JPMorgan Debt Obesity Scale™ is designed to show your likely ability to service your current debts, by calculating your total secured and unsecured debt as a percentage of your gross (i.e. before tax) annual income. By ‘servicing debt’ we mean an individual’s ability to make both interest and capital repayments out of their regular income, so that the debt can be reduced over time.

The JPMorgan Debt Obesity Scale™ rates levels of unsecured debt (e.g. credit cards, store cards and personal loans) more severely than secured debt (i.e. a mortgage). This is because the former is likely to charge a very high premium on its interest rates and a borrower does not have an asset to help repay the debt.



**Calculating your Debt Obesity Scale rating**

To determine your Debt Obesity Rating, you simply need to calculate your total unsecured debt as a percentage of current gross annual income, and then do the same for your total outstanding secured (mortgage) debt. You can then see which Debt Obesity Rating these two figures put you in.

**The JPMorgan Debt Obesity Scale™ has five ratings:**

<b>Okay</b>	Debt can easily be serviced by current income
<b>Moderate</b>	Debt will account for a significant amount of the individual’s income but should be manageable
<b>High</b>	Debt will account for a high amount of income and may compromise an individual’s ability to meet other living costs
<b>Severe</b>	Debt will account for a very high level of income and the individual is unlikely to be in a position to meet payments and other living costs as well
<b>Chronic</b>	The debt is beyond the individual’s means and they are likely to be in chronic financial difficulty

For financial well-being, most individuals should aim to be in the Okay category – or the Moderate category at most. The other categories – High, Severe, and Chronic – all indicate serious debt problems and professional debt guidance may be required.

Note: The JPMorgan Debt Obesity Scale™ is not a diagnostic tool and should not be used as a substitute for individual financial guidance. Your ability to service debt may rely on a range of factors besides gross salary, including other financial commitments and sources of capital. Changes in interest rates will also impact your ability to service debt. If interest rates rise, the cost of current debts may also rise. The JPMorgan Debt Obesity Scale™ takes account of average prevailing interest rates in 2007/08.

If you feel like your debt is a problem, regardless of where you appear on the scale, get in contact with an independent debt advice organisation. If you find your Debt Obesity Rating is ‘High’, ‘Severe’, or ‘Chronic’, it is important to take specific remedial action as soon as possible.

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## Want to learn more?

Here we've just touched on a few principles of good financial planning. Below are some useful sources of information if you want to learn more about financial planning and get help and advice about your own circumstances.

### Financial Services Authority

The UK financial regulator offers a range of online tools and guides to help you gauge your financial health and get a better understanding of your financial choices.

[www.moneymadeclear.fsa.gov.uk](http://www.moneymadeclear.fsa.gov.uk)

### IFA Promotions

Find an independent financial adviser (IFA) close to where you live or work. You can specify which area of financial planning you are most interested in.

[www.unbiased.co.uk](http://www.unbiased.co.uk)

### Citizens' Advice Bureau

Free independent and confidential advice on debt and other financial matters in over 3,000 locations in the UK.

[www.adviceguide.org.uk](http://www.adviceguide.org.uk)

### Consumer Credit Counselling Service

Offers free, confidential advice and support about debt management and budgeting.

[www.cccs.co.uk](http://www.cccs.co.uk)

## JPMorgan Asset Management – your partner for a better financial future

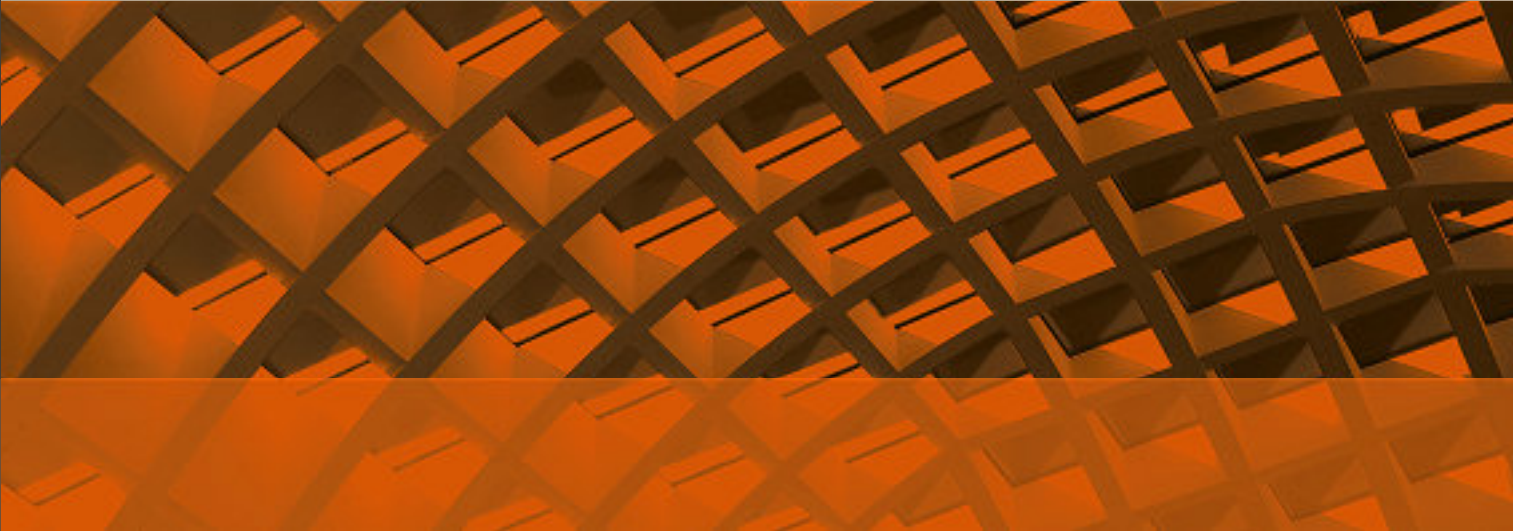
JPMorgan Asset Management is committed to help more people plan for a more prosperous financial future with a range of investment solutions, including:

- Monthly savings
- Tax-efficient ISAs
- Investing for children
- Investment trusts
- OEIC funds

To discover the solutions for you, call our UK-based Investor Services Team on 0800 20 40 20. Or visit us at [www.jpmorganassetmanagement.co.uk](http://www.jpmorganassetmanagement.co.uk)

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