

### Inside this issue:

- 1 An end to interest skimming
- 2 Pension contributions need to be changed
- 3 Pseudo ETFs - Watch out for them
- 4 I Like This Sector ETF
- 6 Commodity ETFs & ETCs
- 10 Stock prices - It's important not to think at present
- 12 About this Newsletter and the SIPP Book

## No More Interest Skimming With This Great 'Cash' ETF

In the SIPP book I talked about the legal *interest skimming* that most, if not all, the SIPP brokers play. Basically they receive interest on client balances at say 5% and then pay the client 2 or 3%, some in fact go even lower than that.

Brokers, not just those in the SIPP market, have been milking retail clients like this for years, and as it's such easy money I don't expect things to change.

But our job as good personal finance practitioners is first to recognise the problems, not to whine too much, and instead focus on finding solutions. And this new ETF is one hell of a solution.

Deutsche Bank is about to introduce a money market ETF where the fund's holdings are deposited on the 3 month money market. The 3 month money interest rate is invariably around the official Bank of England base rate.

Currently, interest rates in the UK are 5.25% so expect this ETF to pay around 5.25% minus the annual management charge of 0.15%.

### How To Use The ETF

If you like to hold cash in your SIPP then buying this ETF is the only way to do it and get a decent return. Or, if you have excess cash in your SIPP waiting to invest, again use this ETF to hold the cash.

Do take dealing charges into account though which as a percentage will vary depending on how much cash you have to invest, ie it won't make a lot of sense to buy £500 of this ETF with a commission rate of £10 (2% costs).

The ticker on the ETF is going to be XSTR and look out for it to be listed sometime in April 2008.

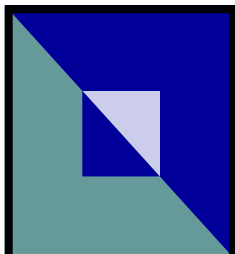
*"Brokers have been milking retail clients for years"*

### Stocks & Shares ISAs—The Interest Rate Is even Worse

Similar to the problem of low interest rates on cash balances in SIPPs, the rates paid on Stocks & Shares ISAs are probably even worse. For example, I have an ISA account with TD Waterhouse and they pay just 0.5% interest but at least that's Gross and not Net!

With such low rates of interest a problem therefore occurs if you don't like stocks, perhaps thinking they have the potential to drop 10% - 20% this year.

If so, selling your current holdings would be the right thing to do but then earning 0.5% or even 2% on your money is just wrong, especially when inflation, which I estimate to be at least 8% in the UK, will eat away a large chunk of the money. But using this Cash ETF would go a long way to solving the problem.



“The new ISA year is just a few weeks away so this question will get answered”

## Will This ETF Be Allowed In a Stocks & Shares ISA?

There is a little known rule, called the *5% test*, that applies to Stocks & Shares ISAs. The test applies to the capital return expected by investors. If for example the investor is certain or near certain of receiving back 95% or more of the initial investment (at any time over 5 years) the test is failed.

So on paper it would seem that this ETF is going to fail this 5% test but in reality nobody I have spoken to can shed any light on the matter. It's all slightly confusing because although the Inland Revenue sets the rules it passes the buck and says it's the ISA brokers themselves who have to regulate what products their clients can or can't invest in.

Talking to 3 ISA brokers last week none of them could give me any indication of whether this ETF will be allowed or not. In fact, none of them had heard anything about it which I was very surprised about.

But with the new ISA year just about the start this question will have to be answered and I'll email you with the news.

## Tax Rate Change - Pension Contributions Need To Be Changed

From April 2008 the basic rate of income tax is reduced to 20% from the current rate of 22% and while that's good news for tax-payers it also means that the tax-rebate into our pensions drops.

- Say you currently pay £780 as a pension contribution
- The pension fund, in our case a SIPP, will then reclaim £220 ( $£780/78 \times 22$ )
- Total contribution into the SIPP is therefore £1,000

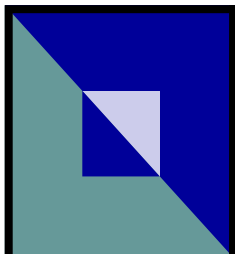
But after 6<sup>th</sup> April 2008

- If you still pay in £780 it will be topped up by only £195 to £975
- **To counteract the decrease in the basic rate of tax increase your pension contributions by 2.6%**

## Good News For Higher Rate Tax Payers

Higher rate tax payers get a break because pre April 2008 an extra 18% could be reclaimed (40% - 22%) but post April 08 this will rise to 20% (40% - 20%).

“To counteract the decrease in basic rate tax increase your pension contributions by 2.6%”



## Watch Out For 'Pseudo ETFs'

“It’s very hard to beat the overall market indexes overtime so why even attempt it”

If you’ve read the SIPP book you should fully understand what ETFs are and their associated advantages/disadvantages.

- **Main advantage** – It’s very hard to beat the overall market indexes (whatever financial product/sector you’re interested in) overtime so why even attempt it. Use ETFs instead to simply track an index with their benefit of ultra-low management fees.
- **Main disadvantage** – ETFs, unlike all actively managed funds, don’t have the potential to out-perform.

*Enter pseudo ETFs.* These are where the financial ‘engineers’ and their computers use past data to come up with the *next generation ETFs*.

This might be for example where instead of investing in all 100 stocks in the FTSE 100 the computer tries to work out *in advance* which stocks in the index will be the 20% best performers and which stocks will be the bottom 20% of performers.

The ETF then leaves out what it thinks will be the bottom 20% and perhaps even doubles up, ie buys 2 times more of the potential 20% best performing stocks.

So if the computer is right and the FTSE 100 rises 8.7% over a year the ETF might return say 12.5% or more.

But who says these programs will be correct?

Right now with the current credit crunch we’re seeing **hard evidence that the financial engineers aren’t as good as they were supposed to be.**

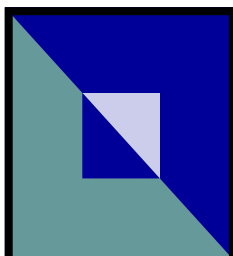
In fact, these programs and algorithms have generally been exposed as yet more evidence of the phenomenon known as ‘bull market genius’, ie it’s really hard not to make money when all you do is buy assets in a rising market (and the more you leverage your trades the more money you’ll make but then vice-versa as they’re all finding out right now)

## Marketing Fluff

I call these new style ETFs *pseudo ETFs* and generally think they’re nothing more than marketing fluff. They’re developed and designed to try and convince investors that with ETFs it’s now possible to beat the indexes and deliver potential out-performance.

But if out-performance is what people seek then don’t use ETFs in the first place, try your luck with actively managed funds instead.

“We’re seeing hard evidence that the financial engineers aren’t as good as they were supposed to be”



## I Like This Sector ETF - Macquarie Global Infrastructure

“At present in the UK there are few sector ETFs whereas in the US there are 100s”

I know the SIPP book suggests primarily to only invest in index tracking ETFs but there are other ETFs listed on the markets, notably sector ETFs. As the name suggests these ETFs invest only in the stocks from certain sectors such as computer services, Oil & Gas supplies, or health care.

At present in the UK there are few sector ETFs whereas in the US there are 100s. As we're usually behind the US in most things expect far more of them to be introduced into the UK market over the next few years.

### Macquarie Global Infrastructure 100

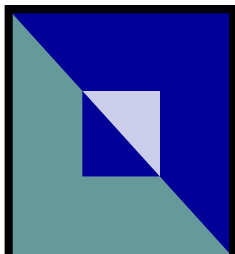
The Macquarie Global Infrastructure 100 Index, calculated and managed by FTSE.com (owned by the FT and London Stock Exchange), is designed to reflect the stock performance of companies within the infrastructure industry, principally those engaged in the management, ownership and/or operation of infrastructure and utility assets.

### The Global Infrastructure ETF - Top 10 Stock Holdings

Stock	Country	Sector	Weighting
<b>E.ON</b>	Germany	Gas, Water, Utilities	5.44%
<b>Suez</b>	France	Gas, Water, Utilities	4.00%
<b>Endesa</b>	Spain	Electricity	3.19%
<b>Iberdrola</b>	Spain	Electricity	3.13%
<b>ENEL</b>	Italy	Electricity	2.88%
<b>Exelon Corp</b>	USA	Electricity	2.77%
<b>National Grid</b>	UK	Gas, Water, Utilities	2.34%
<b>RWE</b>	Germany	Gas, Water, Utilities	2.28%
<b>Veolia Environ.</b>	France	Gas, Water, Utilities	1.86%
<b>Tokyo Elec Power</b>	Japan	Electricity	1.85%

### The ETFs Top 5 Country Allocations

- USA - 39.49%
- Spain - 8.68%
- Japan - 8.49%
- UK - 8.28%
- Germany - 7.87%



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## Newsletter

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“It’s the western world where some of the real infrastructure problems lie”

Forget about the often non-existent infrastructure needed for the developing world, it’s the western world where some of the real problems lie, especially in America where massive investment needs to take place in transportation, railways, roads, bridges and the like.

This ETF is heavily weighted in US stocks (40%) and remember with the Sterling/Dollar exchange rate so favourable to UK citizens I think investing in US assets right now adds further value.

- iShares offer a UK ETF on the Macquarie Global Infrastructure Index 100
- Ticker is *INFR* and it’s traded in Sterling
- Management fee is 0.65% per annum
- More information - [www.ishares.eu](http://www.ishares.eu)

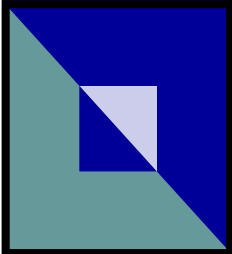
### I’m Using My 2008/09 ISA Allowance To Invest

I’m not adding this ETF to my SIPP fund, instead I’m going to buy it for my Stocks & Shares ISA for the 2008/09 tax year.

I run my ISA and SIPP as totally separate entities but feel with my ISA I can afford to take a little bit more risk (not suggesting that this ETF is that risky) and not operate it in such a mechanical fashion as I suggest doing with the management of a SIPP.

Whatever the case I think that Global Infrastructure is a good sector for investors to be in over the next 5-10 years. Also, with high inflation investing in infrastructure should offer a reasonable hedge as cost increases will be passed on to the customer and not absorbed by the companies.

- [FTSE.com](http://FTSE.com) - [More information on the Macquarie Infrastructure indexes](#)



“Commodity prices have taken a hammering over the last few weeks”

## Commodity ETFs/ETCs

It's hard right now to read a paper without there being some article on commodities and the future potential, or lack of it for the sector.

Commodity prices have taken a hammering over the last few weeks and right on queue, the majority of the media and other assorted talking heads are suggesting that the bull market in commodities is now over.

But remember, most of these people tend to forecast the long term trends on what happens that day or week. So if prices fall sharply one week they'll be calling for lower prices in the future. Then, if prices start to move back up they'll all change their tune and now tell us to expect higher prices.

### Reuters CRB Commodity Index - Weekly Chart (July 06—Present)

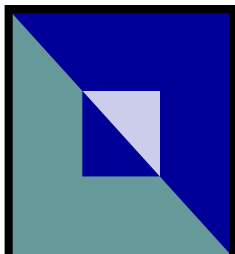


“The shakeout in prices over the last few weeks is nothing that noteworthy”

### Long Term Trends Are Tenacious

The *tenacity* of longer term trends is something that many long term investors never forget. Prices have a habit of rising (or falling) much further and for much longer than almost anyone predicts.

In my eyes there's no doubt that the commodity sector is in a long term tenacious bull market and the shakeout in prices over the last few weeks is nothing that noteworthy. This is because big, sudden and vicious price plunges in commodity bull markets are to be expected, it's part of their character, always has been and always will be.



“Commodities are viewed by many as a slightly esoteric investment class”

“If I am going to invest in the sector I would only allocate a maximum of 10% of my total portfolio”

## Why No Mention Of Commodities In The SIPP Book?

In the SIPP book when I built the sample portfolios I made no mention of using ETFs to invest in commodities as an asset class.

This was because commodities are viewed by many as a slightly esoteric investment sector and I didn't want to cloud the overall picture by introducing products that many people had no experience of, or were in general wary because of the sectors' often huge price volatility. But this is not to say that commodities don't have a role to play for SIPP investors.

Personally I don't hold any commodity investments via ETFs in my SIPP but this may well change in 2008. But if I am going to invest in the sector I would only allocate a maximum of 10% of my total portfolio with 5% most probably being the likely weighting.

## So Many ETFs – Things Are Getting Slightly Out Of Control

Firstly, just to confuse us, Commodity ETFs are sometimes called ETCs or *Exchange Traded Commodities*. Whatever they're called they're one and the same.

Secondly, I'll be honest with you. Right now the whole ETF sector is becoming very crowded indeed with a never ending stream of new ones coming onto the market.

As a guess and using the FTSE 100 as an example I would think there are at least 6-8 different FTSE 100 ETFs available to invest in, so all this choice can become confusing.

In the SIPP book I just focussed on the ETFs offer by Barclays iShares for two reasons –

1. The iShares range of ETFs are the most established, and
2. The majority of the iShares ETFs have good trading volumes which is important as it keeps the bid-offer spread nice and narrow, ie cheap.

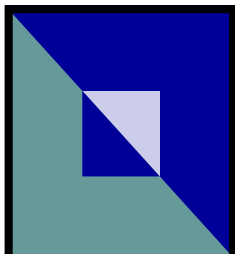
## Which Commodity ETFs To Invest In

ETF Securities are a leader in developing ETFs/ETCs and if you go to the their website [www.etfsecurities.com](http://www.etfsecurities.com) the main title screams – **66 new ETCs!** You can start to see what I mean about the problem of choice.

ETCs are available to go long (profit from rising prices), go short (profit from falling prices) and leveraged ETCs (money is borrowed so profits **and** losses are both magnified).

Add in all the other ETF providers who have introduced commodity based ETFs and I'd estimate there must be at least 100 if not more to choose from.

So if I was going to invest in the commodity sector how would I approach the problem? The basic mantra in the SIPP book is to **always try and keep things as simple as possible**. I would therefore just focus on ETCs that track the main commodity indexes, of which there are two –

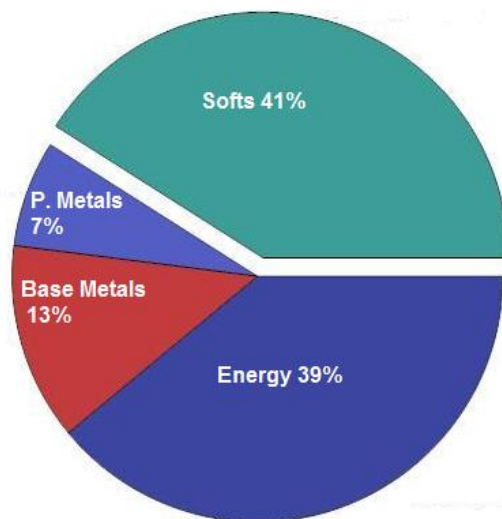


- Reuters CRB Index, and the
- Dow Jones–AIG Commodity Index

“One of the main problems with the commodity indexes is that energy products take up at least a 1/3<sup>rd</sup> of the weightings”

Lyxoretf.co.uk (a subsidiary of Société Générale) offers a tracker on the CRB (ticker LCTY) with the commodity weightings shown on the pie chart to the right.

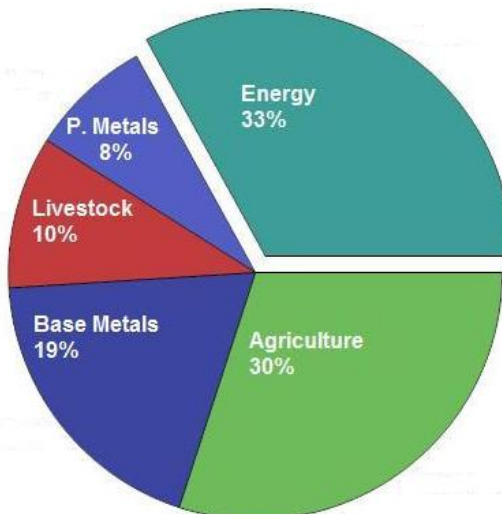
Annual management charge is 0.35% and the base currency is **Sterling**.



www.ETFSecurities.co.uk offers an ETC tracker on the Dow Jones All Commodities index (ticker AGCP) with the commodity weightings shown on the pie chart to the right.

Annual management charge is 0.49% and the base currency is **Sterling**.

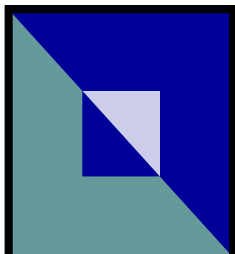
Note that of the 2 ETCs this one has the better trading volume.



### Commodity ETCs Without The Energy Component

One of the main problems with the commodity indexes listed above is that energy products take up at least a 1/3<sup>rd</sup> of the weightings. Some commodity purists don't always like this, believing that commodity investing is more about grains, livestock and metals etc.

ETCs from both the above companies are also available which completely strip out the energy components.



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## Newsletter

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“Expect plenty  
of fireworks  
both up and  
down”

- Lyxor ETF CRB Non Energy (ticker LCNE) – invests in softs and metals - More details [www.lyxoretf.co.uk](http://www.lyxoretf.co.uk)
- ETF Securities Agriculture £ DJ-AIGCI (ticker AGAP) – invests only in softs - More details [www.etfsecurities.co.uk](http://www.etfsecurities.co.uk)

There are also many more ETCs that offer exposure to single commodities such as Coffee, Soyabeans or Copper but personally I feel for most SIPP investors it's better to keep things simple. **If you want exposure to the commodity sector I would advise you go for an ETC which tracks one of the main commodity indexes.**

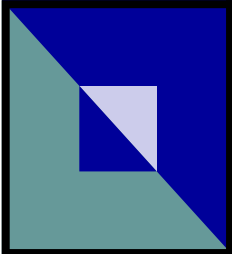
### Summary and Warning

If you wish to invest in the commodity sector perhaps the most important point to realise and fully understand is the high price volatility that comes automatically attached to the sector.

Yes, I believe that the global fundamentals support much higher prices but again if you invest for the long term expect plenty of fireworks both up and down.

### More information

- [www.lyxoretf.co.uk](http://www.lyxoretf.co.uk)
- [Wwww.etfsecurities.com](http://Wwww.etfsecurities.com)
- [Wikipedia link on Reuters CRB Index](#)
- [Wikipedia link on Dow Jones-AIG Commodity Index](#)



“If the FTSE opens up or down 100 points it’s hardly news”

## It’s As Important As Ever Not To Think About The Future Direction Of The Markets

Right now all hell is and has been breaking out in the markets. Nobody seems to know from day to day what’s going to happen and if the FTSE opens up or down 100 points it’s hardly news.

Uncertainty breeds fear and fear normally means that most investors expect lower prices. In fact right now if you polled the majority of market participants about where they expect stock prices to be over the next 6-12 months I’d think the consensus would be definitely lower.

The natural inclination of SIPP investors is therefore to most probably hold off investing for now (*if only because they’re scared*), and wait for better prices sometime in the future. But doing this means people are **thinking** and in my experience **thinking is usually why people get sub-optimum investment results over the years.**

In the SIPP book I make the point time and time again that over the long run it’s far better to operate your SIPP fund like a simple computer that’s programmed to buy at regular intervals, regardless of the current market conditions.

Yes, this means that sometimes (with hindsight of course) it would have been better to wait but other times buying when everyone else thinks you’re crazy (including most probably yourself) will prove to be an excellent decision.

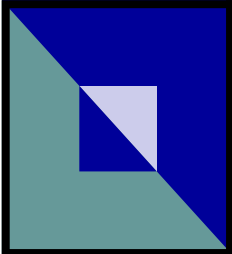
“If you stand back, look at the longer term charts, things don’t look too bad”

## Strong Bull & Bear Arguments Can Be Made Right Now

If you stand back, look at the longer term charts of some of the markets and forget all the current news, things don’t look too bad. In fact, if you’d been on a desert island for the last year and heard no news you wouldn’t believe (on the back of what the overall stockmarket has been doing) that there is a massive global banking crisis.

### American S&P 500 Index—Weekly Chart (April 05 - present)





## FTSE 100 - Weekly Chart (April 05 - Present)

“Bulls can argue that stocks haven’t fallen nearly as much as would have been expected”



Therefore, bulls can easily argue that stocks haven’t fallen nearly as much as would have been expected. On Wall Street for example the market hasn’t even taken out the 2 year lows, although as you can see in the FTSE chart above we are right around 2 year lows at present.

This might mean that stocks have some *hidden strength* and buying this current weakness could be a profitable investment.

The bears however will argue that the current bad news is only going to lead to further negative news so expect a lot more problems over the coming months, hence keeping the downward pressure on stock prices.

“Bears will argue that the current bad news will only lead to further bad news”

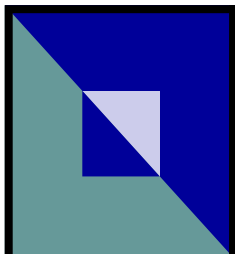
### Summary

Time will tell who is right and who is wrong (maybe both will be wrong and the market trades in a big sideways range for the rest of the year). But I’d strongly advise all SIPP investors who are following the investment strategies I outline in the book to continue **NOT to think and keep adding money to your fund whatever the market does.**

For many of us, retirement is a long way off so what happens in the markets in 2008 is most probably not that relevant.

I hope you’ve enjoyed this Newsletter.

Regards,



“I plan on publishing either bi-monthly or quarterly”

## About The Newsletter

This is the first issue and over the next few months I will be experimenting with the layout and the content.

I am planning to publish either on a bi-monthly or quarterly basis. If you have any comments or want me to discuss anything related to SIPPs or general investing/investments in subsequent issues please don't hesitate to get in contact - [alex@sippbook.co.uk](mailto:alex@sippbook.co.uk)

## How To Manage A Successful SIPP - And Beat The Professional Money Managers

The above is the title of my recent book on SIPPs (Self Invested Personal Pensions).

The basis of the book is fourfold -

1. Continuing to find the right stocks or funds to invest in over many years is actually very difficult, regardless of what many experts in the financial markets would have you believe.
2. Many investors don't realise the true impact that costs play when running a long term investment portfolio. Saving just 1% a year can have a massive positive impact over 10-20 years.
3. I believe that ETFs (Exchange Traded Funds) carry significant investment benefits over the long term in contrast to attempting to invest in actively managed funds which always carry the risk of either underperformance or excessive fees versus actual performance delivered.
4. You don't need exceptional performance from your investments to make decent returns over 10-20 years.

“The SIPP book offers a simple, logical but extremely effective investment strategy”

The SIPP book offers a simple, logical but extremely effective strategy that anyone, even if they have little experience of the markets, can use to run their personal pension.

The reason for having the real potential to beat the professional fund managers is not because better stocks or investments are chosen, rather because **the costs that the professionals charge will normally lead to a drag on long term performance**. I run my personal SIPP with an annual charge of 0.5% whereas I would estimate most SIPPs are being run with charges in excess of 1.75% and some at an outrageous 3%+.

The cost of the SIPP book is £25 (incl. P&P) and it comes with a full money-back guarantee.

[To order visit www.SIPPBook.co.uk](http://www.SIPPBook.co.uk)