Lump sum vs Regular contributions

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25/07/2023

TRULY INDEPENDENT
Financial Advice for Everyone

When planning for your future, consider increasing your pension savings. But should you do this through a lump sum or by raising your regular contributions? In this article, we look at each option.

WHY INVEST IN YOUR PENSION PLAN?
First, it's crucial to recognise the advantages of investing in your pension plan. Saving for your future is essential for your future financial independence and security, and your pension plan is one of the most tax-efficient ways to do it.

Pension tax relief on your contributions, employer contributions (especially if they offer a matching scheme) and investment growth potential are just a few of the benefits of investing in your pension plan. All these factors make contributions to your pension plan an effective way to maximise your savings.

SHOULD I MAKE A LUMP SUM PAYMENT INTO MY PENSION PLAN?
If you suddenly receive a large sum of money, such as an inheritance, work bonus or tax refund, should you invest it in your pension plan?

Exceeding your regular pension contributions can bring you closer to achieving your retirement savings goals. A lump sum payment is a quick and straightforward method to enhance your plan while utilising your pension annual allowance before the end of the tax year.

Investing your lump sum as soon as possible allows it more time to grow, giving you more money during retirement. Additionally, depositing a work bonus into your pension plan could save you on tax and National Insurance deductions.

However, ensure that your payment doesn't exceed your pension annual allowance to avoid tax charges. For the 2023/24 tax year, the pension annual allowance is set at £60,000, and this is the total value that can be paid into all your pensions each tax year before triggering a tax charge. Lower limits may apply if you're a high earner or you've already accessed a pension.

SHOULD I INCREASE MY REGULAR PENSION CONTRIBUTIONS?
If you can't afford a lump sum payment but still want to save more for your future, consider increasing your regular contributions. This is an excellent habit to develop, as even small increases can accumulate over time when combined with tax benefits and potential investment growth. Additionally, regular contributions can benefit from pound cost averaging.

You can also make contributions to your spouse's or partner's pension. These contributions will count towards their annual allowance, not yours – so it's essential to make sure they have enough allowance left before making any payments on their behalf. You can contribute up to £2,880 a year to the pension of a non-earning spouse, partner or child which becomes a contribution of £3,600 into the pension with tax relief.

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WHAT IS POUND COST AVERAGING?
Pound cost averaging involves investing smaller sums at regular intervals instead of a more significant amount as a lump sum. This strategy can reduce the risk and impact of investing a considerable sum just before potential market drops.

Let's say you have £12,000 to invest. If you put the entire amount into the market and then experience a 10% drop over the next year, your investment would decrease in value significantly. However, if you decide to invest £1,000 each month across the year and the market experiences the same drop, you would buy into the market at a lower price each time. This means your overall investment may only decrease by 5% in total.

Of course, if the market rises instead of falls during that period, you'll make smaller profits than you would have with a lump sum investment. But it's important to remember that markets tend to recover long-term. While pound cost averaging might not necessarily yield better returns, it could make it easier for you to handle significant market drops.

It is a valuable investment strategy for those looking to minimise risk and manage the impact of market fluctuations. Investing smaller amounts at regular intervals can reduce losses and maintain a more balanced portfolio.

WHICH OPTION IS RIGHT FOR ME?
Deciding on the best pension strategy for your future can be daunting. Ultimately, your best choice depends on your financial situation, goals and risk tolerance. Take the time to assess your current circumstances and evaluate each option thoroughly. And keep in mind that the last day of the tax year is 5 April 2024; that's your deadline for maximising your pension annual allowance for the 2023/24 tax year.

WANT TO GET YOUR RETIREMENT PLANNING ON TRACK?
By planning ahead and choosing the right strategy, you can secure a comfortable and financially stable retirement. We will dedicate our time, expertise and experience to creating a retirement plan centred on what you want your retirement to be. To discuss your options or to find out more, please get in touch with us.

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