# 360

from **AW Financial Management**

**July 2018**


## In this issue




Welcome to our Summer update and what a Summer it has been already, if you like sunshine and football! World Cup fever gripped the nation and now we can but bask in the sunshine. Apart from the great performances on the pitch, we like many were especially encouraged by the way in which the manager and the team conducted themselves, both on and off the pitch.

## We're Coming Home!

If you are off on your travels over the Summer, you will be taking a keen interest in exchange rates perhaps. When I went to my Bank for my last round of Euros ahead of my annual ski trip in January, the Bank told me that they didn't offer currency anymore and that the best place to go was Asda!

So, if you want Euros today, you'll get 1.126 for every pound. If you are heading to the States, you'll get 1.312 dollar for every pound and if you happen to being going to China, you'll get 8.914 Chinese Renminbi's for every pound. Meanwhile, if you're coming back from Russia, I understand that you would get about 1.2 pence for every Russian Rouble you didn't spend.

## Global Markets & Your Portfolio

It has been encouraging to see good investment returns from all of the portfolios over the last 3 months, recovering from the 'sell-off' earlier this year in February. Economies are still growing globally and in a synchronised manner, with *The Economist* forecasting virtually every economy other than Venezuela to be growing 2019. The US economy has performed particularly well over recent months, with an upwards trend of job creation and output continuing, reflected in the relative pattern of share market returns. The US' 'rival' in their ongoing trade war, China, maintains it's position in the leading pack in terms of global growth, albeit with concerns that there may be a slowdown in growth as the economy gradually transitions from a manufacturing-heavy economy to a consumption-led one.

Our lower and medium risk strategies (both the unrestricted and their ethical counterparts) have performed particularly well over the last quarter, relative to portfolios of a similar risk, benefiting from the good performance of the more defensively positioned equity funds held within the portfolios. These lower risk funds, which can lag the market during a 'boom' period, tend to provide a good degree of protection against downside risk, hence are regarded as 'safer' equity funds for investors who may anticipate notable losses in equity markets. We therefore see these funds as valuable assets to hold in portfolios, especially given the recent uncertainty and volatility in investment markets.

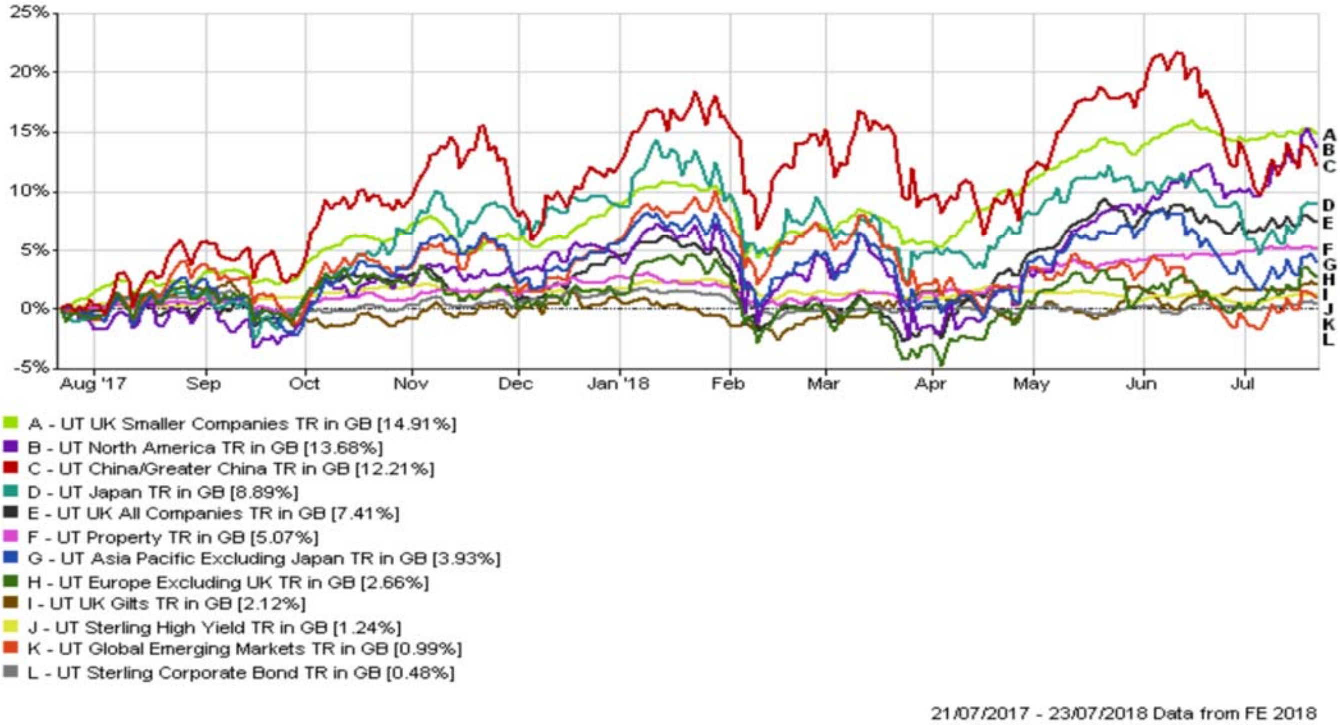
Our unrestricted highest risk portfolio, Strategy 5, continues to produce significant investment returns, benefiting from good stock selection and the higher weighting to smaller companies, both domestically and worldwide.

| Description | AWFM Risk Model | Ethical | | Unrestricted | |
|---|---|---|---|---|---|
| | | 3m | 1yr | 3m | 1yr |
| Cautious Risk | 1 | 1.47% | 2.07% | 2.52% | 1.40% |
| Cautious to Moderate Risk | 2 | 3.05% | 4.71% | 4.59% | 3.08% |
| Moderate Risk | 3 | 4.27% | 6.27% | 4.73% | 4.71% |
| Moderate to Adventurous Risk | 4 | 5.27% | 8.04% | 4.50% | 6.54% |
| Adventurous Risk | 5 | 6.08% | 8.95% | 7.97% | 14.35% |

*" You are my hiding place; you will protect me from trouble and surround me with songs of deliverance" - Psalm 32 verse 7*

# Investment Returns & Outlook

After a soft first quarter we have seen investment performance pick up over the subsequent 3 months, despite the current fragile geopolitical situation. Every investment sector has shown positive returns over the last 12 months, with Equity sectors across the board and the Property sector producing returns in excess of the latest UK inflation rate (bar the Global Emerging Markets sector, which has suffered largely due to the relative strength of the US dollar in comparison to domestic currencies). In spite of the political whirlwind surrounding the Brexit "deal or no deal", UK markets have performed strongly, with the UK Smaller Companies sector at the forefront in terms of performance over the last year. The shares of smaller companies do tend to come with higher risk, and so we continue to allocate an appropriate portion to this area within portfolios, depending on the risk each client is willing to take. For most clients, the allocation to these assets will be relatively small.




Global interest rates continue to 'normalise' (increasing steadily from extreme low points), with the US Federal Reserve increasing the rate twice this year so far, bringing the Fed's benchmark rate to a range of 1.75 - 2.00%, and markets pricing in a rise of the Bank of England's base rate to 0.75% in August. Although this will be a gradual process of rate rises, it is a cause for concern for Fixed Interest (bond) investors. As Central Bank base rates rise, the interest rates available on more secure investments (e.g. bank savings accounts) rise, hence the pre-determined interest rates ('coupon') paid by Fixed-Interest investments become relatively less attractive. For this reason we continue to favour short duration positions (shorter lengths of time over which loans are repaid) for our Fixed Interest funds, which should leave them less sensitive to any proposed and implemented interest rate changes.

Politically Mr Trump continues in his haphazard fashion, deciding daily who will be at the mercy of his morning tweets—whether that be condemning huge domestic corporations such as Amazon, or threatening countries with sanctions such as those that continue to import oil from Iran. The main focus for the President appears to be the imposition of 'Protectionist' policies; taxes on certain goods and services into the US in an attempt to maintain US competitiveness. The trade war with China carries on, with Trump now threatening to impose tariffs on all Chinese imports into the US, stating that he's "ready to go to 500", in reference to the $505.5 billion of US imports from China in 2017. As to be expected China are imposing retaliatory tariffs, which is the likely course of action for any other country or political region targeted by the unpredictable president. It remains to be seen the impact the various global trade policies will have on respective domestic economies, and growth on a global scale—one can never know for sure! We are cautious of a trade war escalating but also mindful that global economies continue to exhibit good levels of growth, along with strengthening corporate profits.

| | | |
|---|---|---|
| POS | A POSITIVE outlook | European Equity; Japan; Pacific Basin (ex Japan); Emerging Markets |
| NEU | A NEUTRAL outlook | UK Equity; UK Smaller Companies; US Smaller Companies; Property |
| NEG | A NEGATIVE outlook | US Equity; UK Gilts; UK Corporate Bonds; Global Bonds |

Aside from the trade war, Chinese authorities have however boosted investor confidence around the globe by announcing a stimulus package comprising of tax cuts and a pledge to use tax policy to stimulate growth. This should help to mitigate the impact of a trade war to a certain extent and bring investor focus back to the current cycle of positive corporate earnings. We do however remain wary of China and whether the Chinese economy can sustain periods of significant growth, given the high levels of debt in China and the desired transition to a consumer-focused economy. As with all these matters, time will tell.

## A Shot Over the Bar? – Inflation/Interest Rate Outlook

The Bank of England Base rate was reduced to 0.5% on the 5th March 2009. So we have had these historic low rates now for nearly 10 years. 2 years ago on the 4th August 2016 interest rates were further reduced to 0.25% as what some would describe as a knee-jerk and perhaps unhelpful/unnecessary reaction to the Brexit referendum vote.

Interestingly, according to the Bank of England's own data, the average rate from 1694 to 1981 was 5.14%, the average rate from 1981 to 2005 was 9.7% and the average rate from 2005 to date has been 3.45%.

The Bank of England's Monetary Policy Committee use interest rates to either curb or encourage inflation to seek to achieve the target inflation rate of 2.0%. Lower interest rates typically encourage inflation which at the present time is 2.4% but of course inflation is measured as the difference in prices over the last 12 months and so you might have already felt the effects of inflation by the time interest rates increase.

The next committee meeting will be on the 3rd August. With the previous vote in June being 6-3 in favour of keeping rates at 0.5% there is growing anticipation of a small rate rise by virtue of the summary from the June meeting: "All members agree that any future increases in the Bank Rate are likely to be at a gradual pace and to a limited extent." The 3 members voting for a rate rise were voting for a rise to 0.75%. Interestingly, the latest member to add his voice to the rate increase argument was Andrew Haldane, the Chief Economist at the Bank of England.

## Pensions – the Long Game!

It was probably the Mirror Group pension scandal created by the late Robert Maxwell which started the UK's deep distrust of pensions. Back in the early 90's Robert Maxwell "borrowed" (stolen?) £400m from the pension fund to try to shore up his company the Mirror Group. Maxwell himself bailed out overboard from his yacht around the Canary Islands at the time and his naked body was recovered from the Atlantic.

Defined Benefit schemes (Final Salary) were established in large numbers on the 50's and 60's. I myself (Martin) am a member of the Barclays Bank 1964 Staff Retirement Benefits scheme. Successive Governments made legislative changes which meant, for example, that as from 1985, pensions needed to be inflation proofed and in 1989 schemes were forced to equalise benefits to men and women.

A further scandal then created by the Tory Government under Margaret Thatcher allowed (encouraged?) workers to transfer out of their Final Salary schemes. There followed a long-standing review of the transfers resulting in billions of pounds of compensation to approximately six million individuals. Financial Advisers at the time were pilloried for their advice which to some extent will have been justified. The responsibility should of course have been shared more equally by the Government and their regulator, who between them were responsible for protecting the public.

The final piece of the jigsaw was that during the 90's and 00's many employers found that they could not sustain the "promises" of increasing pension liabilities and these either saw schemes close or worse, that companies would fold under the weight of the financial pressure of the schemes.

These successive issues saw many individuals shun "Pension" funds and schemes in favour of alternative ways to secure funding in retirement. Many turned to property investments and have done very well, but recent tax changes have made property investment far less attractive.

It is rare for the press ever to comment on the positive stories around pension plans of course, because good news doesn't necessarily sell. But legislation currently prevailing has put pensions in a much better position as a tool to both fund an income in retirement but also to act as a tax efficient way of passing on funds. Furthermore, transfer values for Defined Benefits schemes are up and many are able to consider (with a requirement for specialist advice) whether it is better for them to stay in the scheme or to transfer into a money purchased scheme. Transfer values in excess of £1m are not uncommon.


And if you had been invested in a money purchase type pension for many years? A typical medium risk investment fund over the last 20 years would have turned a £300 per month investment into a fund worth about £109,000. But the tax relief on contributions is important. Over the period, £72,000 gross (20 years at £300 per month) would have only cost a basic rate tax payer £57,600 and a higher rate tax payer would have only parted with £43,200 after tax relief.

Starting saving into a pension fund when you are young does require patience and acceptance that the funds are put away for the long term and can't be passed back to you in the event of pressing needs. The advent of Pension Auto Enrolment has left many employers, large and small with additional responsibilities once again but on the whole we encourage this move to help people, young and old to build their retirement savings and join in the long game!

## BREXIT – an Own Goal for the Tories?

There isn't a lot to say on this topic and I think we, as much as everyone else in the country, are fairly fed up with the ongoing debate. But last week at least we saw some movement, with the resignation of both David Davis and Boris Johnson from the cabinet.

The difficulty for Mrs May now appears to be that she is going to satisfy neither the Leavers not the Remainers and to this extent, we wonder whether the back-pass from David Cameron to Theresa May, could well end up in an own goal. At the time of writing, Dominic Raab, the Member for Esher & Walton had just got his call up to the first team as Secretary of State for Exiting the European Union. However, it soon became clear that his boss would be looking to play the Captain's role with the help of her chief Europe Adviser, Olly Robbins. Mr Raab, therefore, may be left warming the bench and from time to time "deputising" for Mrs May. In his own words and putting a brave face on matters : "there will be one team and one chain of command".

After these disruptions, are we facing the prospect of extra time or will one or other side of the negotiations score a golden goal before the 18th October target date to agree a withdrawal treaty? There's a fairly tight timetable thereafter as the hope is for a treaty to be ratified by both sides in January in readiness for the UK's exit at midnight on March 29th 2019. It remains to be seen whether the Frenchman and European Chief Negotiator, Michel Barnier will be looking to emulate the dominant performance of his countrymen in Moscow of if a score draw will be in everyone's interests.

It's fair to say that it won't be as exciting as the win against Croatia but there's a lot to suggest that it could go to extra time. Let's just hope we're all still friends by the time the UEFA EURO 2020 finals do the rounds of Europe — culminating in a London final just five months before Britain is scheduled in December 2020 to be free of all its obligations to the EU. It would be so much easier for us all if both administrations put forward their best five civil servants to settle matters on a penalty shoot-out!


## Savings and ISAs

National Savings and Investments which started life in 1861 as the Post Office Savings Bank this month reduced the rate on its Direct ISA from 1.25% to 1% as they endeavour to balance value for tax-payers and the needs of savers.

We continue to emphasise the necessity for an accessible cash reserve as part of a sensible financial plan and, although concerns about the stability of UK banks have subsided somewhat since the crisis of 2008/09, NS&I continues to offer good peace of mind combined with a competitive rate. However, rates for all cash savings continue to be sub-inflation (RPI: 3.3%) and, so, a real return on cash remains a remote prospect for some time.

As mentioned earlier in this issue, the last meeting of the MPC remained strongly (6-3) in favour of holding the Base Rate where it is, although hopes (for savers, at least) of an up-tick were raised by Andy Haldane crossing to the other side. We now await with interest (no pun intended!) the outcome of their next meeting.

The alteration to the NS&I ISA rate highlights also the possibility that part of your annual £20,000 ISA limit may be wasted by allocating some or all of it to a Cash ISA. For one thing a recent study by Moneyfacts suggests that ISA cash rates offer, generally, poorer value than standard savings accounts. Perhaps more importantly, for most the tax-free ISA interest earned on even the maximum allowance would have fallen within the (£1,000 for Basic Rate, £500 for Higher Rate tax-payers) savings allowance available outside an ISA. If suited to the saver's risk profile and time horizon the Stocks & Shares ISA alternative offers more effective use of the ISA allowance with scope for both tax-free income and capital gains. What's more a balanced portfolio will currently yield 'natural ' income of around 3% - of course, tax free in the ISA!

## AWFM News

- We are delighted to welcome Molly to the AWFM 'squad' having recently returned from her gap year working with missionaries' children in China.
- A great result for Jack as he scores well on the CII's Investment Principles and Risk paper whilst Sean also passes the Pension transfers paper.

*If you have any questions about this newsletter or your existing investments, please contact us to discuss your situation further.*



**Contact us**
**w: www.awfm.co.uk**
**t: 01322 669059**

**Partners:**
martin@awfm.co.uk
jon@awfm.co.uk
sean@awfm.co.uk

**Administrators:**
nicola@awfm.co.uk
edward@awfm.co.uk
jack@awfm.co.uk
molly@awfm.co.uk

**River House**
**1 Maidstone Road,**
**Sidcup,**
**Kent, DA14 5RH**