360

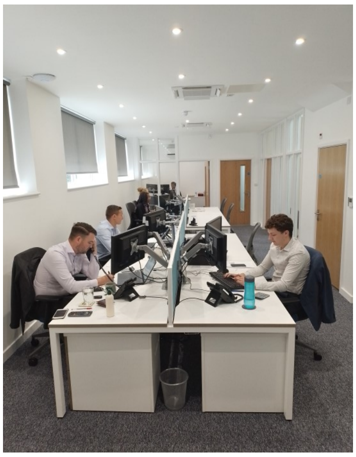
from *AW Financial Management* **Summer 2022**

It seems like only yesterday that we were writing our last 360 newsletter but here we are now in the Summer months, currently basking in the warmth of the sunshine. Metaphorically, economically and politically though, the cold harsh winds have blown in from the north and we find ourselves in an environment where inflation is the key concern not just here in the UK but globally, and we are seeing interest rates rise internationally, in an attempt to quell rising prices, even though the largest part of inflation relates to energy costs. When the North wind doth blow, we shall have snow…..

The Old Exchange—our new Office

Hopefully you received our change of address notification. We moved over the Jubilee Bank holiday weekend. Highlights of the new office are:

The property benefits from a complete re-fit including a fabulous new air-conditioning system, highly controllable and maintaining a very practical working environment whatever the weather, two good-sized meeting rooms with quality Audio-Visual displays, and visitor and staff parking on site.



The property is much bigger than we currently need but it does allow for expansion of the business over the coming years.

We have also purchased a New dedicated Server as part of our relocation.

Each of our Partners has a dedicated office and we have at least one spare office (available to be rented on a serviced office type arrangement).

We still need to do some work to the grounds to tidy these up, but on the whole we are delighted with the result and hope to be able to give you a tour before too long.

In this issue

Global Markets and Your Portfolio

It really has been a difficult last 6 months but in the usual fashion we provide our 3 months and 1 year figures for the portfolios that we manage directly here at AWFM. Even if you are not directly invested in one of these portfolios you will get a feel for the sort of returns that you might expect from a similar risk based portfolio.

Figures are based on values as at the close on 4th July and are shown before platform and advice fees but include the management fees of the underlying funds in each portfolio.

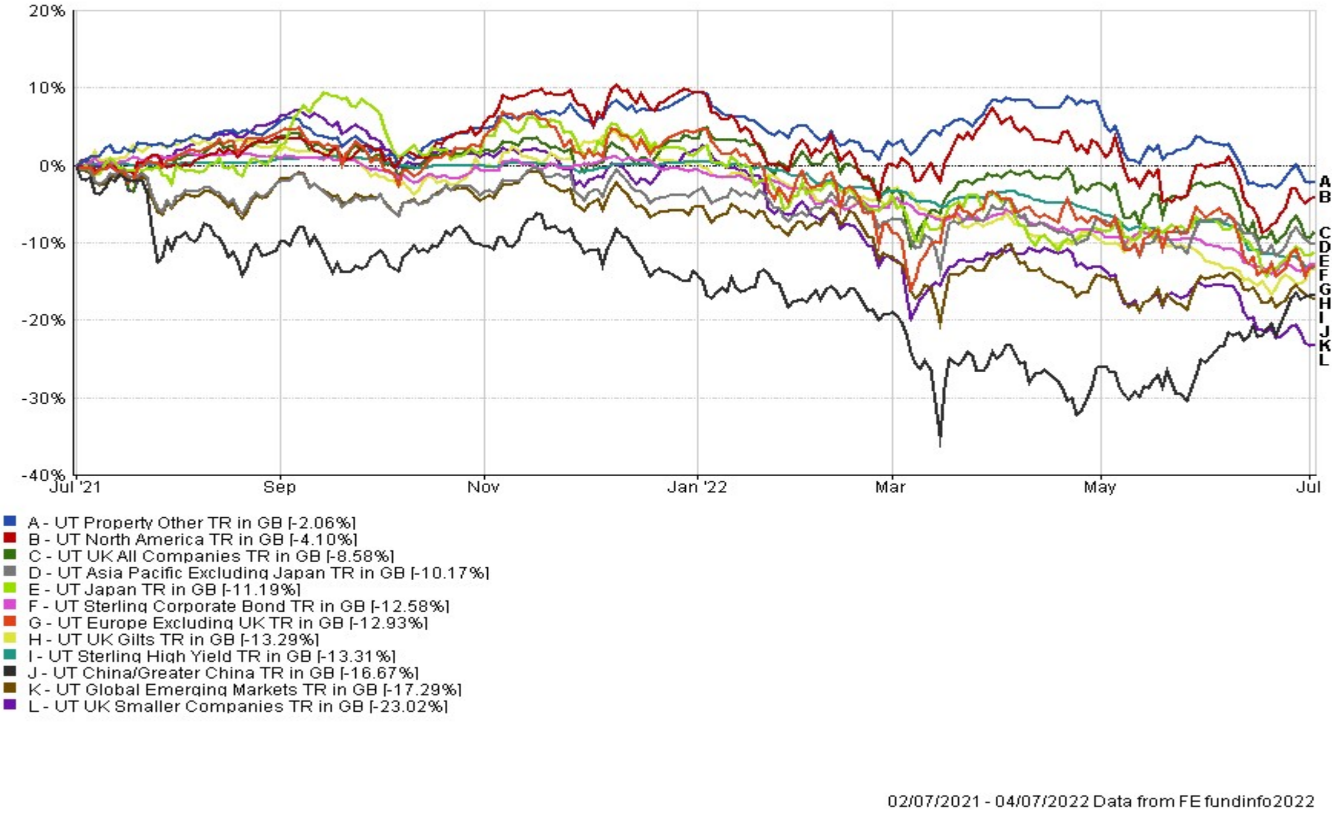
As you will see from the top of page 2, low risk portfolios have struggled especially during this period due to the increase in interest rates forcing down the capital value of fixed interest funds such as Corporate Bonds and Gilts.

Description	**AWFM Risk Model**	**Ethical**		**Unrestricted**	
		3m	1yr	3m	1yr
Low Risk	1	-8.74%	-12.69%	-7.55%	-10.61%
Low to Medium Risk	2	-9.49%	-12.41%	-9.58%	-14.02%
Medium Risk	3	-10.27%	-12.50%	-9.96%	-13.50%
Medium to High Risk	4	-10.46%	-12.98%	-10.83%	-12.44%
High Risk	5	-11.55%	-13.47%	-14.18%	-22.74%

It is clear in this market, more than ever that there is no such thing as "no risk"!

"Let love and faithfulness never leave you; bind them round your neck, write them on the tablet of your heart. Then you will win favour and a good name in the sight of God and man" - Proverbs 3 verses 3&4

Investment Returns & Outlook



From the chart above one can see that Chinese equities and Emerging Markets have been the hardest hit over the last 12 months but the relative safe havens associated with the Fixed Interest market (so Corporate Bonds & Gilts especially) have seen losses in excess of 12.5% over the course of the last year.

It is particularly interesting to note that many of the Equity markets have outperformed the Fixed Interest sectors, despite their higher volatility.

The best performer has been the Property sector although we would expect a tightening economic outlook and higher interest rates to knock this sector too over the coming months.

The highest risk element of the UK Equity market “Smaller Companies” have been the worst performer over the last 12 months but this is largely due to due to the improvement in Chinese Equity valuations in the last month or so.

Negativity continues to surround the Fixed Interest sector especially when taking a consensus view.

Interest Rates & Inflation

The Bank of England currently suggest inflation is running at 9.1% which of course is way above the target inflation rate of just 2%.

The Bank of England Base Rate is now 1.25% having been increased from just 0.1% just before Christmas on the 16th December 2021.

Consequently Instant Access savings accounts have seen an improvement.

According to www.moneyfacts.co.uk the best instant access accounts now offer interest rates of about 1.3% to 1.4% per annum.

Similarly Premium Bonds offered through NS&I are now quoting an estimated annual prize fund rate of 1.4% per annum and this continues to be a firm favourite for many of our clients.

Thank you Ernie!!!

Inflation:

9.1%

Bank Base Rate:

1.25%

What is Capacity for Loss?

Our regulator, the FCA have asked us to assess and reassess a client's "capacity for loss" but what does this really mean?

We know from very first hand and current experience that investment values fall as well as rise. The key question is whether the client is able to weather the storm, hold tight and then (hopefully) benefit from better longer term returns. Of course this links in with their own attitude to investment risk, but the capacity for loss assessment needs to be based on the adviser's detailed understanding of the client's financial position.

A client may therefore have a very low personal threshold for exposure to risk but the capacity for loss assessment by the adviser suggests that the client can afford to take much more risk than the client is initially prepared to. The opposite of course is also true where the client is keen to take on risk but the adviser suggests there is not sufficient scope to be able to bear those losses.

Simple examples might be:

- A couple in their 20's have been saving hard for a deposit on a house but are fed up with getting little or no interest. Although they are hoping to buy within the next 2 to 3 years, they are wondering whether they could invest their savings to achieve a better return. In this case, the adviser would almost certainly advise the couple not to invest because they cannot afford the risk of short term losses in investment values, despite the couple's willingness to try to achieve a better return.
- A client approaching retirement has a pension fund worth £300,000 but they have already accessed a Final Salary pension paying them a fixed and inflation linked pension which is sufficient to meet all of their fixed monthly costs. The client will further benefit from a State Pension in a few years' time which will provide more than sufficient income to cover all of their fixed and discretionary spending. Although this client is very cautious by nature, they do have the capacity to bear losses in investment values and could therefore be encouraged to take on more risk.

Detailed "fact-finding" enables the adviser to provide the very best possible advice to each enquiry.

How do we assess Capacity for Loss at AWFM?

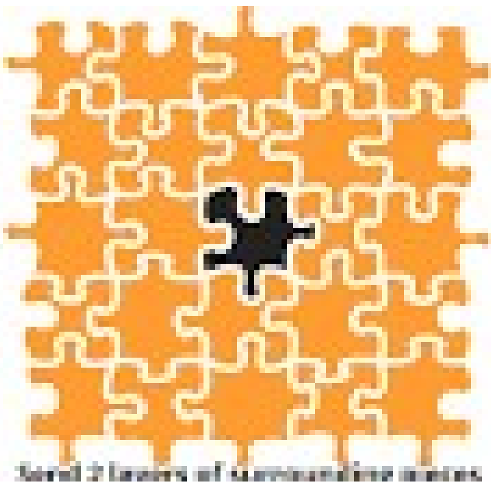
We continually innovate here at AWFM and having been set the challenge of creating a standardised system, we came up with a points based scoring system to help each adviser make an assessment for each client of their capacity for loss. The highest scores suggest a good ability to sustain losses in investment values whilst the lower scores suggest little ability to sustain losses.

<u>Investable assets</u>

Our first assessment is based on the overall assets that a client has at their disposal. This will include Cash savings, Investment funds, Pension funds and any other investment that is not their own residential property. The greater the value of the investable assets, the higher the score. Many clients invest a significant part of their overall asset value in their residential property. According to our data, across all of the clients in the firm, the residential property accounts for 31% of their overall asset value. This leaves the average client with 69% of investable assets, even though they would not necessarily want to invest everything.

<u>Security of Income</u>

Only really felt by those who are in retirement and with a guaranteed pension income for the rest of their lives, we seek to evaluate the approximate percentage of current income that is secure vs the proportion that is less secure. State Pensions, Final Salary pensions etc are secure whilst earned income, investment income or Flexi-Access Drawdown are not secure as they rely on outside factors. The greater the proportion of secure income, the higher the score in our assessment.



<u>Age</u>

Whilst pensioners score quite well on the security of income assessment, it is the younger people who are typically able to take on more risk because they have time on their side to wait for recovery in values to come. Younger people score higher points in this category therefore.

<u>Lifestage classification</u>

Some are accumulating wealth, others are in the consolidation phase where they are neither adding to, not taking from their investable assets, others are using the income produced from their funds to live off and still others are drawing on their capital to provide sufficient income. The higher score is given to those still in the accumulation phase whilst the lowest score goes to those who are drawing down on their capital.

<u>Cash reserves</u>

At AWFM we recommend that clients hold a minimum of 6 months worth of normal monthly expenditure in a deposit account or Premium Bonds etc. This is a minimum and many of our clients hold far greater sums, to offset the risk they are taking with their pension or investment funds. The higher the value of the cash reserves, the greater the score, but this does come with a warning around not over-providing in this area due to the risk of losing value against inflation.

There are 10 areas of assessment in total which help to give a balanced view of a client's capacity for loss and deliver us a percentage based quantifiable result that we can use as the basis of our discussions around risk.

Mr & Mrs Average?

We've been putting more and more information into our bespoke client database and have started to look at the results that this produces , averaged across our clients. We have always wanted to deal with a wide range of clients in different lifestages and from different backgrounds and with varying financial profiles. But we thought you might be interested to see some of the averaged-out results that we are now able to access across all of our clients. For example:

- The average net income across all of our clients on a monthly basis is £4,700 per month.
- The average value of cash savings is £178,110.
- The average residential property value is £792,253.
- The average total asset value (including the residential property) is just over £2.5m.
- The average value of Pension funds is £334,000 and the average value of Investment funds is £331,000.
- Clients have other investments assets such as second properties, and business assets etc averaging out at £921,000.

In reality everyone's situation is different, although similar financial planning principles will apply. We continue to seek to provide the very best advice to each and every client, no matter what their financial situation may be.

We are continuing to actively engage with new clients and if you have friends or family members who you think would benefit from our services, and you want them well looked after, please do feel free to recommend us. We really appreciate your confidence in us and value each and every introduction.

How much is enough?

With markets currently in a "fasten your seatbelts" period of such turbulence some are wondering whether the resources they have at their disposal are sufficient to keep them going for the rest of their lives. Inflation has sky-rocketed and capital values are depressed leading to a concern as to the adequacy of "retirement" provision.

Often the dilemma that individuals face is that they want to provide themselves sufficient inflation proofed income for the rest of their lives and yet:

1. They don't want to "over-provide" and keep working unnecessarily especially if they are no longer enjoying the work they do.
2. They don't know what their spending pattern will be over the longer term.
3. They don't know for how long they will need the income and access to capital because they don't know how long they are going to live for.
4. They don't know if they are going to have increased spending during later years in the case of long term care.

Although cash-flow modelling has its limitations therefore, it can be a useful tool based on certain key assumptions, as to whether an individual or couple has sufficient assets. Typical assumptions for example might include the ONS data on life expectancy. The author of this piece put his and his wife's ages into the life expectancy calculator and it revealed the following result:

- Average life expectancy for him is 84.
- There is however a 1 in 4 chance of him living to the age of 92 and a 1 in 10 chance of him living to the age of 97.
- He has a 3.8% chance of living to 100.
- His spouse however has an average life expectancy of 87 (living a full 6 years longer than him).
- She has a 1 in 4 chance of living to age 95 and a 1 in 10 chance of living to 99.

It is right that cash-flow modelling takes this statistical information into account to try to help clients answer the fundamental question of whether they have enough now. However, it is also necessary to look at the way markets react in different circumstances to really get a good grip of the effect of withdrawals on a pension and/or investment fund.

With the software that we use we can simulate withdrawals based on various different starting points to try to assess the impact of the income on the overall fund value, using actual historic data and returns.

Retiring just ahead of the dot.com bubble bursting in 1999 therefore would produce worrying results to date whereas retiring just a few years later would have yielded far better returns.

And regular reviewing of finances and financial planning is essential, as always!

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

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

Support Staff:
harin@awfm.co.uk
nicola@awfm.co.uk
edward@awfm.co.uk
jack@awfm.co.uk
kiki@awfm.co.uk
zack@awfm.co.uk

The Old Exchange,
3 London Road,
Farningham,
Kent
DA4 0JP