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WEALTH MANAGEMENT

Newsletter

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Stay Rational

The returns on investments have been good over the last 12 months and, generally, from the financial crisis nearly ten years ago. This doesn't fuel optimism for everybody and there are two issues.

The first, which has given cause for a few questions recently is Brexit. This is the easiest to deal with, whilst we might debate the positive/negative consequences on our own politics, economy and how it affects inflation, it is of less consequences globally. In the context of a diverse portfolio we shouldn't be egotistical about our own importance.

Even if we consider UK stocks in isolation, their fortunes as a whole group are significantly affected by global interests.

The second issue is that there will be no end of articles pointing at how high valuations are, and why this should lead to the next "Bear" market when prices fall. This is complicated, as looking at many measurements in isolation can give a false sense of security or an irrationally pessimistic conclusion.

How should you react to this? The problem is knowing WHEN markets will move in any direction. Economist Butons Malkiel's famous book *'A Random Walk Down Wall Street'* sums up the nature of stocks in the title and further emphasises how trying to capitalise on short term is like throwing dice. If you believe in the alchemy of predicting when to leave and enter a market, your run the risk of being out of the market when the rises occur or locking in losses.

Investing for the long term is a different beast. Aside from investment fundamentals there is a great deal to be gained from avoiding behavioural pitfalls and adopting the right psychology. Bull (rising) and Bear (falling) markets are as certain as taxes and death. They are not going to matter as much over time providing the portfolio is suitable to the intended timing of income withdrawals etc.

The rational investors understand the rise is of no consequence to the destination. In the words of the late Benjamin Graham *"In the short run, the market is a voting machine but in the long run, it is a weighing machine".*

Inflation gets complicated

After an extended period of exceptionally low inflation and low interest rates, Inflation is on the rise and interest rates seem set to rise, albeit slowly, in response on both sides of the Atlantic.

But inflation affects different people in different ways, and there are several alternative ways in which inflation is measured.

The Retail Prices Index ('RPI') was created in 1947, when the typical shopping basket consisted of items we barely recognise today: rabbit meat, cod liver oil, tinned salmon, lamp oil, condensed milk and men's and women's hats.

Reflecting the very different lifestyles of today, these items are no longer included among the 700 items whose prices are now measured by the Office for National Statistics to calculate RPI, the latest additions to which include gin and non-dairy 'milk' drinks.

A second inflation index, the Consumer Prices Index ('CPI') was introduced in 2003. This comprised a different basket of consumables from the RPI and excluded mortgage interest payments. CPI is on average 1.2% lower than RPI, and has been adopted by the government to calculate welfare payments and pensions, thus reducing the burden of these expenditures on the State.

The Royal Statistical Society has calculated that the adoption by the government of CPI rather than RPI in calculating public service pensions will reduce their value by £30,000 over 25 years, assuming RPI of 3% and CPI of 2.33%

The Chancellor announced in his November Budget that CPI will in future also be used to peg business rates and to determine annual investment limits for junior ISAs and trust funds, the capital gains tax exemption and the lifetime pension savings allowance, which will rise to £1,030,000 for 2018/19. However, RPI is still used in determining rail fares, alcohol, student loans and index-linked gilts (government bonds).

To further complicate the issue, the government has now created a variant of CPI called CPIH (H for Housing). This includes the cost of renting a home but not the average mortgage payment. Consequently, it does not reflect variations in house prices. These are dealt with in yet another index.

People's age, location and food preferences will all affect the impact of inflation. Pensioners will be affected disproportionately by increases in food and energy costs, and they are consequently less well served by CPI.

People living in rural communities, on the other hand, will be more affected by the price of fuel, which is included in the RPI. Most people will have little idea of which index relates most closely to their lifestyle, but it is the government which is best placed to play the system in what it regards as the national interest.

Pension sharing on the rise

Pension rights are usually the second most valuable asset, after the family home, which need to be considered on divorce, and three options are available to divorcing couples:

- Pensions can be off-set against other matrimonial assets
- Courts can make Attachment Orders, directing pension trustees to pay all or part of the pension to the ex-spouse on retirement or death
- Courts can make pension sharing Orders under which benefits are transferred at the time of the divorce.

Figures produced by the Ministry of Justice show that the number of pension sharing Orders rose from 8,027 in the year to March 2016 to 11,503 in the year to March 2017.

Legal experts ascribe the increase largely to the increased size of pension pots. The average transfer value of a final salary scheme is now more than £210,000. This makes offsetting less practicable, though pension sharing does involve higher costs.

George Osborne's 'pension freedoms' have also had an effect. It is no longer necessary to apply pension funds to buy annuities, and a shared pension could now be withdrawn in the form of cash.

Another factor favouring sharing is that Attachment Orders leave ownership of the pension and the control of benefits in the hands of the ex-spouse scheme member.

Market Commentary

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4th Quarter 2017

Equities

In October, synchronised Global Growth saw continued price rises, with many Indices reaching new all-time highs and a continual collapse in realised volatility,

In the UK, CPI Inflation rose to 3%, a 5-year high, whilst wages continued to lag, confirming the real income squeeze being felt by consumers; retail sales fell by 1.2% on the year, half the level recorded in August.
Despite this, however, the FTSE All Share Index rose 1.9%, with Mid-Caps (FTSE 250) slightly outperforming (+2%).

Europe (ex-UK) returned 2.3% as economic optimism out-weighed both the reduction in the ECB's much-anticipated bond-buying program and the outcome of the Catalonian referendum (and subsequent Declaration of Independence). Spanish equities and bonds both lagged the regional markets as political uncertainty once again came to the fore.

November, equities showed more regional variation than of late. US shares rose (the S&P 500 was up 3.1%, with smaller cap stocks doing even better), despite the Fed's insistence that a December rate hike was still a probability, a view reinforced by strong job growth.

Not helping was the failure to cobble together a "Grand Coalition" in Germany, after an inconclusive election result. Nevertheless, economic data, (Purchasing Managers Indices and Unemployment rates. Pointed to further growth ahead, tempering the negativity. In the UK, the first Interest rate hike in a decade, (with hints of more to come in the next 2 years) caused the Pound to rise, leaving the FTSE All Share Index down 1.7% on the month, as Brexit negotiations dragged on.

Overseas earning Companies bore the brunt of the selling pressure, though Oil firms fared slightly better as Oil prices rose, boosting reported profits during the period. Japan saw some profit-taking too, as the Topix Index reached the highest levels for 26 years, but still ended up 1.5%. Asia ex-Japan fell 0.2% as weakness in US.

Technology late in the month spread to their Asian counterparts. Emerging Markets equities lost 0.8%, (though the year-to-date performance is still +27.7%), dragged down by sharp losses in Chile and (again) Turkey. December saw the Fed follow through on its threat/promise to raise Interest rates, but markets yawned and continued their rise; the MSCI World Index was up 1.5% on the month, with all regions participating. The UK All Share Index taking the laurels with a 4.8% gain, closely followed by EM (Latin America), up 4.5%. Global EM and Asia (ex-Japan) saw gains of 3%, the S&P 500 was up 1.1%, whilst the laggard was Europe (ex-UK), which rose only 0.3%, dragged back by weakness in Spain and Italy (on continuing political concerns). China too, (basis the Shanghai Composite) underperformed Emerging Markets as a whole on news that the Government was trying to rein in credit creation (though we shall have to wait to see how committed they are to this aim).

Bonds

October saw European bond yields overall fall. Markets were encouraged by the ECB's stated willingness to intervene further, should growth weaken.

US 10-year bond yields rose 5bps, while the shorter end (2 years) rose 12 basis points. UK Gilt yields fell by 0.02- 0.3% across the curve. Emerging Markets bonds did best, however, rising by 2.8% in local terms, helped by the weakening Dollar, as Investors rotated out of the USD equivalents, which rose only 0.4% in the period.

Corporate bonds outperformed Government equivalents as the spread between the two narrowed further.

In November, US Government bond yield curves flattened, as shorter-dated bond prices fell. In the US, 10-Year yields were up 3bps, whilst 2-year yields rose 18bps, in response to news of progress on the Tax Reform programme, which would improve growth prospects and thus the continuation of interest rate normalisation by the Fed.

In the UK, Gilt yields fell a little despite the Bank of England's rate hike as the accompanying "guidance" was deemed dovish, spurring the idea of "one [rate hike] and done" for the UK. In Europe, German yields rose a little as talks to form a German Government coalition stalled, but Italian bonds rose 0.6% on the month as political worries eased a little as the prospect of early General Elections receded somewhat.

Corporate bond returns were broadly in line with their Sovereign equivalents on the month, but both High Yield and EM Bonds saw declines of around 0.3-0.5% respectively. Sterling I.G and HY bonds both underperformed Governments, whilst the big winner for November was Inflation Linked Bonds, which rose 1.7%.

Continuation of the positive growth story globally was presumably the main catalyst for this, but with negative yields-to-maturity, there does not appear to be much value to be had in this strategy.

The massively anticipated Fed rate rise in December (the day before the event, Fed Funds 3 futures prices implied a 98.8% chance of a hike of 0.25%) went off without much ado. Bonds globally were mixed.

At the Corporate level, US Bonds (both Investment Grade and non-IG), beat their European equivalents.

Property

In the first month of the Quarter, Property prices generally rose, but the growth was concentrated in Asia; Asia ex-Japan and Japan itself rose 2.5% on the month, whilst Developed markets were only marginally positive (+0.5%). The UK and the US fell slightly, by around 0.2%.

November saw almost the exact opposite, as Asia ex-Japan fell by 1.5%, whereas Developed markets rose by just under 1% in the period (Developed World Property +0.8%, Developed Europe was +1.1%). As has become commonplace recently, the UK was at the back of the pack, rising a scant 0.14% on the month.

December finished with another regional performance inversion, as the UK (+8.2%) led the field. Most other regions saw rises of 3% or more, with only Japan and the US falling, but by less than 1 percent on the month. Global Property rose 1.8% overall in December.

Example Returns

Shown below are 4 portfolios out of 21 numbered according to their percentage exposure to equites & property

Aspen EBIP Portfolio	40	60	80	100
This Quarter %	2.28	3.29	4.27	5.23
12 months %	5.11	7.66	10.20	12.74
36 months %	16.60	23.89	31.47	39.34
60 months %	28.94	41.72	55.44	70.14
120 months %	58.02	69.75	79.94	87.99

Notes to table' Based on Models Net of adviser and Investment Charges for portfolio worth under £1M. Individual returns may vary accordingly to asset allocation and timing. Past performance does not determine future return. Investments can fall as well as rise