EQ investors

Newsletter

Summer 2015

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There has been further expansion at EQ in recent months and some tremendous press coverage. The UK CEO of one of the largest global wealth management groups told me recently that EQ is "the talk of the town". That's very flattering but now we have to deliver on our promises to set new standards, not just in terms of integrity but also in respect of service and performance. It won't be easy (it never is) but when I look at the quality of our team and the level of enthusiasm I can't be anything other than optimistic.

We have now launched **EQ Bespoke** to manage client portfolios larger than £750,000. You can read more about that on page 2. In the autumn we will launch **EQ Direct** which will accept amounts from £15,000 upwards and will offer fantastic value for money.

Parallels between sport and investment fascinate me. Both activities are highly competitive and losers don't survive long. Past performance can be analysed in considerable depth but doesn't guarantee the future. This is partly because the skill of the practitioner is not the only factor, luck also comes into play, especially in the shorter term.

There can be some interesting strategic similarities. For casual players, tennis and golf are 'losers' games' – the winner will usually be the person that makes the fewest mistakes. However, it's very different at the elite level; unforced errors here are relatively rare and so the winner has to take risks with a more adventurous approach.

You can draw a similar distinction with investment strategies. Successful investing in equities requires a relatively aggressive approach, being prepared to take risks, albeit in a calculated way. Whilst the professional investor clearly tries to avoid losers, there is always the comfort that winners can more than make up the shortfall. In contrast, fixed interest is very much about avoiding losses since the maximum return from any bond is always capped. In the current environment of record low yields from bonds this creates a dilemma for wealth managers because the downside risk is much greater than in the past.

I hope you enjoy reading this newsletter. As always, we welcome your feedback.

John Spiers

John Spiers

Chief Executive

2.

Investor behaviour: when inaction is best

By **Toby Walker**

Every once in a while most of us get a strong feeling that markets are going to move, usually in a downwards direction. When that happens we are tempted to take risk off the table by selling all, or part, of our portfolios. Sometimes this works out well but when it doesn't we are loathe to face up to our error. That's because human brains cope badly with failure – we take mistakes personally and hate acknowledging them. The result is that we often do tremendous harm to our investment returns.

"Human brains cope badly with failure, we take mistakes personally and hate facing up to them"

Every year the Dalbar Quantitative Analysis of Investor Behaviour ("QAIB") measures the returns actually made by US investors in mutual funds, taking account of their decisions over when to buy and sell, as well as the underlying performance of the funds. Since most funds fail to beat the index after charges we would expect to see a modest degree of underperformance.

What the survey actually shows is a massive and consistent trend of poor returns. In 2014 alone, whilst the S&P 500 delivered 13.7%, equity mutual fund investors only made 5.5% - an undershoot of more than 8%. Over longer periods of time the same trend is clearly apparent.

"Attempts to time market movements result in considerable damage to returns"

The conclusion seems unambiguous – attempts by investors to time market movements result in considerable damage to returns. Interestingly, a more detailed part of the survey suggests that US investors get timing decisions right more than half of the time; the trouble is that the losses from the bad decisions greatly outweigh the gains. The successful trading bets encourage confidence that we know what we are doing but when it goes wrong we are late to face up to a bad call. By the time we do, markets have risen sharply and the lost returns can be huge.

One of the most critical parts of the EQ advisory process is to assess clients' attitude to risk and make sure that you are comfortable with the characteristics of your portfolio. No-one can predict accurately when markets will enter a period of turbulence. Our aim is to make sure you do not panic when that happens, because the evidence suggests that can cause huge damage to returns.

	Actual Investor Returns[1]		Index Returns	
	Equity Funds	Fixed Income Funds	S&P 500	Barclays Aggregate Bond
30 Year	3.79	0.72	11.06	7.36
20 Year	5.19	0.80	9.85	6.20
10 Year	5.26	0.69	7.67	4.71
5 Year	10.19	1.21	15.45	4.45
3 Year	14.82	0.72	20.41	2.66
12 Months	5.50	1.16	13.69	5.97

Source: Dalbar. [1]Returns are for the period ending 31 December 2014. Average equity investor and average bond investor performance results are calculated using data supplied by the Investment Company Institute. Investor returns are represented by the change in total mutual fund assets after excluding sales, redemptions and exchanges. This method of calculation captures realised capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. After calculating investor returns in dollar terms, two percentages are calculated for the period examined: total investor return rate and annualized investor return rate. Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions and exchanges for each period.

New service launch: EQ goes Bespoke

In May we launched our new investment management service for clients with total portfolios in excess of £750,000. Clients will have a dedicated investment manager who can personalise the portfolio to optimise individual tax circumstances and preferences. For example, we can ensure that investments generating taxable income are favoured in an ISA while the general investment account is focused on capital growth. We can also try to ensure that annual capital gains tax allowances are fully utilised.

Bespoke portfolios have access to a wider range of investments than our model portfolios, including structured products and investment trusts. This provides an opportunity to benefit on occasion when shares are trading on excessive discounts to net assets and to participate in some more esoteric investment themes.

The Bespoke team will also be handling institutional accounts, for example charities and trusts. Each of these requires a specialist approach to reflect the specific needs of the organisation.

"We have been very fortunate to attract a strong team"

The Bespoke Team

We have been very fortunate to attract a strong team to provide this service. Mike Neumann, formerly Director of Investment Management at Bestinvest, will be joining as head and we already have two highly qualified portfolio managers, both well known to us.

3.

Making an impact

By **Damien Lardoux**

It's almost three years since we launched our managed Positive Impact Portfolios ("PIPs") and they have been a terrific success, both in terms of performance and popularity. So much so that a number of other wealth managers have also started recommending EQ's PIPs to their clients.

"Ethical investors used to pay a financial penalty for keeping true to their beliefs"

As the name suggests, PIPs are designed to emphasise investments that are expected to have a beneficial impact on our environment and society but they are also about selecting investments that are expected to deliver good returns.

Until recently investing with a conscience meant excluding certain opportunities from your portfolio because they did not comply with the ethical criteria. Typically these would be investments in tobacco, armaments or mining, which would lead to periods of underperformance when such sectors were regarded as offering good value. This meant that ethical investors used to pay a financial penalty for keeping true to their beliefs. Inevitably that greatly reduced the attractions of ethical funds.

More recently a new approach has emerged: making a positive commitment to companies that are clearly trying to do good, as well as maximising their financial returns. This is a much more attractive concept. Many of these companies operate in growth sectors and their higher standards of corporate governance should lead to less risk of fines from regulators as well as more engagement from staff.

This is exactly the approach that our Positive Impact Portfolios follow. Launched almost three years ago, they have a unique fund selection process developed by the EQ Investors research team. Each portfolio holds 20-25 funds, covering bonds as well as equities.

PIPs are eligible for ISAs and SIPPs as well as general investment accounts. If you care about how and where your portfolio is invested then speak to your adviser about the merits of switching. They have recognised the strength of the unique fund selection process developed by our research team.

"Other wealth managers have started recommending EQ's PIPs to their clients"

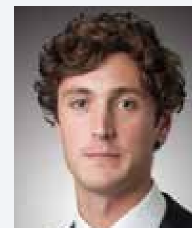
Late 1700s	1928	1960s	1970s	1980s	2009	2012	2013	2014
Religious investors in the US refused to invest in tobacco, alcohol, slave trading	US Pioneer Fund became the first mutual fund to screen out sectors	During the Vietnam War, push for screening out armaments companies	Apartheid in South Africa led to the first negative screening of a country	SRI Investments by churches, universities + launch of thematic ethical funds	Global Impact Investment network formed	EQ Positive Impact Portfolios launched	National Impact Initiative launched by G8	Social Stock Exchange set up, Social Investment Tax Relief introduced

Andrew Rees

Andrew joined EQ Investors from Bestinvest where he was an Associate Director of Investment Management. Andrew's area of expertise is managing bespoke portfolio mandates for private clients, Trusts, Charities and large Family office accounts. Andrew has over 13 years of professional experience.

Andrew has a Masters in Wealth Management from the Chartered Institute of Securities and Investment, an MSc in Finance and Investment from BPP Business School in London and a BA from McGill University in Canada.

Daniel Bland



Daniel joined EQ Investors from Quilter Cheviot, where he managed private client portfolios and developed expertise in specialist fixed interest and equity mandates.

He began his career in Financial Services at RBS after graduating from the University of Nottingham, subsequently joining the investment team at Bestinvest and has over 7 years' experience as an Investment Manager. Daniel has a Masters in Wealth Management from the Chartered Institute of Securities and Investment.

4.

Investment Outlook: searching for value

By **Kasim Zafar**

At the time of writing the financial problems in Greece are headline news but less well known is that Greece has defaulted on its sovereign debt several times in the past, five to be precise. In the modern era, the combined length of time that Greece has been in default of one form or another is 90 years!

"One market that does seem to offer genuine value and improving prospects is Japan"

"We are keeping our bond weightings at the bottom end of the permitted range"

Equities – a bit of a mixed bag

We analyse a number of valuation metrics, with our preferred measure being the Cyclically Adjusted Price/Earnings ratio which averages corporate profits over the past ten years."

"We find at a headline level the US market looks expensive, and to a lesser extent so do the UK and Europe, but we do believe there are good opportunities in some sectors, such as technology. The lack of value in equities needs to be balanced against the unattractive state of the bond market and the derisory returns from cash. One market that does seem to offer genuine value and improving prospects is Japan, which we discuss on page 5.

In the UK, uncertainty from the General Election has been replaced with concern about the potential for Brexit after the Europe referendum. We think that it is highly unlikely but the UK faces serious issues, notably with its stubbornly high trade and public sector deficits plus the lack of growth in productivity.

Fixed Interest – still overpriced

We continue to believe that Bonds offer terrible value. In many cases yields are actually negative, so investors are guaranteed to lose money for the privilege of holding these bonds for a full term. Even in those regions where a positive notional return is available, such as the UK and USA, these nominal yields only make sense if inflation remains extremely low and the ability of governments to repay is beyond doubt. We are sceptical and believe the most likely outcome will be a resurgence of inflation at some point. Therefore, we are keeping our bond weightings at the bottom of the permitted range and investing mainly through those bond funds which allow the managers to achieve positive returns even if market conditions become adverse.

Property – beginning to lighten

Our overweight position in property has been very successful in recent years. Yields are now down at levels that historically have seemed expensive but with favourable conditions for tenant demand and the extremely low level of bond yields we remain generally positive. However, the price of property funds can swing by more than 5% depending on whether buyers or sellers are in the majority. Since no-one can predict the timing of that change in sentiment accurately we have begun a steady programme to pare back our position over the next year.

Alternatives – Global Macro & Long/Short favoured

We are running above average exposure to these funds as a direct result of our lack of enthusiasm for Fixed Interest. Within the various investment sub-strategies we feel most positive about Global Macro and Long/Short equity strategies. Cross asset market volatility has increased and this should lead to a more favourable environment for the former. Meanwhile, although stock dispersion has recently decreased due to elevated macroeconomic risks, it remains at levels that are attractive for stock pickers, favouring the Long/Short managers.

Commodities – opportunities for shale producers

The slowdown in Chinese growth has had a big impact on demand for industrial metals and we see little sign of an improvement for a while. Soft commodities such as food could have a spike upwards as the latest El Niño impacts but this is a theme that is hard to play successfully. We did increase our exposure to Energy late last year. Even if oil prices stay relatively subdued, our analysis suggests that the prospects for US shale producers are undervalued as they have been very successful at reducing their production costs. As a result the US has become a 'swing producer' alongside the Middle East.

5.

Investment spotlight: land of the rising sun

By **Josh Seager**

After a prolonged period of hardship it's hard to recall that back in 1990 Japan appeared on the verge of taking over as the dominant economic powerhouse. It has now embarked upon radical economic reforms that have been described as the Three Arrows of Abenomics, after Shinzo Abe the prime minister. These radical measures could bring back at least a glimpse of the good times.

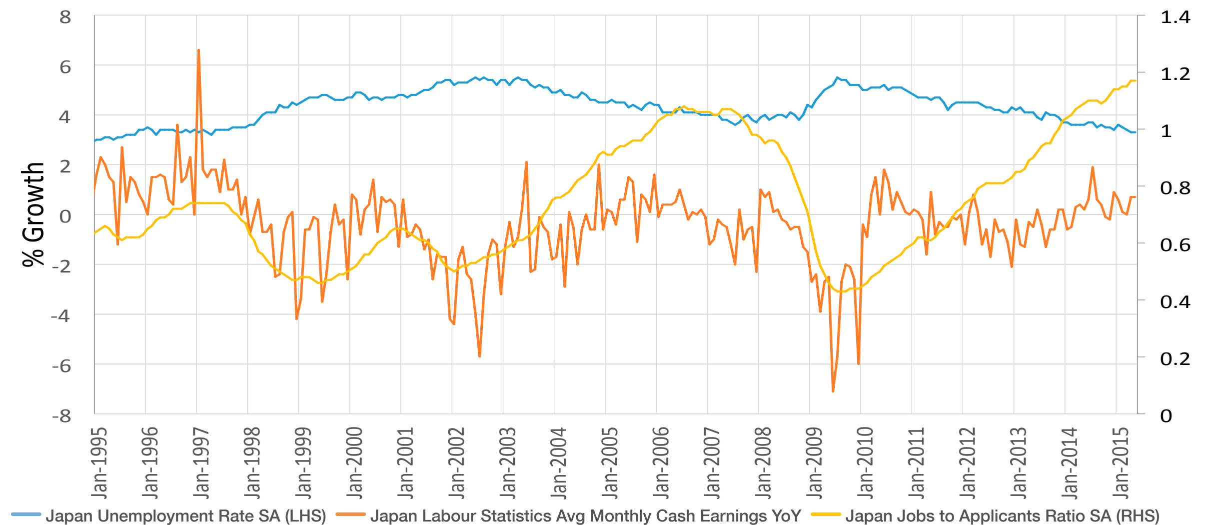
The 3 Arrows of Abenomics

- ➔ Massive quantitative easing
- ➔ Fiscal stimulus
- ➔ Structural reforms

"Japanese companies have often been notoriously unfriendly towards shareholders"

Twenty years of deflation have led to an environment in which there is no incentive to spend as goods keep getting cheaper. Therefore one of the key policy objectives has been to create inflation. We are now seeing a modest uptick and the effects have begun to feed into retail sales. More money travelling through the economy has enabled corporates to hire additional people and reduce unemployment.

Exporters have so far been the largest benefactors of Abenomics as a result of the devaluing Yen. We anticipate that, as exporters start to distribute some of their increased earnings via increasing salaries and bonuses, consumers will begin to spend more domestically. At this point, corporates who are more reliant on domestic consumers will start to feel the benefits of the economic reforms.



"On a number of valuation metrics, Japanese equities look cheap in comparison to other developed global markets"

This should increase disposable incomes, willingness to spend and, in turn, corporate profits.

Many Japanese companies have been notoriously unfriendly towards shareholders and generated poor returns on equity, not least because they have been hoarding cash. As part of a range of measures to change corporate culture the JSX Nikkei 400 share index has been created. Membership of this is restricted to companies that score most highly on a range of criteria that include return on equity and the appointment of independent directors. There are encouraging signs that this is beginning to have an impact.

Large cash reserves, low dividend pay-out ratios plus growth in earnings make a compelling argument for strong dividend growth and share buy backs which should translate into positive equity market performance.

Attractive valuations

On a number of valuation metrics, such as price to book and cyclically adjusted price/earnings ratios, Japanese equities look cheap in comparison to other developed global markets and to their own range of historical values.

Conclusion

We believe that an improving macro-economic environment, favourable valuations and structural reforms make Japan a relatively attractive place to invest. As with any investment, there are downside risks. Previous attempts to revive the economy have failed, government debt is massive and the working population is declining. However, Shinzo Abe's government have shown themselves to be committed to stimulating inflation and growth within the economy, both of which should be positive for the equity market. On balance, we believe that they are likely to achieve this and have increased our portfolio allocations to Japan.

Pensions: more changes on the way

By **Katharine Lindley**

The framework around pensions has been revolutionised over the past year. For those over 55 there is now great flexibility over withdrawing funds but at the same time the tax efficiency of passing pensions on to children and grandchildren has increased the temptation to use these funds as a vital part of IHT planning. Whatever your situation it's almost certain that you need to review your strategy.

"There is little incentive to take risk if you are going to be taxed at up to 55% on the upside."

"It's likely that the present availability of tax relief at up to 45% on contributions will be curtailed."

Cap on Additional Relief likely

It's likely that the present availability of tax relief at up to 45% on contributions will be curtailed. The Conservative's manifesto proposed a reduced Annual Allowance for those with incomes over £150,000, tapering from £40,000 to £10,000. **For high earners who have scope to accelerate pension contributions ahead of the 8 July Budget, it is worth doing so.**

Lifetime limits can cramp investment

The Lifetime Allowance will reduce to £1m from April next year; a significant cut considering it was £1.8m from April 2010 to 2012. To the intense annoyance of many, including new Pensions minister Baroness Ros Altmann, the limit is based not on how much you contribute but on the value of the funds. So you get penalised for good investment performance, which makes planning very difficult. The LTA will rise with inflation from 2018 but this is inadequate protection against pension fund growth.

Take the case of someone aged 40 with a current fund size of £300,000 who is contributing £460 per month after tax relief. If the fund generates an annual return (after charges) of 5% then the fund will have reached £1m by age 60. However, if annual inflation averages 2.5% then the LTA might be £1.5m in 20 years' time in which case monthly contributions could increase from £460 to £1,700 before being caught.

What can you do?

If you are approaching the limit then almost certainly you should be looking to change the investment strategy to reduce downside risk. There is little incentive to take risk if you are going to be taxed at up to 55% on the upside.

Those who currently have plenty of headroom might be surprised how easy it is to breach the LTA. Take the case of someone with 10 years until retirement, a current pension fund of £675,000, making monthly savings of £500, their fund could exceed the indexed LTA by retirement.

With so many changes to rules on how much you can save each year and the pension fund you can build up, there is a danger that people will delay retirement planning until it's too late. **The sooner you start saving, the better your chances of a comfortable retirement.** For someone in their 20s, if they contribute £660 per month and the fund generates an annual return of 5%, their fund could be worth £1m in 40 years' time. If they delay pension saving until their 30s, then they would need to save just over £1,200 per month to build a £1m pot.

Novia relaunch their online portal

If you have an EQ account with Novia then it's worth checking out their new website. In addition to current values and details of holdings it shows the trend of valuation over the past 12 months. You can access it simply by clicking on the button at the top right of the EQ website. You will need a client number and password. Call us if you have mislaid these.

Social Investment: ready for take-off

By **Sophie Muller**

The UK is a world leader in developing innovative forms of financing for social enterprises. This is understandable given that these social ventures employ over 2 million people and contribute £55 billion to the UK economy. Social Investment Tax Relief has been introduced to try and stimulate involvement in financing these activities from private individuals. In this introductory article we look at the key issues.

"EQ intends to be active in this market, both in terms of helping clients to identify attractive proposals and making investments ourselves on behalf of the EQ Foundation."

The UK is a world leader in developing innovative forms of financing for social enterprises. This is understandable given that these social ventures employ over 2 million and contribute £55 billion to the UK economy. In the past we either had investments (made in the expectation of a financial return) or donations (on which no financial return was expected and the outcomes were often unclear). Social investment seeks to offer a combination of financial and social returns. The purest version is the Social Impact Bond (SIB), which offers investors a predetermined rate of return depending on the outcomes of a specific social intervention.

The first SIB was issued in 2010 with the objective of reducing reoffending rates from Peterborough prison. If the rate of reoffending drops by at least 7.5% investors will get their capital back and if it falls by more than that they will earn a positive return. Data from the first cohort has shown an encouraging decline of 8.5%. There are now over 31 SIBs in the UK – more than in all the rest of the world.

HM Government is trying to stimulate further activity, evidence for which is the introduction of Social Investment Tax Relief. This offers similar incentives to the EIS but can be adapted to suit a wider range of organisations. The ambition is to raise £500 million for social investment over the next 5 years, although so far it has been slow to get off the ground. This is partly because the maximum that can be raised by a single organisation is low (about £275,000), although there are proposals to increase this to £5 million per year subject to EC permission.

Another drawback to promoting SITR at present is that the FCA regards these no differently from other investments, which effectively means that advisers can only discuss them with those who are defined as Sophisticated Investors. Big Society Capital and others are pressing for a relaxation of this.

EQ intends to be active in this market, both in terms of helping clients to identify attractive proposals and making investments ourselves on behalf of the EQ Foundation.

Raymond James statements

Please note that we are changing the frequency of distributing statements for clients with holdings on the Raymond James platform from quarterly to six monthly.

Live valuations are available 24/7 with access from the EQ website.

Important information

This newsletter does not constitute advice or a personal recommendation. It does not take account of the specific circumstances of individual investors. If you wish to establish if any of the products or services described herein may be suitable for you, you should contact us for advice. Specifically, VCTs and EIS are complex products. If you are at all uncertain about their suitability for your circumstances please seek our advice. Remember that the value of your investments can do down as well as up and that you could get back less than you invest. The levels and bases of taxation can change at any time.

8.

The Benefits of being a B Corporation

By **Alex Michelsen**

EQ Investors plans to be one of the inaugural **B Corporations** when this concept is launched in the UK in September. What does this mean?

B (or *Benefit*) Corporations first emerged in the USA five years ago. They are companies that can demonstrate they have a social and environmental mission and strong ethical values that are reflected in the way they do business. Directors and officers must consider the effect of their decisions on all their stakeholders: shareholders and employees, suppliers, customers, community and the environment.

It works like a certification scheme for ethical companies – akin to Fairtrade products or organic food.

"A certification scheme for ethical companies – akin to Fairtrade products or organic food"

There are now over 1,300 B Corporations worldwide, in 41 countries but (unusually) the UK has been a bit slow off the mark. That's about to change with a formal launch in September at which over 50 companies are expected to have qualified.

We intend to be one of the pioneers because the requirements are very much in line with our core values. By becoming a B Corporation we can establish clear guidelines for our policies on employment, dealing with suppliers, our impact on the environment and how to help others less fortunate than us. These policies will also be transparent and available for all to see.

We are really excited about the implications of this for us and will keep you updated as it unfolds.

Further information on B Corporations visit: **bcorporation.uk**

Double your donations with EQ Matched Giving

We offer an incentive for staff and clients who are raising money for charities by offering to double donations (up to £1,000) subject to a few conditions. We are now entering that period of the year when there is plenty of activity and lucky recipients of our matching recently have included: Walk the Walk, Nepal Earthquake Appeal, St Paul's Money Advice Centre and the British Heart Foundation. Full details of EQ Matching can be found at: **eqinvestors.co.uk/philanthropy**

Things to think about

- Contribute to your pension before the Budget (July 8th)
- Would our Positive Impact Portfolios suit part of your portfolio?
- Do you qualify for the EQ Bespoke service?

Call us if you would like to discuss any of these ideas

020 7488 7110 enquiries@eqinvestors.co.uk @eqinvestors EQ Investors

EQ Investors, Centennium House, 100 Lower Thames Street, London EC3R 6DL.

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Company number 07223330. Registered address: One America Square, Crosswall, London EC3N 2SG.