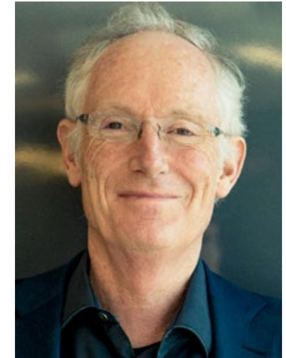
Newsletter

Autumn 2016

In this issue

2. NEW Income Portfolios; Meet the EQ team
3. Celebrating 4 years of Positive Impact
4. Asset backed bonds; Fund in focus
5. Final salary transfer values soar
6. Hinkley Point: a risky bet on nuclear energy
7. Five reasons not to withdraw your pension cash
8. Obesity research study; The Big Give Christmas Challenge 2016

Uncertain times



To the surprise of many, including myself, markets have generally been strong over the last three months, despite a number of warning signals. The IMF has lowered its outlook for world trade growth to the lowest level since 2008 and reported that global debt is at record levels, both in absolute terms and as a proportion of GDP. Meanwhile, political stability is looking more precarious than at any time since the end of the Cold War. What's going on?

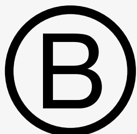
Markets are being distorted by the intervention of central banks, currently in the UK, Europe & Japan. This has led to the madness of countries and companies being able to borrow at negative rates of interest (they will pay back less than they borrowed). This cannot continue indefinitely and when it does stop the result is likely to be messy. One of the most worrying signs has been that a number of large fund groups have arranged borrowing facilities so that they can cope with large redemptions. This is a recognition that there is no longer any depth in the market for historically highly liquid securities such as corporate bonds.

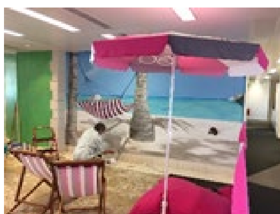
For many of our clients the capital value of their portfolios is less important than its potential to generate an income in retirement. Eight years ago a 65 year old single man could expect an annuity of more than 7.7%, today it's at a record low of less than 5% (and much lower if you look at the joint life or index linked options). This is one of the negative impacts of central bank intervention. An increase in gilt yields could be more beneficial for the financial security of many clients than a stock market boom.

We are sticking with our cautious investment approach – we'd rather face some criticism from clients for not maximising growth in a rising market if it means we can conserve capital better when the markets have a setback. Despite this, most portfolios are standing at close to record levels and it's been really encouraging to see our Positive Impact Portfolios performing so well. Investing with a conscience doesn't have to mean sacrificing financial returns any more.

John Spiers

John Spiers
Chief Executive





In search of winter sun

The last couple of months has seen the addition of a mural to our breakout area, the EQ beach! Created by artist Pierre Beaudry, it's definitely brightened up the office, just as the nights start to draw in. You're very welcome to pop in and take a look.

2.

EQ launches Income Portfolio range

We are pleased to announce that we will soon be launching a new range of portfolios to help those requiring an income from their investments.

These new portfolios have been developed for investors who are looking for an actively managed, diversified portfolio and not just a single income fund in a restrictive 'one size fits all' approach.

Aiming for a yield of around 4% with a minimum target of 3%, the portfolios will invest across all asset classes (equity, bond, commercial property and alternatives) on a global basis.

The underlying fund costs for the portfolios currently vary between 0.58% (Cautious risk profile) and 0.65% (for Balanced Plus). The number of underlying funds in the portfolios currently varies between 21 (Cautious) and 18 (Balanced Plus). We are expecting a couple of exciting fund additions in the coming months which would add to this number.

To find out more about the Income Portfolios and whether they might be suitable for you, please speak to your EQ consultant.

Meet the EQ team: Hayley Jarvis

Hayley Jarvis heads up our growing Employee Benefits practice at EQ. Here she explains how we are helping some of our corporate clients to help their staff.

What do you do at EQ?

I am responsible for looking after EQ's corporate clients. We offer a range of services covering employee benefits and the new auto-enrolment rules.

How can you help on the employee benefit side of things?

We advise on a strong employee benefits programme which includes lump sum payments and/or monthly income due to illness and lump sum payments in the event of death. This can be provided for employees for their family situation but this can also be a way of providing additional finance to the company bank account. We are also able to support shareholders of businesses.

A number of clients are looking to offer more than just the standard employee benefits package. This could include discounts on a number of products, services and family fun days out.

How about auto-enrolment?

Under the new rules, all employers must offer a workplace pension scheme which meets certain minimum standards. I help clients with the setting up of their auto enrolment pension schemes as well as provide an ongoing service for both companies and employees. This covers guidance, advice and employee communications.

Looking forward, are there any themes you see developing?

Mental health and cancer in the workplace is gaining more traction in terms of how the company and employee deal with this.

Employers are increasingly keen to ensure that the benefits they offer are relevant to their employees and they actually make use of their benefit packages.

To find out more please contact Hayley by email: hayley.jarvis@eqinvestors.co.uk or call 020 7488 7141.

Celebrating 4 years of Positive Impact

It's been four years since we launched our Positive Impact portfolios and they have been a terrific success, both in terms of popularity and performance.

Damien Lardoux
Portfolio Manager

Why Positive Impact?

The 21st century appears to have delivered a perfect storm of economic uncertainty, social upheaval and environmental change. Many people are questioning whether the traditional approach to investment, which has advocated the accumulation of wealth at almost any cost, is too one dimensional.

The Positive Impact approach seeks out companies making a positive approach to society or the environment (positive screening), whilst avoiding companies that are obviously harmful (negative screening).

Innovation

Key to this screening process is our proprietary 'Greencard' scoring system, which measures the social and environmental impact of investment funds. We have recently refreshed the scorecard, adding in some new positive screens (e.g. safety), and negative screens (e.g. coal). Our aim is to ensure that the portfolios are always optimally positioned to deliver the maximum positive impact.

Positive Impact Portfolios
Autumn 2016 Update

Our quarterly update focuses on specific investments made by the funds within the Positive Impact Portfolios. As well as avoiding harmful investments, we continually seek to find funds which aim to make a positive contribution to society or the environment, alongside an attractive financial return.

We assess every fund in the portfolio against 41 criteria for impact. This update will concentrate on three of them: renewable energy, social change and health & safety.

1 INVESTING IN RENEWABLES
Wind: the energy of the future

The Paris Agreement – the UN's latest agreement on climate change – has now been ratified by 81 countries and takes effect on 4 November 2016.[1] Its goal is to limit the rise in global average temperature to less than 2°C above pre-industrial levels, pushing its signatories to decarbonise their economies as quickly as possible. In the UK, the government of Theresa May has already approved the controversial nuclear project at Hinkley Point.[2] However, more than 50% of the UK's current energy mix still come from fossil fuel sources.[3] The focus now needs to be on further developing our renewables capacity, particularly onshore and offshore wind.

EXAMPLE HOLDING:
Vestas Wind Systems

Vestas, a Danish company founded in 1945, is now the second largest manufacturer of wind turbines in the world.[4] Since launching their first turbine in 1979, Vestas have increased the power output of onshore wind turbines over 100-fold[5] – a single turbine can now power over 1,500 EU households.[6] Over the same timeframe the wind industry has brought down the cost of wind energy by more than 20 times,[7] making onshore wind competitive on cost with both nuclear and coal.[8]

Vestas itself demonstrates leadership by sourcing 100% of its own electricity consumption from renewable sources.[9] In 2016, Vestas launched a new recycling initiative to reduce product waste by over 75%.[10]

FUND IN FOCUS:
Jupiter Ecology

Vestas Wind Systems A/S received investments from the Jupiter Ecology fund which favours companies providing solutions to the challenges of climate change. As renewable energies tend to be a relatively volatile sector and still partly dependent on government subsidies, fund managers tend to select the few companies which would emerge as the leaders of the future. Vestas is seen as one of them helping to make this technology available at a sustainable cost.

Find out more about Jupiter Ecology and see where it fits into the Positive Impact Portfolios in the Rated Funds section of our website:

eqinvestors.co.uk/eq-rated-funds/

1.

Download our latest quarterly update from the EQ website

To find out more about the themes and issues we invest in – and those we avoid – please call us or download the latest brochure from the EQ website.

Performance

Since their launch in 2012, the Positive Impact Portfolios have demonstrated that you don't need to sacrifice returns when you want to do good. For example our most popular, the balanced risk profile, is up 47.9% from inception (1st September 2012) as at 30th September 2016 – an annualised gain of 10.3% per year.[1]

Our strict selection process means no fund is included in the portfolios based on its social or environmental credentials alone – it must aim to deliver an attractive return for its sector of the market.

But the approach itself favours companies that are bringing solutions to real social and environmental problems to market, and actively trying to run their businesses in a sustainable manner. These tend to operate in emerging sectors with high-growth potential.

Who is it for?

The Positive Impact approach is a great way to add diversification to a standard portfolio. Or they can be used as a standalone investment solution for those who view social and environmental considerations as paramount to their investment objectives.

There are seven levels of risk graded model portfolios available, with the maximum equity exposure ranging from 45% for a cautious risk profile to 100% for the highest risk profile.

Looking forward

There is a growing interest in sustainable investing, and we have seen a corresponding increase in the number of new fund launches over the past months. In some cases EQ is playing a key role in bringing these launches to the UK by positioning the Positive Impact Portfolios as a lead investor.

This is great news for our clients. Not only are these funds driving innovation in the impact investing space; but also, introducing more players into the market is putting downward pressure on fund costs which directly benefits investors.

How to invest

All EQ clients can access the Positive Impact Portfolios. Our entry-level **Simply EQ** service offers ISA, Junior ISA and pension (SIPP) tax wrappers.

[1] Performance figures quoted include fund charges but not platform or adviser charges.

eqinvestors.co.uk/positive-impact

4.

Looking for yield? Try Asset Backed Bonds

With conventional bond yields at record lows, more people are looking at alternative sources of income.

Sophie Muller
Head of Research

What are Asset Backed Bonds?

These bonds pay a fixed rate of interest and are repaid on a predetermined date (usually after 1-3 years). They are made available via crowdfunding platforms. There is no secondary market and so the bonds are not readily realisable.

To date, the bond issuing companies have ranged from country pubs and care homes to sustainable energy projects, such as solar farms, hydro power and anaerobic digestion plants.

What are the risks?

These bonds are not covered by the Financial Services Compensation Scheme (FSCS). They are typically issued by smaller, unquoted companies but are secured against specific assets, often by property.

The loan-to-value rate (LTV) is an important indicator – the lower the LTV, the better. Higher yields should usually be taken as an indicator of higher risks. We recommend that investors diversify their risk by spreading their commitment across at least 8 issues.

The EQ introducer service

EQ is offering an introducer service, initially to bonds issued by Downing via its crowdfunding platform, Downing Crowd. Downing is a long-established investment manager, regulated by the FCA. Downing acts as the arranger and security trustee for the bonds, and brings more than 20 years' investment management experience to these crowdfunding opportunities.

We have chosen to launch our service with Downing based on their track record, and because their fee is contingent on investors' capital and interest being paid in full. This means they have an incentive to carry out rigorous due diligence and ensure that the bonds are repaid when due.

How to invest

The EQ website will include the latest bond offers from Downing. EQ will receive a small commission on these investments, paid to us by Downing (which does not reduce your investment).

Please note: we are not offering advice on the selection of the bonds and the decision as to whether they are suitable is entirely down to you.

For details of current offers please visit:

eqinvestors.co.uk/investing/asset-backed-bonds

You will be redirected to the Downing Crowd website to complete the investment process.

Fund in focus

The Worldwide Healthcare Trust is a thematic equity fund that we hold within our Bespoke portfolios. The trust allows us to access a theme with huge potential for growth, as well as one that is benefitting people across the world.

Michael Born
Research Analyst

What differentiates the trust?

Not only do the trust's management team, Orbimed Advisors, have more than 25 years' experience investing in healthcare, a quarter of their staff are medical doctors or hold medical research PhDs. This gives them a better understanding of drug and patent cycles than their peers, and enables them to model the results of clinical trials to select strong candidates for investment.

Example holding: reducing cholesterol

Regeneron is currently a major holding of the trust. One of its three products (Praulent) has the potential to help patients with high cholesterol, who are at risk of heart disease and for whom traditional statins alone have proved ineffective. Trials have successfully reduced patient cholesterol levels by 40% or more.

5.

Final salary transfer values soar

Previously seen as being only rarely suitable, final salary pension transfers are increasingly on the radar and in certain situations can be the right decision.

Angus Branfield
Director

What has been the catalyst?

Mainly the introduction of pension freedoms in April 2015. These headline grabbing changes and the new flexibility they offer are only available to members of defined contribution schemes. In order to access them, Defined Benefit (DB) scheme members are required to transfer to a personal pension such as a SIPP. Another factor has been a steep rise in transfer values.

What has caused this dramatic rise in values?

It is all to do with falling gilt yields: they result in a higher cost for schemes to provide the income promised to members. Tesco recently calculated that each 0.1% drop in yields adds £312 million to its liabilities.

When a transfer might be considered

In the past, the overriding factor was the 'critical yield' – broadly the rate of return you would need to earn on the transfer value just to break even. This is almost always much higher than what can be achieved 'risk free'.

However, the pension reforms have become a valuable way of passing on inheritance. A DB pension generally dies with you and your spouse. By transferring to a SIPP, you have money that remains in a pension wrapper which can potentially be passed onto your beneficiaries without any IHT implications.

If the DB scheme is only a small part of your overall wealth, or if you have impaired life expectancy, or you are single and have no requirement for the spouse's pension payable on death, it might be beneficial to transfer out.

Pension safety net

DB pensions aren't always as safe as we're led to believe. The collapse of BHS has exposed the challenge of paying DB pension in future, especially for those schemes with huge funding deficits. The Pension Protection Fund (PPF) provides a safety net but only 90% of your pension is protected with an overall cap at £32,500 a year. Anything above this is lost.

And BHS isn't the only example. The PPF owns ten per cent of the Monarch airline group after a restructuring in 2014.

Risks involved

A key concern for many is running out of cash. 80% of people under-estimate their life expectancy.[1] A 65 year old male has an average life expectancy of 86 (21 years) but a 1 in 4 chance of living to age 94 (29 years) and a 1 in 10 chance of living to age 99 (34 years).

On transfer a member is giving up 'guaranteed' benefits for a lump sum with which they are then taking the investment risk. You, rather than your employer, are now the risk taker. For some, no matter what other benefits a transfer might offer, that is a step too far. Others consider the risk worth taking for the potential benefits gained.

I am thinking of transferring, what do I do now?

Professional advice is a vital part of the process, starting with the assumption that 'staying put' is the right solution. Transferring should only be considered if your situation merits it.

Anyone can ask their pension trustees or administrator for a transfer value once a year, free of charge. The offer then normally lasts for three months barring an exceptional change of circumstances, so enquiring shouldn't cost anyone a penny.

EQ can provide an analysis of final salary pension schemes for a fixed fee.

1 Zurich-YouGov research, 2015

6.

Hinkley Point: a risky bet on nuclear energy

Following a final six-week review and after agreeing a 'golden share' deal, the UK Government has given the green light to two nuclear reactors at Hinkley Point in Somerset. The controversial move will see the first new nuclear plant built in the UK for 20 years.

Damien Lardoux
Portfolio Manager

As a leader on tackling climate change, the decision can be viewed as a major milestone to achieving a reduction in greenhouse gas emissions of 80% by 2050. Low and zero carbon sources represented slightly less than 50% of the UK energy mix in 2015. At 20%, nuclear power is the fourth biggest source of energy, after gas, renewables and coal – contributing significantly to the 38% drop in greenhouse gas emissions since 1990. So why do I have reservations?

First, let's take a look at the technology behind it. The European Pressurised Reactor (EPR) designed by Areva and EDF has faced huge problems in its two European implementations to date, in Finland and France. Significant design faults have resulted in six and nine year delays, and they aren't expected to complete before 2018. Costs have more than tripled the initial forecasts and in Finland they have cancelled the option for a second reactor. I find it hard to believe that EDF, the main contractor at Hinkley Point will be on time and on budget.

Much has been made about the Chinese involvement, but the state-owned CGN brings its own experience of building two EPR reactors. These are expected to start producing electricity next year, after only a four-year delay! Less is known on these two reactors but concerns have been raised about faulty components and a lack of safety test data. Without one working instance of the new EPR technology, it can't be denied that the UK Government is taking a gamble, even if EDF is taking on the construction risk.

Interestingly, the Chinese themselves are not planning to build any more reactors on home soil due to the high cost! Onshore and offshore wind farms currently produces electricity at a cheaper rate than what Hinkley Point promises. According to WindEurope, wind turbines have become 10% more powerful year-on-year, with high competition also reducing costs. The electricity produced by Hinkley Point is indexed to inflation and will soar over the 35 years of the contract.

Comparing the build times also raises questions. Hinkley Point will take at least nine years to establish, whilst onshore and offshore wind farms take eighteen months and four years respectively. It

becomes quite clear that renewables would help to meet the climate change deadline sooner and with more certainty than the unproven EPR technology.

While nuclear power does not create climate change-related "greenhouse" gases, it poses security and health concerns. Chernobyl, Three Mile Island and Fukushima caused serious consequences for the surrounding areas. Climate change itself may further increase the risk of nuclear accidents as heat waves causes cooling problems, as seen in France and the US. Uranium mining also creates health issues for the workers and the local community. That's not forgetting the perennial challenge for the nuclear industry of what to do with reactive waste.

Rightly, the advocates of Hinkley Point argue that to rely only on renewables is risky, particularly at peak demand over the winter months. However, the development of interconnectors between the UK and other European countries would help to meet this demand and bring cheaper electricity when needed.

Looking at this from the demand side, Government measures to increase energy efficiency particularly of commercial and residential buildings would substantially reduce the UK's need for generating new capacity. At times of peak demand, the rescheduling of non-essential use of electricity by energy intensive industries would alleviate pressure on the grid and could avoid building a new nuclear plant.

We firmly believe it would have been wiser for the UK to promote cheaper and more reliable solutions to face the coming energy challenges.

7.

Five reasons not to withdraw your pension cash

A recent survey found people are withdrawing their pension savings and depositing them in bank accounts. But by doing so they could face unexpected tax charges.

Jeannie Boyle
Director

A study published by Citizens Advice has shown people accessing their retirement pot under the new pension freedoms are simply depositing their cash straight into low interest bank accounts.

The survey found almost 30% were taking this option even though they had no immediate plan for using the money.

Apart from the loss of future returns, pension withdrawals can have significant tax implications. Here are five key reasons why it's better to keep the money in your pension unless you actually need it:

1 Income tax

Once you've taken the 25% tax-free lump sum, any further withdrawals are added to your income to assess how much tax should be paid. If you're still earning a salary you could easily find yourself paying 40% or even 45% tax on your pension money. Spreading your withdrawals over several years can help reduce the tax paid.

2 Emergency tax

In many cases HMRC applies 'emergency tax' to the payment. This means they assume you will be receiving the same payment every month and tax you accordingly. It's up to you to then reclaim the extra tax paid.

3 Low interest rates

Rates are currently so low the value of your money will be eroded by inflation. In September 2016, the Retail Price Index was running at 2%, while the average Cash ISA currently pays around 1%. At these rates £100,000 would only be worth £90,617 in real teams after 10 years.

4 Inheritance tax (IHT)

Money in a pension is usually exempt from IHT. If you withdraw the money without spending it, your loved ones may pay 40% tax after your death. If the money stays in your pension your family will pay no tax if you die before age 75 and their own rate of income tax if you die after age 75.

5 More income tax

If the interest you receive each year exceeds £1,000 (or £500 if you are a higher rate taxpayer) it will be taxable, whereas there is no tax to pay on interest payments whilst the money is invested in a pension.

While the pension freedoms have provided a wealth of new opportunities, it is vital that you consider absolutely every option before committing to one.

Many people opt for cash over investment because they feel uncomfortable with investment risk, particularly in the approach to retirement. If you feel more comfortable with cash (despite the effects of inflation) it's important to remember this option is available without taking the money out of your pension.

Most pension providers offer the option of a cash fund (a mix of different deposits and other cash like investments) which allows you to reduce investment risk without the need to withdraw the money.

If you have a self-invested personal pension (SIPP) you will be able to select from a range of deposit accounts. Using the cash options available from your pension provider means you don't have to withdraw the money until it's actually needed.

SAVE THE DATE SAVE THE SAVE THE

Protecting family wealth - an introduction to Inheritance Tax Planning

6pm, Wednesday, 22nd February 2017

Clients and guests welcome – RSVP tax-planning@eqinvestors.co.uk

Shortlisted: Paraplanner of the Year 2016

Dan Atkinson
Head of Technical Consulting

EQ's Dan Atkinson has been shortlisted as one of three finalists for the award. The winner will be announced at the Personal Finance Society Awards Gala Dinner on 24 November at Wembley Stadium. Let's hope Dan gets to climb the 39 steps to reach the Royal Box and collect the trophy.

Obesity research study

The obesity crisis is gravely concerning, with one in four adults in the UK now classed as obese. Although this is a problem that is felt across the whole of society, it disproportionately affects the most disadvantaged.

The EQ Foundation has agreed to sponsor a year-long study into Obesity, run by The Centre for Social Justice. The aim of this project is to come up with a coherent strategy for tackling the root causes of obesity and provide a clear outline for how Government can implement these solutions. We'll keep you updated on progress and expect to see the final report and recommendations published towards the end of 2017.

The Big Give Christmas Challenge 2016

The EQ Foundation is proud to be a part of the UK's biggest online matched fundraising campaign, from midday on Tuesday 29th November to midday on Friday 2nd December. We will be supporting the following charities:

To donate please visit: www.thebiggive.org.uk

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. 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.

Low-cost portfolios scoop prize

We are delighted that our low-cost portfolios have been recognised in the Wealth & Finance International Awards. The popularity of passive investments has been rising fast and we expect this trend of continue. These portfolios have been designed for people who prefer the lower cost of passive funds and the greater certainty of tracking index performance.

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