360

from *AW Financial Management* **October 2017**

Welcome to our Autumn 2017 edition of 360— which has an autumnal theme running through it! This is our quarterly update on all things financial and we hope you find the articles, reports and commentary both useful and informative.

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Fall Back …

No, not a market forecast but just a reminder ... the clocks go back at 2.00 am on Sunday 29th October – oh, and there will be 45 working days remaining until Christmas!

In this era of smartphones, there is perhaps little need for most of us to be reminded but local man William Willett - a builder who lived in Chislehurst - first campaigned in Britain for daylight saving. He didn't live to see it introduced in 1916 but is immortalised by the Willett memorial and also the Daylight Inn built in 1935 – both of which remain in nearby Petts Wood to this day.

November Budget

Another date for your diary: Wednesday 22 November 2017. This is when the Chancellor of the Exchequer, Philip Hammond, will publish the Government's Autumn Budget. Some predict that it may be his last – if the PM also announces a cabinet reshuffle and substitutes a more 'Brexit-friendly' successor.

As ever, predictions abound and are probably just as reliable as the estimates we keep hearing regarding the total 'bill' for our departure from the European Union. Pensions are again likely to be under scrutiny: will higher and additional rate tax relief on contributions be curtailed? Will pensioners continue to benefit from the 'triple lock' which has resulted in above inflation rises in the state pension in 2015 and 2016? At the time of writing the Office for Budget Responsibility had just warned that it is about to cut its forecasts for GDP growth soon after the IMF had reduced its expectations for the UK economy.

As Michael Fish and many of us learned in 1987, forecasts can be very unreliable but on the face of it the Chancellor has little headroom and so we expect few, if any, 'giveaways' on the 22nd.

Global markets and your portfolio

Were you inclined to look back over the previous editions of 360 this year, "the same old song" might come to mind as you read this.

Again we report positive returns across all investment risk profiles although they have been curbed over these most recent three and 12 month periods by comparison to those we set out in our April and August editions. This perhaps reflects an air of uncertainty on many levels: (dare we mention again) 'Brexit', North Korea, Catalonia, world debt, inflation, interest rates and so on.

Description	AWFM Risk Model	Ethical		Unrestricted	
		3m	1yr	3m	1yr
Cautious Risk	1	0.95%	5.48%	0.17%	4.39%
Cautious to Moderate Risk	2	1.68%	10.00%	0.50%	7.58%
Moderate Risk	3	2.03%	11.41%	1.49%	10.78%
Moderate to Adventurous Risk	4	2.34%	12.85%	2.25%	14.45%
Adventurous Risk	5	2.75%	15.87%	3.91%	20.09%

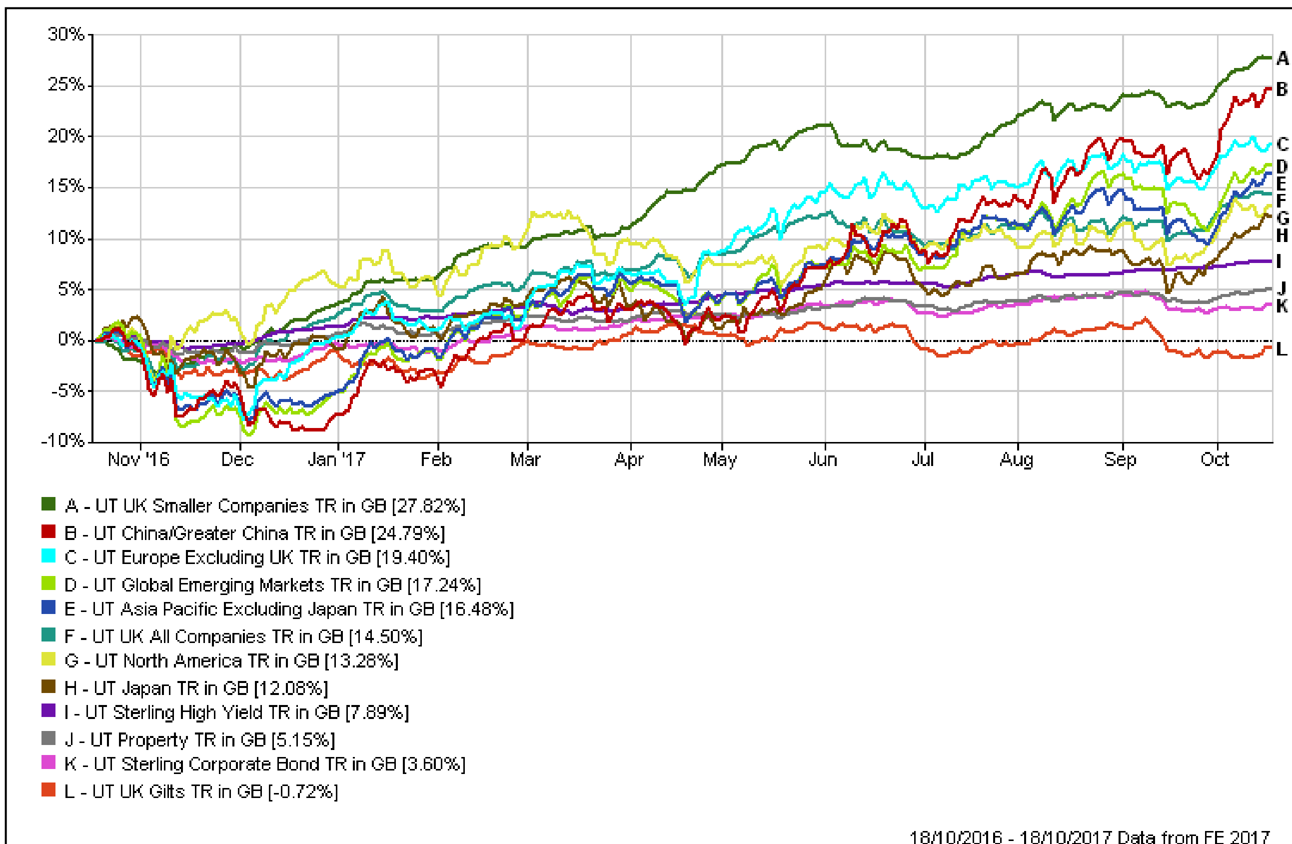
However world economies are still growing, the latest industry surveys are still optimistic and whilst uncertainty and risk remain a necessary feature of investing, good portfolio diversification and risk management allied with a focus on your long term investment objectives should help guide us through any metaphorical storms. As an aside, we are very pleased to see the Ethical portfolios doing so well!

"Sing to the LORD, for he has done glorious things; let this be known to all the world." - Isaiah 12 verse 5

Investment returns & outlook

As in July when we last reported, all investment sectors bar one continue to show positive returns - and, as you see below, by a margin over the risk-free return. However, with increasing inflation there is talk of higher interest rates both here and in the US. On 2nd November, the Monetary Policy Committee in the UK is set to meet and many predict it voting for a quarter -point rise in the Bank Base Rate following the trend of rising rates in the US. This is generally perceived as 'bad news' for bonds as an asset class as they pay a fixed rate of interest rate (the 'coupon') which become less attractive as the 'market rate' rises and more so if it falls. A rise of this magnitude will simply take us back to where we were in August 2016 — and for the seven years preceding and to a certain extent is probably already priced in. Nevertheless, you will notice that the negative return from UK gilts over 12 months and the modest positive return from corporate bonds have both deteriorated since we reported last time.

Later in this edition we highlight the latest UK inflation figures and how they may directly impact us individually and also how the fixed interest investment element of portfolios is impacted by the incidence or even expectation of rising interest



rates. For equities however, the impact may be double-edged : hiking interest rates could be viewed as evidence the economy is in good shape and the stimulus brought about by lower interest rates needs to be dampened down. On the other hand, higher interest rates spell larger borrowing costs both for business and for the consumer and the risk which the Bank will wish to avoid is of killing off economic growth and prompting a recession.

Many of you will have noted that the UK Smaller Companies funds have done especially well over this last year. Smaller usually equates to higher risk of course and so asset allocators (ourselves included) place only a small proportion of most portfolios in this sector, but it has helped to produce a very good return, when used.

Turning to the outlook for the next few years, as the table below shows, consensus amongst those fund managers surveyed by Old Mutual Wealth in September was negative on both Gilts and corporate bonds – the latter having deteriorated from a 'neutral' outlook in June. This is a theme and position that you will have heard us mention over the last few years but the 30 year Gilt run does seem now to be at or around the buffers!

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

The fund managers are positive about Europe and Japan, the latter probably more so since the strengthening of the mandate by Prime Minister Abe.

We suspect that UK Smaller Companies may be in the neutral territory on the back of their superb returns over the last year or so.

Property remains difficult to call especially when in the Commercial sector. The fundamentals of strong yield investments though are still attractive, although in every case for only a small proportion of the portfolio, due in the main to concerns about liquidity.

Inflation – Bad News for All?

At the time of writing, financial markets are digesting the latest inflation data which reflect a rise in September of the Retail Prices Index ('RPI') to 3.9% in and to the Consumer Prices Index ('CPI') to 3% - their highest levels for five years. But, apart from our rising cost of living what significance do these measures have for us?

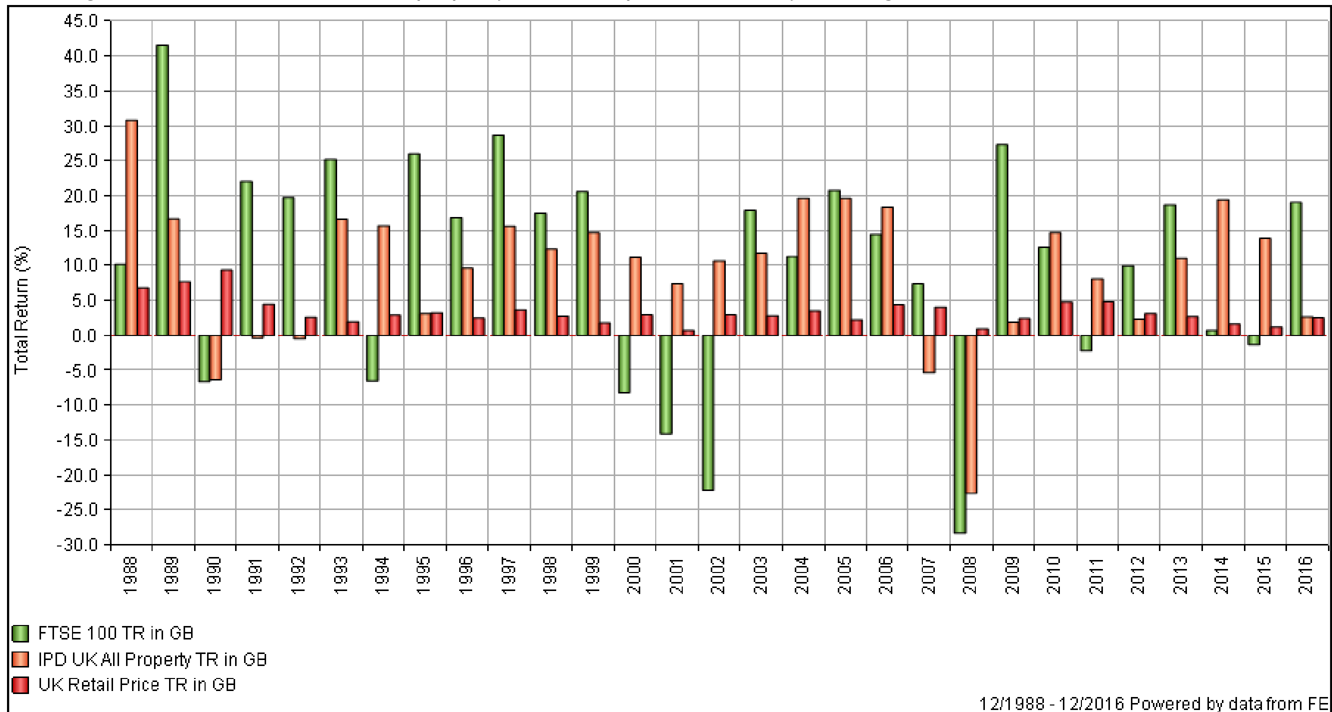
RPI came in to being after the First World War to compensate ordinary workers for price increases and the basket of goods gauging price fluctuations included items such as cod liver oil and rabbit meat. Its composition has, of course, altered with our lifestyles and revisions by the Office of national Statistics ('ONS') this year see the introduction of cycle helmets, gin and 'non-dairy milk drinks' (that's almond and coconut milk to the uninitiated) to the basket which is not representative of all lifestyles! CPI was launched much later - in 1996 - as an internationally comparable measure of price increases and one of its key differences is that it excludes mortgage payments.

As anyone who pays school fees or for private medical care knows, your 'personal inflation' rate may be higher than both of these measures as spending is not necessarily confined to the (now) 650 or so representative items of which these indices are comprised. However, the two official measures and the difference between them still have significance for many of us. For instance, state and public sector pensions were until 2003 calculated by reference to RPI but the government substituted CPI in 2003 thus saving millions over time for the Treasury. The September reading of CPI is of particular significance as this is the inflation component of the 'triple lock' by which state pension increases are calculated once a year. So, a 3% increase in the state pension with effect from next April (to be confirmed in the Budget statement) looks on the cards and, whilst less attractive than 3.9%, follows a year (to August 2017) during which average wages grew by only 2.2%.

Interestingly, RPI is still used to calculate the increasing costs of items such as train fares and student loan interest as well as taxes on alcohol and cigarettes. Again, many of us may not be impacted but clearly RPI is more beneficial than CPI to the Treasury in relation to payments it is collecting from us!

On a more positive note, the rise in CPI is helpful to some—at least in the short term. For example, those saving for retirement who may be close to or are already caught by the pension Lifetime Allowance — currently set at £1m. In very simple terms, this is the level to which an individual's accumulated pension benefits may grow before they would potentially become subject to a 'recovery charge' payable to HMRC. Whilst a nice 'problem' to have, the potential impact of breaching the allowance warrants careful planning as when benefits are crystallised in excess of the limit the charge bites at either 25% or 55% of the excess dependant on how benefits are taken. Whilst in most cases that we know of, the value of money purchase pension funds has increased well in excess of 3% over the last 12 months, the increase in the allowance by £30,000 may provide modest respite for those affected. No doubt you'll also be pleased to know that the government — like most borrowers— benefits from rising inflation as its £58.3bn debt falls in real terms whilst earnings and tax revenues are likely to increase thus eroding the national debt.

Finally, you will often have heard from us and financial commentators that, if you can tolerate the associated volatility, investing in real assets — shares and property, for example— is the way to hedge the effects of inflation. The table below



demonstrates this by comparing annualised returns of UK equities (as measured by the FTSE100 index in green) and property (reflected by the IPD UK Property Index in orange) with RPI (shown in red). However, whilst at least one of the two asset classes has outstripped inflation in the vast majority of years since 1988 there are two years when this was not the case and in some years the disparity between equities and property was significant—these are examples of uncorrelated returns and supports the case for diversification and resultant reduction in volatility. It is also the reason why such investments should be made with a long term view.

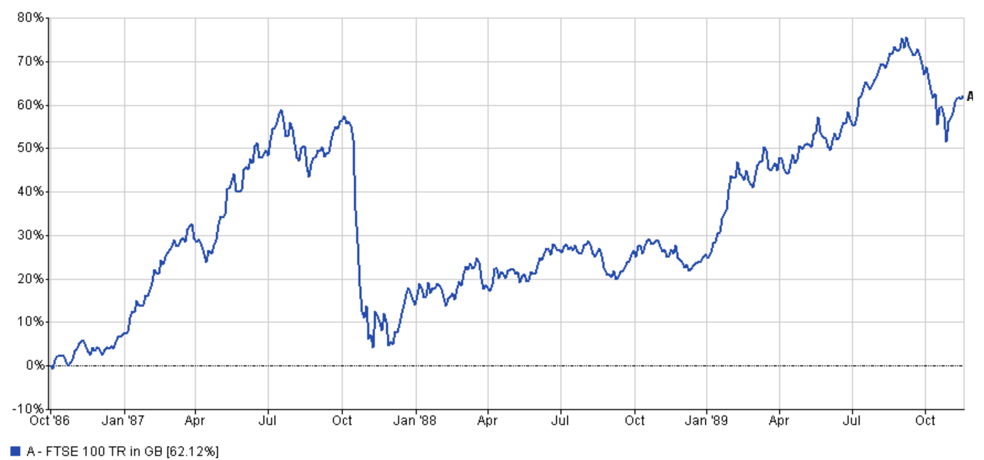
Black Monday

In common with one half of the team here at AWFM, you may have little or no recollection of the events which unfolded on Monday 19 October 1987.

For those who do, it may be because the FTSE index of our largest UK companies fell by 10% on each of two consecutive days or possibly because you were trying to negotiate the aftermath of the worst storm in living memory only a few days earlier. Ultimately, the UK market fell by 26% and the FTSE to 1,684 at its lowest in the weeks to follow. Since then, myriad economic and political events have impacted on asset values – at times, adversely – but thirty years on and with the FTSE now at around 7,500 all of this seems a very long time ago.

We seem, currently, to be enjoying an Indian Summer here with unseasonably high temperatures and the River Cray posing no threat to River House as the South-East is spared the effects of Storms Ophelia and Brian. Markets appear to be riding the crest of a wave with both the S&P500 in the US and the FTSE close to or at record highs and volatility remains stubbornly low. In spite – or perhaps because – of this, some financial commentators ask whether there may be trouble ahead. We can, of course, be certain of one thing— that further downturns will continue to be a feature of investing just as they have since the South Sea crisis of 1720 which resulted in what is considered to be the very first stock market crisis.

If we are about to experience a 'correction' (defined, technically, as a fall in asset values of 10% or more) this should not come as a surprise following, as it would, an eight year 'bull' run. Furthermore, where equities form part of a diversified portfolio and assuming investment aims have not altered, the wisdom of remaining invested is reflected in this chart which shows the movement in the FTSE 100 over the year prior to and two years following 'Black Monday'.



As you will also have heard us say ad nauseam past performance is no guide to the future but a 34% fall following a 57% rise is important context.

Other News

In our April edition, we talked about the introduction of the new £1 coin and whilst it seems that some machines are still not equipped to take them, the 'round pound' ceased to be legal tender earlier this month. A month earlier saw the introduction of the new £10 note with a depiction of Jane Austen superseding Charles Darwin. The launch was not without controversy – firstly over who was chosen to feature but also because, like the (now not so) new £5 note, these harder wearing polymer bank notes contain traces of animal fat. As with the new coins, they are, nevertheless, less susceptible to counterfeit by virtue of several new security features.

Whilst notaphily seldom features in our financial planning discussions, it was interesting to read that the keen-eyed amongst you could benefit financially from spotting those notes with serial numbers prefixed 'AA01' , 'JA01' (as in 'Jane Austen') and 'JA75' (her year of birth). Apparently, these will be coveted by collectors although the first, second, third and fourth notes issued were given to the Queen, Prince Phillip, Theresa May and Philip Hammond respectively. Perhaps in due course they will be of more use to the latter than the first two recipients! No word yet on exactly when the old 'tenner' will go out of circulation although it will be "next spring".

AWFM News

Thank you so much to all who were able to join us at Chislehurst Golf Club for our thanksgiving and celebration for our 20th Anniversary. It was lovely to spend time with so many clients, friends and family— all of whom have helped make this business what it is.

Looking now to the next 20 years, we are pleased to welcome Jack Barratt, who joins us on 30th October a recently graduated student of economics at Bristol University and, prior to that, Bexley Grammar School. Jack will be continuing his studies— aiming for the CII's Diploma in Financial Planning whilst fulfilling his new role with us as Trainee Paraplanner.

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

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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

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