wealth management

financial Newsletter

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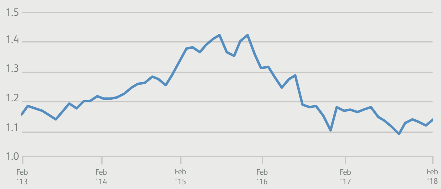
What is the British Pound worth vs. Euro?



What is the British Pound worth vs. Dollar?

FTSE 100 Chart

KEY FACTS & FIGURES – The UK Economy		
BoE Base Rate	0.5%	Jan 2018
Unemployment	4.4%	Jan 2018
Inflation (CPI)	2.7%	Jan 2018

Agenda

– Investing in the strategic bond sector
– Three high conviction ideas for investing for income in Asia
– How to plan for older workers
– The financial services industry is an ever-changing world
– Investing for the next generation
– Volatility strikes back
– The Architas outlook - risks and opportunities in 2018

Base rate

The Bank of England's Monetary Policy Committee voted to keep the base rate at 0.5% after the increase from 0.25% to 0.5% was announced in November 2017.

UK economic outlook

- UK gross domestic product (GDP) in volume terms was estimated to have increased by 0.4% between Quarter 3 (July to Sept) and Quarter 4 (Oct to Dec) 2017.
- Growth in the latest quarter was driven by business services and finance within the services sector.
- Business investment growth was flat between Quarter 3 (July to Sept) and Quarter 4 (Oct to Dec) 2017, but when compared with the same quarter a year ago business investment grew by 2.1%.
- GDP was estimated to have increased by 1.7% between 2016 and 2017.
- Household spending grew by 1.8% between 2016 and 2017, its slowest rate of annual growth since 2012, in part reflecting the increased prices faced by consumers.

Inflation

- The Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 2.7% in January 2018, unchanged from December 2017.
- The largest downward contribution to change in the rate came from prices for motor fuels, which rose by less than they did a year ago.
- The main upward effect came from prices for a range of recreational and cultural goods and services, in particular, admissions to attractions such as zoos and gardens, for which prices fell by less than they did a year ago.
- The Consumer Prices Index (CPI) 12-month rate was 3.0% in January 2018, unchanged from December 2017.

UK unemployment

- Estimates from the Labour Force Survey show that, between July to September 2017 and October to December 2017, the number of people in work and the number of unemployed people both increased, but the number of people aged from 16 to 64 not working and not seeking or available to work (economically inactive) decreased.
- There were 32.15 million people in work, 88,000 more than for July to September 2017 and 321,000 more than for a year earlier.
- The employment rate (the proportion of people aged from 16 to 64 who were in work) was 75.2%, higher than for a year earlier (74.6%).
- There were 901,000 people (not seasonally adjusted) in employment on "zero-hours contracts" in their main job, little changed compared with a year earlier.
- There were 1.47 million unemployed people (people not in work but seeking and available to work), 46,000 more than for July to September 2017 but 123,000 fewer than for a year earlier.
- Latest estimates show that average weekly earnings for employees in Great Britain in real terms (that is, adjusted for price inflation) fell by 0.3% both including and excluding bonuses compared with a year earlier.

Investing in the strategic bond sector

Valuations across much of the bond market are stretched – yields are low and credit spreads (the premium over government bonds that companies must pay to borrow) are tight. Meanwhile, central banks, whose policies have been one of the central pillars that have helped valuations reach such extreme levels, are starting to withdraw support. On the other hand, fundamentals are good: economic growth is positive, and on the whole companies have strong balance sheets and good cash flow.

There are, however, some signs, particularly within the high yield bond market, that the current investment cycle is very mature. At this stage one would typically expect sentiment toward the sector to become more negative. One factor that has traditionally signaled that the economy is approaching this stage is a deterioration in the quality of bonds being issued. We are starting to see this with companies pushing the envelope of what can be achieved in the new issue market. This might be in terms of the amount of borrowing they are taking on, or through weaker legal protection for lenders.

For now, however bond markets remain reasonably well supported. The amount of companies defaulting on their bonds remains low and rating agency Moody's expects them to remain low throughout 2018.

The key risk to this ongoing relatively benign backdrop is the outlook for inflation and the pace at which central banks withdraw economic stimulus by either hiking interest rates or reducing their Quantitative Easing (QE) programmes. So far, central banks have been very careful to communicate their intentions well in advance and are adopting a very gradual approach to reducing support. If they are able to maintain this approach then fixed income markets may well remain relatively benign. This risk was highlighted by the recent market sell-off, which was prompted by concerns over US inflation and the speed at which this might mean the US Federal Reserve will need to hike interest rates.

Given the likely pressure on government bonds and current valuation levels in the corporate bond market it is hard to argue that corporate bond yields should fall materially during 2018.

It is therefore unlikely that we will see a repeat of the large capital gains that have characterised bond markets in recent years. Rather we would expect gains to be much more limited and income a more dominant component of returns.

This mixed outlook leads us toward favouring a defensive position in portfolios with income sourced from areas of the market not distorted by central banks. We are holding low levels of interest rate sensitivity, which should minimise the impact of rising government bond yields. Typically we have large allocations to liquidity (cash and government bonds). This helps to mitigate periods of market volatility and means we should be well placed to exploit opportunities when they arise. Our largest sector allocation remains financials. From a fundamental perspective, banks remain in a strong position with the bailouts and rescues we have seen over the past twelve months removing the weaker banks and leaving a stronger financial sector overall.

Author, Invesco Perpetual Henley Fixed Interest Team

Three high conviction ideas for investing for income in Asia

Asian markets were strong beneficiaries of the rebound in global trade and accommodative monetary policy in 2017, with strong gains across the region's asset classes. Fidelity's Eugene Philalithis and George Efstathopoulos explain why they maintain conviction for remaining overweight Asian equities in their Multi Asset Income range portfolios.

1. Asian equities

Despite very strong returns across Southeast Asia in 2017, ASEAN (Association of Southeast Asian Nations) equities still trade at a discount to both the rest of Asia and versus their emerging market counterparts. As such, ASEAN markets offer some scope for 'catch-up' returns in 2018.

> Even if global growth disappoints, the improved domestic outlook for the Asean region should provide a valuation cushion. The sector composition of domestically focused economies such as Malaysia, Thailand and the Philippines should help provide some defence within Asian focused portfolios.

2. Japan equities

Japanese equity market performance has lagged that of the rest of Asia. Valuations remain conservative, with higher share prices having been entirely driven by earnings growth. With the structural forces keeping inflation low, the country's asset markets can continue to benefit from a disinflationary boom even as other markets start to see inflation gradually pick up. Although the outlook for the Japanese yen is uncertain, particularly regarding geopolitical tensions on the Korean peninsula, the share prices of Japanese corporates have been decoupling from currency fluctuations in recent months.

3. Chinese bonds

Chinese bonds add some diversification to riskier equities, while offering attractive return potential in their own right. The recent tightening of credit conditions in China has caused local government bond yields to rise at a time when inflation appears to be peaking proving attractive to income starved investors.

Fidelity

How to plan for older workers

Through choice or necessity, the attitude to retirement is changing and so too must the financial planning around it.

Recent research we have undertaken suggests five million over-50s plan to continue working after reaching traditional retirement ages, with 300,000 of these people planning to never stop.

Different people will have different views on those statistics. Personally – as much as I love my job – I hope to get to a time where I can stop. But it is fantastic that those who want to are able to continue working.

That said, there are some who are doing it out of necessity rather than choice. In both cases, people need help working out what it means for their finances, including trying to make sense of complex pension rules.

The reasons people want to continue working are largely positive, with the most common being that they actually like doing so. It gives them a sense of purpose and avoids boredom. Many intend to gradually ease off work, showing the day of cliff-edge retirement is well and truly receding.

A less common answer is the need for extra money. However, this was mentioned by around two in five people, so it is still a significant driver. Interestingly, women are more likely to be motivated by this than men (46% of women compared to 37% of men), which is perhaps indicative of average female pension savings being lower than their male counterparts.

One of the huge benefits of pension freedom is the ability to combine the appropriate level of flexibility and certainty from a pension pot to match changing income needs as people move through retirement.

People can also access their pension pot at relatively young ages if they have a specific need; for example, to pay off expensive debt or to tide over those who have been made redundant.

And FCA statistics show people are making use of that, with over 40% of drawdown pots being accessed for the first time between ages 55 and 60.

This changing attitude to retirement has a clear impact on financial planning and the need for solutions that easily allow the phasing of benefits as people take tax-free cash and/or income gradually rather than all at once.

Other key areas of planning include state benefits and the much-maligned money purchase annual allowance.

Money purchase annual allowance (MPAA)

Pensions in the UK get generous tax reliefs, but there are some limitations. The Annual Allowance is a limit on the tax relievable payments which can be made to an individual's pension plan. Any payments above this level will be subject to a tax charge – the annual allowance tax charge – which has the effect of negating any tax relief given. Since 6 April 2014 the normal Annual Allowance has been £40,000 a year.

MPAA was introduced from 6 April 2015 and further restricts the payments which can be made to a pension when an individual has 'flexibly accessed' their benefits.

There is little in the way of defence for the MPAA, currently £4,000 a year. It seems unnecessary, unhelpful and runs counter to wider Government savings policy. There is a clear desire for more people to save for their retirement, yet the MPAA restricts the ability of many to do that in later life, possibly when they have the greater means and impetus to do so.

It is easy to envisage an individual being made redundant at age 55 and using their pension pot to tide them over while they seek another job. Yet when they get a new job, say, with a salary of £45,000, their intended pension payment of 5% salary alongside the matching employer contribution means they breach this arbitrary limit.

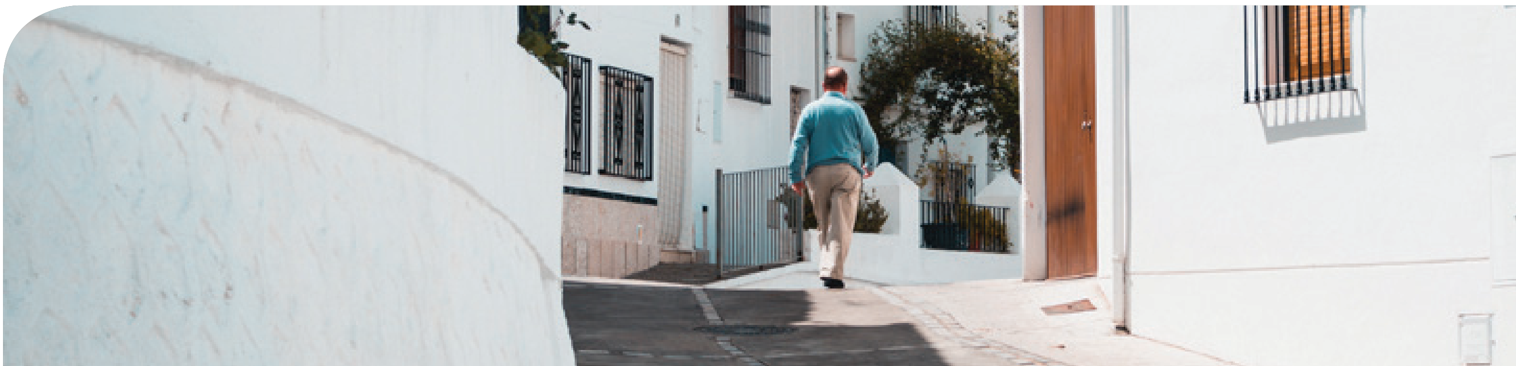
State pension

Another key area for those continuing to work later in life is whether to take their state pension or not. The compensation for deferring is significantly less generous than it was before April 2016. People get an additional 1% of pension for every nine weeks they defer and there is no longer the option to take the additional benefit as a lump sum.

For example, if someone did not take their state pension for one year, they would get a future state pension which is 5.8% larger than it would have been. This means people will need to live around 17 years before the money they receive from their higher state pension outweighs the loss of the first year of income.

While there may be benefits in deferring, for example, reducing taxable income for those who keep working, there is a risk people will lose out financially. Taking the state pension and reinvesting any income which is not needed in an ISA or a pension (perhaps for a partner if the MPAA is an issue) may be a suitable alternative. It is clear many people want, or need, to work beyond retirement age. In these cases, the need for advice remains crucial to avoid the pitfalls around tax and state benefits.

Andrew Tully, Pensions Technical Director at Retirement Advantage



The financial services industry is an ever-changing world

The financial services industry is an ever-changing world with what seems like a constant river of new and updated regulatory rules and procedures, mainly, quite rightly, introduced and put in place for the protection of the consumer. Over the last five years this industry has experienced enormous change for example, the Retail Distribution Review which banned commission payments on investment and pension products being bought, increased professionalism in the level of qualifications financial advisers had to attain and the level of capital adequacy firms must have to ensure they meet robust financial requirements.

The industry has seen the cost of regulation soar mainly due to non-regulated advisers selling non-regulated products to consumers who did not have the knowledge or more importantly the appetite for the level of risk these products hold. We have covered this area before in our newsletters and the importance of only dealing with qualified financial advisers who also have the protection of working under a regulatory umbrella and oversight which a firm such as 2plan wealth management provides for the advisers and ultimately the clients.

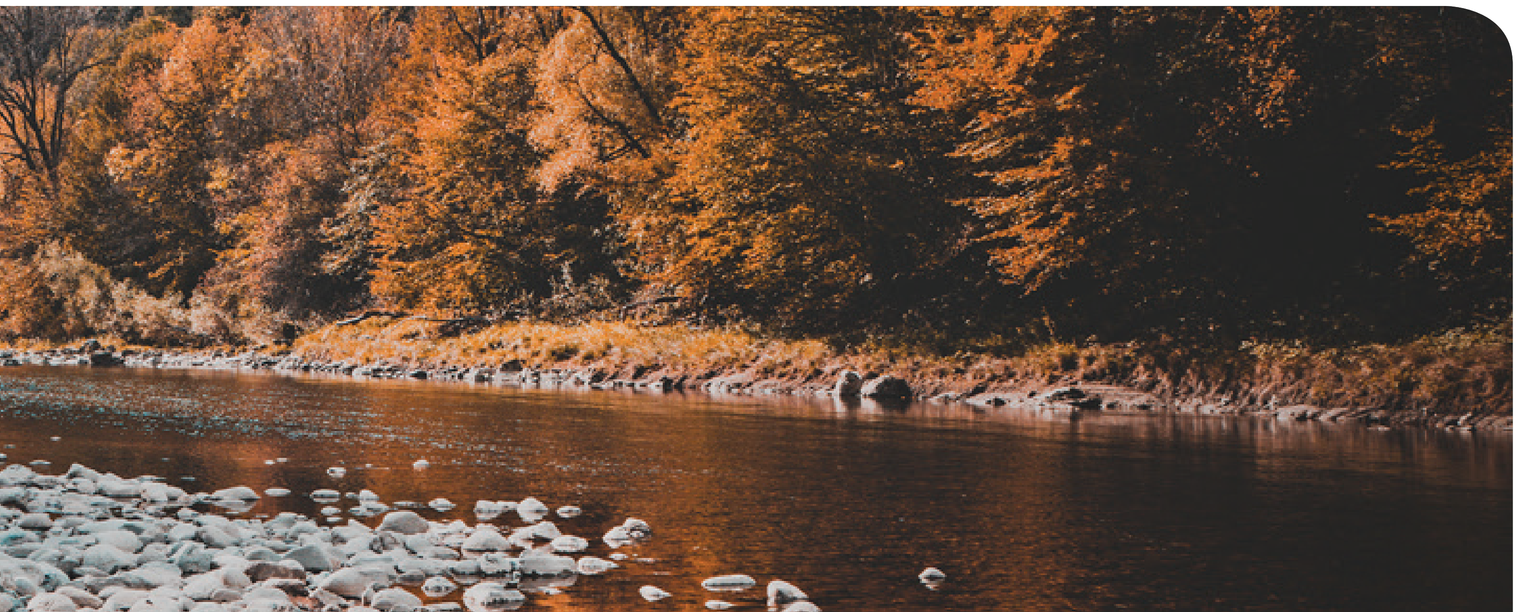
Over the last 10 years the number of qualified financial advisers in the industry has reduced from almost 100,000 to around 20,000 today. Never has financial advice been more important and sought after and many consumers do not enjoy the professional business relationship that others have established with their advisers to guide them through the financial maze of investments and pensions.

2018 sees the introduction of MiFID II which brings about certain changes to the financial advice process an adviser and client go through together to ensure the client is absolutely clear on the advice they are receiving – and that the advice is provided to the client in a written report - before they decide to proceed with any investment recommendations. Furthermore, for those clients who decide to enter into ongoing service agreements then again they will receive written reports each year to ensure clients are on-track towards attaining their financial goals. These reports will cover the reassessment of the client's financial situation, revisit the amount of risk the client wants to take with their investments, appraise their existing investments to ensure they are aligned with their attitude to risk, consider other financial objectives and goals, review investment performance and ensure the continued suitability of the current investments and identify any further financial objectives.

On 25th May of this year we see the introduction of the General Data Protection Regulation (GDPR) which represents the most important data protection regulation change in 20 years. The GDPR includes several requirements that benefit consumers, mandate increased control and transparency, and adds robust accountability requirements as well as significant fines for violations – up to 4% of global revenues or 20 million Euro, whichever is greater. Key differences in this data privacy regulation include stronger conditions for consent and obligations upon those people who collect and store personal date with obligatory contractual terms between the two. The GDPR also requires organisations to include data protection in the initial design of systems, a concept known as 'privacy by design'. Your 2plan independent financial adviser will discuss and make clients aware of any information and changes that will affect them and that they need to be aware of.

As with all the changes that the financial services industry is experiencing, clients themselves see ever changing circumstances in their lives – particularly financial ones which is where their financial adviser comes in. For clients who have established professional business relationships with their financial adviser and receive advice and service on an ongoing basis then even if a client may not achieve their ultimate financial objectives and goals then they will be much closer to achieving them than if they had never been fortunate enough to have met for example their 2plan independent financial adviser or other qualified advisers in our industry.

Chris Smallwood, CEO 2plan wealth management Ltd



Investing for the next generation

"A good start in life" is what all parents want for their young children.

Initially this often translates into a surplus of toys but, give or take technology fads, this stage eventually passes. At that point thoughts turn towards the future and the transition from child to adulthood.

The longer-term perspective raises the possibility of making investments for your children which they can call on in adult life. This can lead to a variety of issues:

- are there particular needs which should be targeted or is flexibility more important?
- which investments would be appropriate?
- can some parental or other controls over when children can have access to the investment be put in place?
- which are the most tax efficient?

Save for what?

For today's children, the path through the early years of adulthood looks rather different from, and more expensive than, that of parents and grandparents:

Higher education may be seen to be more important for getting that dream job but it also comes at a much higher cost. Taking into account tuition fees, accommodation and living expenses, a three year degree is likely to cost students between £35,000 to £40,000. Before 1998, there were only grants. Loans for tuition fees did not begin until 2006. You may have left university with a bank overdraft, but the sum owing probably pales into insignificance compared to the five figure debts many of the coming generations of graduates face.

Marriage can be costly for those who choose it. According to the consumer website Money Saving Expert, the average wedding costs around £20,000.

One third of couples questioned admitted going into debt to pay for their wedding.

Getting on the first rung of the property ladder is another growing cost for the next generation. The typical first-time buyer borrows over 3.39 times their income with a deposit of 17% and we've all heard of the Bank of Mum and Dad.

Once they have the degree, the job and the home (and the mountain of debt), there's another long-term financing requirement which today's children will encounter: retirement provision. The final salary pension scheme, which has benefitted today's retirees, has virtually disappeared for new private sector employees.

Take expert advice

Two principles that apply to many aspects of financial planning are particularly relevant when thinking about children:

1. The sooner you start the better, and the more scope there is for investments to grow (although there's still no guarantee that they will).
2. Take expert advice before making any decisions. The right investment set up in the wrong way can be worse than the wrong investment set up in the right way.

2plan wealth management Ltd

The value of your investments and any income from them can fall as well as rise and you may not get back the original amount invested.

Volatility strikes back

This year has seen volatility return to financial markets, as mounting evidence of the strength of the global economy sent bond yields up and the US dollar down. Equities rose over the month of January as a whole, although stock markets came down with a bump early in February in a warning that the unusually benign market conditions of recent months are unlikely to persist forever.

Global GDP growth driving confidence

Increased market volatility comes despite the most benign global economic outlook since the great financial crisis. In the January update to its 'World Economic Outlook,' the International Monetary Fund revised its forecasts for global growth in 2018 and 2019 up by 0.2% to 3.9% for each year. This underscored bullish sentiment on the global economy's prospects.

The US economy reported 2.6% growth (annualised) in the fourth quarter of 2017, a little below forecasts but still a solid rate, while the Eurozone economy grew 2.5% in 2017, the strongest rate in a decade. In the UK, the economy grew 1.8% in 2017, down from 1.9% in 2016 but much stronger than some feared in the wake of the Brexit referendum. Meanwhile, inflation remains low in most economies.

Rising interest rates pushing bond yields higher

The yield on 10-year US government bonds rose to 2.79% by early February, the highest level since April 2014. Benchmark yields rose (government bond prices fell) by similar amounts in other major markets, such as Germany and the UK. January's 0.31% rise in US yields was the steepest one-month increase since November 2016, which came in the wake of Donald Trump's election as US president.

The US administration's success in passing tax-cutting legislation may be putting upward pressure on US yields, as investors factor in higher US budget deficits in future. But, with the rise in yields happening in most major markets, we think yields are also reflecting evidence of a strengthening performance across most of the world economy, which should incline central banks to tighten interest monetary policy more quickly and put upward pressure on interest rates.

The market is pricing in about an 80% chance of a further rise in interest rates at the US Federal Reserve's March meeting, which would be the sixth hike since the global financial crisis.

Global equities off to a strong start in 2018

The MSCI World Index rose 5.2% in US-dollar terms over January (but just 0.1% in sterling terms, reflecting the pound's appreciation against the dollar over the month), but dropped 5.8% in the week to 5 February, taking the index back almost exactly to where it started the year. US equities led the decline, falling 7.2% over the week to 5 February – the biggest weekly fall since August 2015.

Share prices had reached record highs in many markets, which may partly reflect the fact that bonds, the main alternative investment, were even more expensive (i.e., yields were very low). Some analysts therefore pointed to January's sharp rise in bond yields as a reason for the hit to stock markets.

Stock market volatility has increased, but this comes after an unusually strong and stable period for markets stretching back to mid-2016.

A broader set of indicators suggest investors are not yet taking too negative a view of the situation. Assets sometimes regarded as "safe havens", such as the Japanese yen and gold, rose in value against the US dollar during January, but not excessively. Credit spreads (the premiums investors charge to borrowers with a risk of defaulting) continued to grind tighter over January, approaching or even sinking below pre-crisis lows.

The US dollar weakened 3.2% over January on a trade-weighted basis, even as the market digested growth-boosting US tax cuts. We think currency moves reflected not so much a weakening of the US dollar as a strengthening in the euro and the Japanese yen as investors reacted to stronger growth prospects in those economies. The dollar remains modestly overvalued on some measures.

The price of Brent Crude oil is up 1.1% year-to-date, a modest gain compared with a 5% lift in December. Oil prices have been drifting higher since mid-2017 as major producing nations have reached agreements to curb supply while global stocks decline. Metals prices were flat to slightly higher over January amid an optimistic global economic backdrop.

UK equity markets weighed down by stronger sterling

UK markets were something of an outlier to broader developments. The yield on 10-year government bonds has risen 0.37% year-to-5 February, similar to other major markets, reaching 1.56%, the highest level since May 2016 in the run up to the Brexit referendum. But the benchmark FTSE 100 Index fell by 2% in January, while most other markets were rising. This in part reflected the strengthening value of sterling, which was up 5.3% against the US dollar in January. A stronger pound decreases the sterling value of companies' foreign currency earnings, which is a relatively high share for FTSE 100 companies. But the more domestically oriented FTSE 250 Index also underperformed global markets, sinking 2.3% in January.

The outlook for UK economic growth is generally considered weaker than those of most other major economies, with Brexit-related uncertainty weighing on investor sentiment both in financial markets and the real economy. Growth of 1.8% in 2017 was the weakest since 2012. Perhaps partly reflecting their weaker January, UK stocks fell less than other global markets in the early February correction; the FTSE 100 dropped 4.4% in the week to 5 February.

Outlook

The key question facing investors continues to be whether stock markets will weather the prospect of higher interest rates, or whether rising yields will trigger a deeper stock market correction. We believe the outlook for equities will depend to a large degree on why interest rates are going up.

A rise in interest rates driven by expectations for stronger growth could still make for a constructive outlook for stock markets. However, a rise in bond yields driven by fears of faster-than-expected inflation would probably be more disruptive. We will be watching for signs of inflation slipping its bounds, for example, if there is a sustained acceleration in wages.

Author, Andrew Colquhoun, Scottish Widows Invest Proposition Director, Bulk Annuities & Investment Strategy

The value of investments and any income from them can go down as well as up and is not guaranteed, and you could get back less than you originally invested. Past performance is not a guide to future performance. The views expressed within this article are those of Scottish Widows, who may or may not have acted upon them.

The Architas outlook - risks and opportunities in 2018

2017 finished particularly strongly for sterling investors in most asset classes, especially those in higher risk investments such as equities. 2018 began no differently, as a number of stockmarkets hit record highs in January, with the US tax cuts proving to be a positive catalyst. But after more than a year of calm and generally positive markets, recent weeks have seen some big falls in global stockmarkets.

Volatility, the rate of change of asset prices up or down, has returned. The S&P 500, the main US index, fell 4.1% on Monday the 5th of February - the worst daily fall since August 2011. By the 8th of February, the index had fallen 10% from the peak it set on the 26th of January, but by the 16th, it had recovered over half the lost ground. Other global indices suffered similar fates.

The market decline was actually blamed on good news: strong jobs data in the US caused bond investors to grow concerned that the US Federal Reserve could raise interest rates quicker and higher than expected to keep inflation in check. This fear spilled over to US stockmarkets and subsequently to global stockmarkets.

> If the era of cheap money is coming to an end, it has big implications for businesses and economies. Some companies could struggle if interest rates rise to three or perhaps even four per cent.

Optimistic, but maintaining caution

With markets having such a strong run in 2017, a dip in prices at some point this year was widely expected. Despite this, we believe the overall global economic growth outlook remains strong and that most signs point towards a fairly accommodative investment environment in 2018. It is however important to remember that there are always risks to be aware of.

As part of our asset allocation process, we identify key risks we think have the potential to disturb markets. Three of these are highlighted below; we've already had a taste of the implications of the first. On the positive side, we take a look at three asset classes we believe could do well this year.

Top potential risks and opportunities outlook

Risks - top three risks we have identified for markets:

1) Accelerating inflation: a situation where inflation accelerates quicker than expected could be dangerous. It could push central banks to increase interest rates faster than they are planning in order to keep inflation from rising too high, and is something investors are becoming increasingly focused on. Significantly higher interest rates could stunt the economic growth recovery that has been the main catalyst for the buoyant markets investors enjoyed in 2017.

2) Crowded trades: investors have been concentrating themselves in certain asset classes and market sectors, something that could pose a threat. If markets experience further periods where they are significantly more volatile and prices dip in a popular sector, it could cause a rush to sell.

3) Geopolitical risks: these were largely ignored by investors in 2017, but 2018 could be different. We are already seeing rising tensions in the Middle East and this could become more of an issue for markets.

Opportunities - three asset classes we currently favour:

1) Japanese equities: Prime Minister Abe's re-election towards the end of 2017 provides increased certainty for the asset class. We like the investment environment, and think strong company earnings growth has the potential to support stockmarkets. Despite a strong 2017, Japanese stocks still offer reasonable value relative to many other developed markets.

2) European equities: we believe the economic picture is positive and should continue through 2018. Although the fourth quarter of 2017 was fairly flat for stockmarkets in the region, potentially due to some profit taking after a strong year, the outlook is healthy. Companies' profit margins have been improving, while we think European stocks remain relatively good value.

3) Alternatives: despite a few sector-specific events hurting some assets' performance at the tail end of 2017, we believe they can be a useful addition to portfolios. If we do see traditional financial markets, like equities and bonds, become more volatile again, it could be helpful to have exposure to assets which tend not to behave in the same way.

What does this mean for investors?

As we look ahead, the economic outlook is encouraging. It is important to remember, however, that periods of increased market volatility are certainly possible, as we have seen recently. If this does occur, it's important to remain patient and keep focused on the long-term prospects for investments. Diversifying across a range of asset classes, regions and investment managers will remain as important as ever.

Sheldon MacDonald, Deputy Chief Investment Officer, Architas

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If you would like to discuss any of these topics in more detail, please feel free to contact me to make an appointment. If you have friends, family members or colleagues who you think would be interested in these topics, please pass this newsletter to them.

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