# BULLETIN

YOUR ESSENTIAL FINANCIAL BRIEFING

ISSUE TWO

## Welcome to this series of topical articles to help you navigate your financial world

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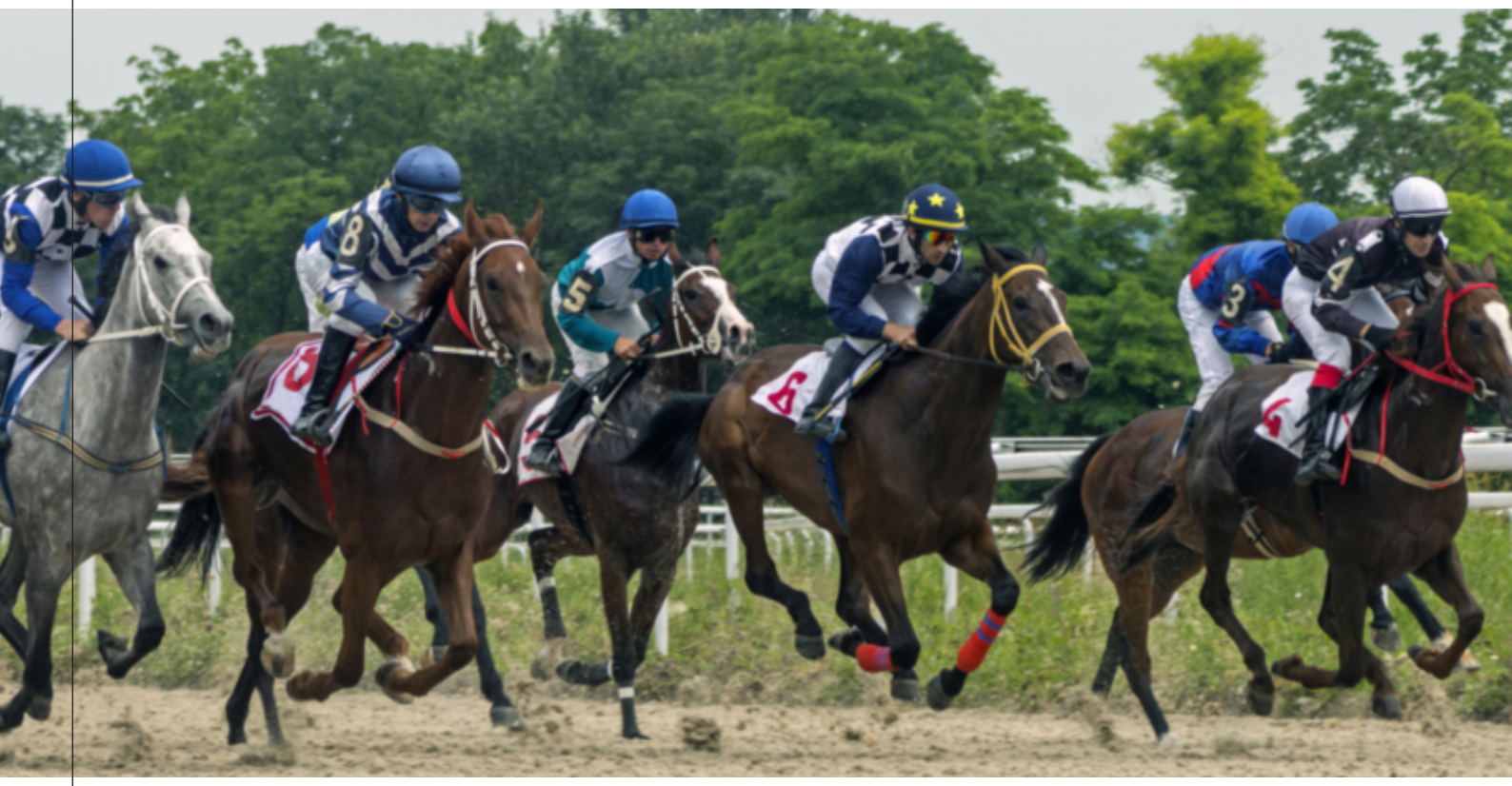


# What are the risks for investors in 2021?

Hamish Douglass is co-founder of Magellan, manager of the St. James's Place International Equity Fund. Here he discusses some of the risks on the horizon for 2021, and why Bitcoin should be seen like a 'punt at the races'

**Can you expand on the concerns you've expressed that the market hasn't 'priced in' the risk of COVID-19 mutations?**

The virus will keep mutating because there are so many infections happening around the world. What we don't know is what the nature of the next mutation will be.

The current vaccines are still highly effective in protecting you against dying, but less so at protecting you from getting infected or sick. It's almost inevitable that, in time, mutations will cause an 'escape variant' – which could get around these current vaccines. It might not happen, but there may be a 5% probability, it may be a 20% probability, I don't know.

It's more likely we get an escaped mutation that undermines the current vaccines, after which scientists recode the vaccines. In that case, you'd have to start the whole vaccination process again, because this new variant would become the dominant variant, and everyone who's just been vaccinated won't have any immunity against it.

That would delay the world recovery by 12 months or so, which would have some impact on the markets. There seems to be very little margin of safety in markets for an adverse outcome with the vaccines. No-one knows what will happen.

**We're not going to punt that there's a 100% probability that the economic story is going to improve**

**So how are you considering the risks of COVID-19 mutations on the portfolio?**

I'm relaxed about it. Across our portfolio, we've still got businesses that are reporting incredible results: whether it's Alphabet, Microsoft, Facebook, Netflix, or Crown Castle.

We're taking a lot of expert advice, and playing it cautiously. We're here to protect people's capital by trying to make prudent decisions. We're not going to punt that there's a 100% probability that the economic story is going to improve, like the market's pricing it at the moment. We actually don't know what this virus will do in 12 months' time.

**What about speculation that the Biden administration will increase regulation on Big Tech? Does that change your views on the technology companies that you hold?**

No, I think the regulatory risk has reduced and it's more predictable now. Are we going to get regulation? Yes, but to regulate technology companies would mean passing more legislation, which is very hard to get consensus on. In the US, that requires 60 senators and you'd need 10 senators from the Republican side. There are deep divisions on this.

Plus, we think the regulatory risk is already reflected in the share prices of these companies. Facebook is trading at 23 times earnings, but it's just grown its revenue at 32% in a year, and it's still got enormous runway to monetise Messenger and Shops. So, these companies would be at much higher prices if there wasn't regulatory risk around these stocks. We factor in regulatory risk alongside other things in the future, and we still like the businesses.

For Alphabet, just look at the results. We're trimming it because it's now at our maximum position size under our new risk rules. But it's just one of the strongest business models the world has ever seen, and a little bit of regulation won't kill this business. It's going to come at some cost. But it's a cost that I think is well within the guardrails and where the share prices are for the economic potential of the businesses.

Over three to five years I believe we'll earn decent returns by holding at these prices. Could there be, say, 10% or 15% of price volatility if a new regulatory enquiry is announced? Absolutely. But when you consider it's a 5% or 6% position in the whole portfolio, you're talking about 0.6% of the portfolio in a month, which is largely just noise in that period. What matters is compounding this money over time. And we're confident in that compounding.

**What are your views on Bitcoin?**

I would say the wisdom and the madness of crowds intersect here. There is no doubt the theory behind the algorithm is a brilliant concept. But there is no basis, other than convincing people of the theory, getting the crowd behind it, and then enough people to buy it to offset people who want to transact in it, to support the value.

There is no government backing. It's not a fiat currency [money, issued by a government, which isn't backed by a commodity such as gold], and there are no fundamentals behind it. It's a digital algorithm on a screen. There's nothing intrinsic about it at all.

The problem is that if more and more people want to get behind it because there is a limited supply, bubbles can occur. I think currencies should be pretty stable. They shouldn't go up and down 200% in a year, so it's much more of a speculative asset.

I like the idea behind creating a digital currency, but I think it's deeply dangerous and highly speculative to make a judgement call whether you make or lose money in it. It's something we would pass on. But if you're going to do it, treat it as a punt at the races. It's not something I would call an investment class asset from our perspective.

# How to get the best out of money you've saved during the pandemic

Seen your spending fall since the pandemic began?
Now is the time to take advantage

Our lives have changed in ways we couldn't have imagined at the start of 2020. Social distancing, wearing masks and sanitising our hands have become part of daily life, while restrictions on movement have forced many of us to press pause on so much that we took for granted.

We've had to adapt to different financial circumstances too, in a variety of ways. The effects of redundancy and reduced incomes are well established, with an increase in the number of households struggling to cover their essential outgoings[1].

But there is also growing evidence that financial experiences and behaviours have changed in other ways. Spending levels fell by around a quarter during the initial lockdown, according to the Institute for Fiscal Studies[2], creating what it referred to as 'forced saving'. That's one reason why the UK savings ratio – the percentage of disposable income saved in a household – leapt from 6% before the pandemic to 29% in the second three months of the year[3].

This equates to a lot more cash sitting in bank accounts. It also represents an opportunity to make that money work harder for you. After all, extra money in the bank is great for peace of mind, but there's a decent chance that it's losing a bit of its value with every day that passes.

So, what are your options? Here are a few to consider.

## CLEAR OR CUT YOUR DEBTS

This is the first port of call if you have unsecured debts such as loans, credit cards or overdrafts to pay off. Start with the most expensive first – usually credit cards or payday loans – and take the opportunity to see if you can shift any of your remaining outstanding debts to lower-interest borrowing.

## INCREASE YOUR RAINY-DAY FUND

The logic for building an emergency fund that you can access when you need cash at short notice can rarely have been stronger. While the rule of thumb of keeping between three and six months of salary in a rainy-day pot may sound ambitious, any money you can set aside to dip into in the event of an emergency will bolster your financial resilience.

## REDUCE YOUR MORTGAGE TERM

With cash savings rates so low, increasing your mortgage repayments is a particularly effective way to put any surplus income to work. Overpayments on your mortgage can help you clear it more quickly, saving potentially thousands of pounds in interest and also making it easier to remortgage. Most lenders allow you to pay 10% of your mortgage balance as an overpayment each year but check first because there can be penalties for overpaying by too much.

## BUILD A LONG-TERM FOUNDATION

If you've cut your spending, cleared your debts, and have a rainy-day fund set up, you might want to make your spare cash work even harder by investing it. Individual Savings Accounts (ISAs) are the place to start, with an annual income and capital gains tax free allowance of £20,000 that means you can keep the income and/or growth you receive. Invested in a mix of funds and assets and left alone to benefit from the effects of compounding, stock-market based investments can help you outpace inflation and reach your long-term goals.

**The logic for building an emergency fund that you can access when you need cash at short notice can rarely have been stronger**

## GIVE YOUR PENSION A SHOT IN THE ARM

Starting or increasing your pension payments is another tax-efficient way of boosting your long-term finances. Government tax relief is paid on contributions, while if you're paying into a workplace pension your employer will top it up too.

## GET IN TOUCH

The events of the last year may have prompted you to review your finances or reassess your goals in life. In which case, quality financial advice may be the best investment of the lot. We can work together to ensure you're getting the best from your finances, help you identify what you want your money to do, and work out a roadmap for your future.

The value of an investment with St. James's Place will be directly linked to the performance of the funds selected and may fall as well as rise. You may get back less than the amount invested.

An investment in equities will not provide the security of capital associated with a deposit account with a bank or building society.

The levels and bases of taxation and reliefs from taxation can change at any time and are dependent on individual circumstances.

Sources:

[1] FCA, FCA highlights continued support for consumers struggling with payments, October 2020

[2] IFS, Spending and saving during the COVID-19 crisis: evidence from bank account data, October 2020

[3] ONS, Coronavirus and its impact on the UK Institutional Sector Accounts: Quarter 2 (Apr to June) 2020, September 2020

# Why you should avoid the comfort of investing with the herd

In uncertain times, it's tempting to invest in expensive companies that seem like safe bets. But overpaying for comfort can prove a costly mistake, says Tye Bousada, founding Partner of EdgePoint Investment Group. EdgePoint are co-managers of the St. James's Place Global Equity and Global Growth funds

**You've maintained it's unwise to overpay to invest in big, growing companies that are expensive compared to the rest of the market. What does that mean?**

If brave enough to wade into the stock market, most people have felt very comfortable finding the obvious growers over the last 12 to 18 months. People are looking for the simple narratives, the very big mega-cap businesses. And they're not really paying attention to valuation.

But that's never proven to be a successful strategy. Go back over the last 70 years, and, in every year, look at the 750 largest businesses in the US. From that list, pull out the 10% fastest growers and compare their average valuation to the rest of those big companies.

You might be surprised to know that people have never paid more, on a relative basis, for growth than they have over the last 12 months; and that includes the 'dot-com bubble' back in 2000. At other times, where people have paid a lot for growth relative to the rest of the market, it's never ended well. That seems to be what's going on in the market today.

**Most people are doing the same thing – seeking the comfort of the obvious growers in the stock market**

**Why do you think that's happening now?**

When the stock market becomes extremely volatile, as in the last 12 months, investors tend to seek out businesses with a high probability of growing in the short-term.

Take Netflix – everyone knows it will grow during the pandemic because people are staying home and watching more shows. The problem is everyone knows this and, therefore, the future expectations of growth are likely already more than reflected in the share price.

**So, if everyone expects a company to grow, then its share price might be too expensive?**

When you invest in the stock market there are only two potential outcomes – making a mistake or capitalizing on someone else's. Your relative gain will be someone else's relative loss, or vice versa. How do you increase the probability of winning? The answer is you must have a view about the business's future that's not currently reflected in its share price. If you can't answer this, you're likely making a mistake investing in it.

**But that sounds like it could be an uncomfortable choice?**

Here's the problem with doing what's comfortable. Most people are doing the same thing – in this case, seeking the comfort of the obvious growers in the stock market. This 'herd mentality' results in rising valuations.

Growth stocks make the average investor feel comfortable today because they'll grow in this volatile world. This comfort causes people to invest in them, despite not knowing how the business might help them achieve their goal. Although owning an obvious growth stock makes you feel comfortable today, overpaying for a business for this reason in the short-term won't help you get there.

**Finally, do you see any parallels with the current popularity of index-tracking 'passive' funds, which allow people to invest across whole markets or sectors?**

It all comes back to whether doing what feels comfortable today is the right thing in the long-term. I was born into the era of the 'nifty 50', a time in the US where investors thought that all they had to do was buy the 50 biggest, most branded companies that were the obvious growers. That made everyone feel comfortable. But had they done that, over the next decade they would have experienced permanent loss of capital and their money cut in half.

Then, in the late 1970s, President Jimmy Carter went on television and told his fellow Americans that the world would soon hit peak oil. Everyone went out and bought oil and gas companies However, 25 years later it cost more money to pull oil tanks out of the ground than the oil inside was worth – there was permanent loss of capital again.

In the 1980s, the idea was to invest in Japan, because everyone would buy Walkmans and televisions from Sony, and Toyota would teach the world how to make cars. At the time, you might have felt comfortable, but 30 years later you've still not made your money back, never mind accounting for inflation.

In the 1990s, the narrative was that emerging markets always grow faster than developed markets. But crises in Mexico, Russia, and South-East Asia resulted in permanent loss of capital. In 1999 everybody ploughed into technology, media and telecoms – but we know how that ended.

Finally, in the mid-2000s, there was a global real estate boom going on. Alan Greenspan, then-Chair of the US Federal Reserve, told Americans not to worry because the average US house price never falls. People felt comfortable following these ideas.

So, I understand many might feel comfortable buying an index fund that's full of mega-cap businesses trading at all-time high relative valuations. But, if history is a guide, that's not a proven strategy towards your financial goals.

# Retirement tips for Generation X

## The sandwich generation faces a tsunami of financial pressures, which underline the importance of a long-term plan – and the value of advice

Members of Generation X are often referred to as the 'sandwich generation', for good reason: they're caught between the baby boomers (their parents, who are living longer and increasingly likely to need long-term care) and millennials (their adult kids, who are struggling with the costs of living), and are being squeezed financially from both sides.

Born between 1965 and 1980, Gen Xers formed the bulk of the workforce at a time when responsibility for long-term savings shifted from employers and the state to the individual. Many are also paying the price for having entered the workforce too late to receive Defined Benefit pensions (where the amount paid is based on the number of years spent with an employer and the salary earned), but too early to benefit from automatic enrolment in jobs they had at the time, as this only took effect in 2012.

### AN UNCERTAIN FUTURE

Taken together, these factors explain why Gen Xers face a particular set of challenges in saving and planning for the future.

A third of this group are at high risk of retiring with 'minimal' incomes, according to a recent report by the International Longevity Centre UK (ILC) – with more than half wanting to save more, but struggling to do so. More than six million members of Gen X expect to be worse off than their parents when they eventually retire[1].

"For members of Generation X, this should be a peak contribution time," says Tony Clark, Senior Propositions Manager at St. James's Place Wealth Management. "But they're faced with a tsunami of financial pressures. Even if they're not paying for care directly, they might be working reduced hours to look after a parent, or parents – which reduces how much they can contribute to a pension."

Almost a third of Gen Xers surveyed by the ILC said saving for retirement was low on their list of priorities, with 19% finding it hard to save regularly due to insecure incomes and outgoings. These difficulties have been exacerbated by the effects of the pandemic, during which more than half a million Gen Xers have been made redundant and 1.3m have seen their hours reduced[2].

### TOP TIPS FOR GEN XERS:

- Consider your immediate financial priorities in the context of longer-term goals – please get in touch for help if you're finding it difficult to stay on track in challenging times.
- We can have a conversation about how your investments are performing and whether they could work harder – for example, by regularly reviewing your risk appetite and any disparate pension pots.
- During our meetings, we can discuss whether you need to make changes to help achieve your goals – perhaps by retiring later or semi-retiring first.

- If you're self-employed, we can look at the best ways to structure your pension contributions to better suit your earnings patterns, utilising available allowances.
- Aim to retire when you're confident you'll have the level of income you need to live comfortably – not at an arbitrary age. Baby Boomers typically retired at 60 or 65, although that's an increasingly unlikely option for Gen X.

**More than six million members of Gen X expect to be worse off than their parents when they eventually retire**

further. Why not ask them or check your contract to find out if that's the case – it could make a big difference.

Improving your retirement savings doesn't have to entail paying in more money, though. It could be that your current investments aren't performing well enough, or that you could get better returns by reviewing your existing retirement pots to see if they could be working harder for you. Please get in touch if you'd like to discuss this.

## THE IMPORTANCE OF A PLAN

All of this serves to underline the importance of knowing what to plan for and what your options are when circumstances or priorities invariably change, says Clark.

"That may include working for longer and delaying your retirement. But actually, your goals shouldn't need to shift. Not if you have a handle on what your savings are – it could be a mix of Defined Contribution and Defined Benefit pensions – and what you should be doing with them, even if you're not ready to retire."

Perhaps the most obvious way to boost your retirement savings is to increase your pension contributions, especially if you're in a workplace scheme where you benefit from both tax relief and employer contributions.

There may even be a tipping point beyond which your employer doesn't just match your extra contributions but goes

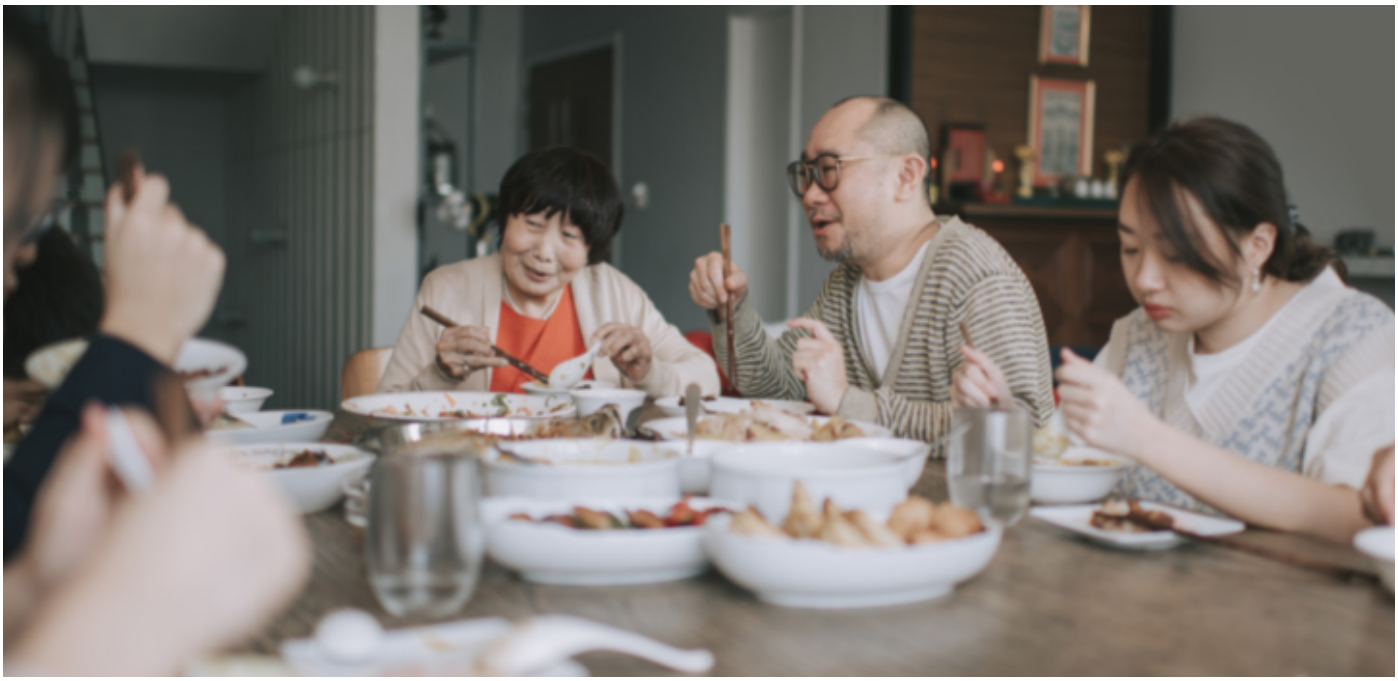
## SHARING THE LOAD

Working together, we can ensure that any decisions you take in the shorter term are informed by and make sense in the context of your specific financial situation and wider life plans. In offering you that long-term guidance, we can also look at how your retirement planning can be linked to estate planning.

The value of an investment with St. James's Place will be directly linked to the performance of the funds selected and may fall as well as rise. You may get back less than the amount invested.

Sources:

[1,2] International Longevity Centre, "The Forgotten Generation? Retirement Income Prospects for Generation X", November 2020, 6035 people surveyed



# How to beat Inheritance Tax in five easy moves

**Planning now to mitigate the impact of Inheritance Tax can improve not only your life, but also your family's. Here's how to do it**

We live in a world where, happily, ever-greater emphasis is given to wellbeing. Our society is attuned to a holistic approach embracing physical, mental and financial health, and how these factors interact.

These are all ways of helping us live better lives – and should include finding better ways to prepare for the final stage. This can be a difficult subject to broach – in fact, over a third of over-55s say they find the topic too hard to raise with their loved ones[1]. But doing so early is not only a way of protecting your family, but also of giving you greater peace of mind right now.

Mitigating your Inheritance Tax (IHT) liability is often put off until it's too late. Many IHT bills are avoidable – so now, as the new financial year begins, it's time to make sure you make the most of exemptions and tax reliefs.

IHT is a complex business, so consider who your estate will pass to and whether it makes sense to pass money to family members now, rather than on your death. Some conversations with your family will be necessary, but it's wise also to engage professional help. Please get in touch to understand your options – some of those listed next will not only lessen the impact of IHT but could also help your family right now and leave you content knowing that proper plans are in place.

## GIVE NOW (TO YOUR FAMILY)

1 Giving away money and assets while you're alive can be a rewarding way to reduce a future IHT bill. You can give away up to £3,000 a year, as well as unlimited small gifts up to £250 each. The value of those gifts will fall outside your estate immediately.

These could make a real difference to a child or grandchild's future, perhaps at university, if they're raising a house deposit, or when they start work. You could also consider contributing to a Junior ISA or investing up to £2,880 a year in a pension for them. (The same person cannot receive both a small gift and any of your annual gifting allowance in the same tax year.)

It is also possible to utilise any unused gifting allowance from the previous tax year. By combining individual contributions, couples can potentially gift up to £12,000 by 5 April.

## GIVE AWAY INCOME YOU DON'T NEED

2 There's no limit on the number of regular gifts you can make from your income, provided these don't affect your standard of living. Keeping a record will speed up checks made later by HMRC – something you should remember for any gifts you make.

**No-one knows when the next crisis will arise**

### SAVE MORE INTO A PENSION

3 Money saved into a pension is not normally subject to IHT. Should you die before you're 75, the proceeds from your pension can be paid as a lump sum or income to any beneficiary free from tax. After 75, beneficiaries will only need to pay tax at their marginal rate on withdrawals.

### REVIEW YOUR WILL

4 To ensure your intentions are carried out after your death, draw up a Will. Most couples, married or in a civil partnership, leave everything to each other, since this doesn't usually attract IHT. If your partner falls outside this category, they could lose out to parents or children.

If your circumstances have changed, perhaps following a divorce, you may wish to amend your Will to make sure a new partner can inherit; or if you have remarried, to ensure as much goes to your children and grandchildren as you would like.

### BUY LIFE ASSURANCE IN A TRUST

5 Sometimes, it isn't viable to fully mitigate a future IHT bill. Taking out life assurance where the sum assured covers the likely IHT bill, and placing it in a trust, could prevent your family from having to sell assets to meet the liability. The trust ensures the policy's value falls outside your estate. It also means your executors will have the funds available when they need them, to settle your estate.

If the coronavirus pandemic has taught us anything, it's the importance of being prepared. No-one knows when the next crisis will arise, only that we can help mitigate any impacts through effective planning.

Making sure that your estate is in order, and that those you love will be well looked after, can bring you peace of mind today and comfort for your family in the future. The start of the tax year is an ideal opportunity to discuss estate planning so do get in touch if you need advice.

The value of an investment with St. James's Place will be directly linked to the performance of the funds you select and the value can therefore go down as well as up. You may get back less than you invested.

The levels and bases of taxation, and reliefs from taxation, can change at any time. The value of any tax relief generally depends on individual circumstances

Will writing involves the referral to a service that is separate and distinct to those offered by St. James's Place. Wills and Trusts are not regulated by the Financial Conduct Authority.

Sources:

[1] A survey of more than 2,000 people by wishLockr, 2018