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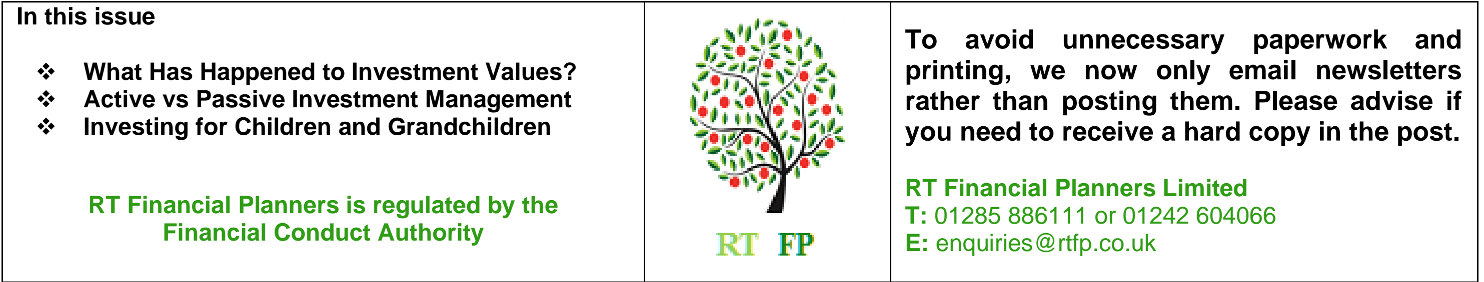
RT FINANCIAL PLANNERS LTD

NEWSLETTER – JULY 2023



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A Look at Investment Markets and Assets

I am sure I don't need to remind anyone how difficult investment conditions have been for almost all asset classes, and this has now been over a very protracted timescale. It has now been over eighteen months that we have been talking about a similar picture. There have been various causes, but the underlying root cause has been inflation.

Over this time, there have been a number of inflationary factors, such as labour shortages, spiralling wage costs and higher food costs because of the position in Ukraine and the resultant, higher energy costs. It was in late 2021 when we started seeing heavy falls in investment markets and the position has been up and down since then but, and putting it simply, values have largely moved sideways, at best.

On the subject of inflation, there has been much talk about prices, such as a pint of milk. It is always useful to make comparisons, for context, and using data from the ONS, a fund management group has recently compared the price of a pint of lager with the price of a pint of milk over the last 35 years – much more relatable than the FTSE level! In January 1988, the price of a pint of milk was 25p. And the price of a pint of lager was £1. This means you could have exchanged your pint of milk for a quarter of a pint of lager (if you were in the right pub and found the right person …). Today, your pint of milk would get you just under one sixth of a pint – 16%, also known informally as a medium gulp! So what's our point? The ONS will say that the annual rates of inflation on milk are 3%, and 5% on lager. But what we ***notice*** is that as of January 2023, a pint of milk is 70p – up almost 3x since 1988. A pint of lager is £4.39 – an increase of **4.5x** over the same 35 years.

Returning to the subject of investment markets, over the last eighteen months, the majority of assets and index measures have equally been impacted. For example, between January 2022 and the end of June 2023, the average cautious and balanced managed funds (measured by the Adviser Fund Index) dropped in value by 9.22%and 10.93% respectively. Measures for indices for cautious assets such as Corporate Bonds and Gilts have been decimated – seeing falls of 16.58% and 26.78% respectively. This has had a detrimental effect on portfolios, including the most cautious ones. The UK market index has fared better than other measures as it is so heavily weighted in oil, gas and resources. Shares have recovered a little more in some economies, but a portfolio holding only equities would be most inappropriate from a risk management perspective.

Our advice remains the same that we need to focus on the longer term, and try to avoid focusing on short term falls.

During periods of heightened financial market volatility, and increased levels of uncertainty, it can be tempting to try and time the market by selling assets and then buying them back at a later stage. This may be particularly tempting with interest rates now yielding higher returns than has been the case for many years.

It is an undeniable fact that timing the market is virtually impossible, even for the most experienced investors. This is why it's often said that time *in* the market is more important than *timing* the market. It is important to recognise that portfolio returns don't happen in nice, neat segments but are unpredictable and lumpy. The risk of moving to cash is that you miss out on the big years.

Sitting tight when investing is important, but it is never an easy ride. On the way up in a bull market, it is easy to be concerned about the valuation levels, forever peering around the next corner and ever watching for the canaries in the coal mine that might signal the onset of the next market downturn. Research also suggests that investors are more likely to focus on gains rather than the perceived risk of loss when the outcome of an investment is uncertain – which is why many investors panic sell when the going gets tough, and is a good reason why investors are always encouraged not to look at their investments every day.

The pace at which markets react to news generally means stock prices have already absorbed the impact of new developments and when markets turn, they turn quickly. Those trying to time their entry and exit will probably miss the market bounce. Attempting to predict the future, can mean it is very likely that you end up being out of the market when it unexpectedly surges upward, potentially missing some of the best performing days. Missing one or two big days, compounded over time, can greatly impact your portfolio.

Research has highlighted that, most of the best days happen around the worst days. Over the last 20 years, 70% of the best 10 days happened within two weeks of the worst 10 days (Source: Factset). This means that if you were to incessantly go in, and out, of the market it would erode returns, as well as having tax implications and transaction costs.

Hindsight is wonderful, but we don't have that benefit, so we urge investors to let the power of compounding returns take effect rather than potentially crystallising losses. We can therefore only reiterate that we still firmly believe that remaining invested and making changes only where necessary is the most sensible course of action.

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Newsletter – July 2023

Are Active or Passive Investments Better?

This has been widely debated for many years, with both sides having what appears to be equally valid arguments. trying to make the case for their own strategy at the expense of the other.

Firstly, I will briefly summarise the characteristics of both. A passively-managed investment strategy is one where the investment manager pools investor money to buy assets in accordance with the constituents and weightings of a chosen index. The manager will, therefore, make no active decisions regarding which assets to include in or exclude from the portfolio, or change the weighting assigned to the assets. In contrast, an active investment manager will decide which assets to include in the portfolio and will, typically, deviate from the benchmark weightings. An active manager will further, typically, hold fewer assets than the benchmark, making the portfolio more concentrated than the comparable passive portfolio. In doing so, it affords the active manager the opportunity to outperform the benchmark.

There are pros and cons to both strategies. Passive investments are almost always cheaper than actively-managed portfolios, due to less management input being needed. But passive investments are limited to the benchmark they track, whereas active managers have the flexibility to invest in the assets they believe will outperform the index. Similarly active managers can exclude assets that they believe will drag on the performance of the fund or index.

It is very often the case that in a strong and rising market, passive funds do very well, as almost all assets can help contribute to the returns. In difficult or volatile markets, active management may have the upper hand by enabling the manager to be more selective in which assets they hold. The US market is also one that many people feel is most suited to passive investing, it seems that active managers who outperform one year do poorly the next. Conversely Asia and emerging markets tend to require more specialist input.

We believe that there is a place for both active and passive investments within portfolios, and instead of choosing a single strategy, combining them both can create a solution that encompasses the best of both worlds. As an example, we can allocate a portion of a portfolio to a passive investment, which will give the index returns, and use the remainder to make active decisions to allocate to high-conviction ideas. The result is a cost-effective portfolio that can achieve excess returns over time, and is effectively using a "core-satellite approach" to portfolio construction.

The core-satellite example is one of many ways that investment managers can utilise both active and passive investment strategies to combine investment solutions. So, we believe an "either-or" approach being debated isn't helpful or necessary – rather how can we use the one or both strategies that may maximise returns at a given point in time.

Investing for Children

We receive many enquiries about making investments for younger children or grandchildren, so we are providing a brief summary of the options available and the merits of each.

Child Trust Fund (CTF) and Junior ISAs (JISA)
Although it is no longer possible for new Child Trust Funds to be set up, they were available to children born between September 2002 and January 2011. It is now possible to transfer these accounts to the newer Junior ISAs, which has opened up the product choice considerably.

JISAs are available to children under 18 who do not hold a CTF account. It is still possible for payments to be made to existing CTF accounts and the maximum annual amount is £9,000 in the current year, which is the same as the maximum for a JISA. Funds in these accounts grow in a very tax efficient environment. The investment can be made into a cash account and/or a stocks and shares account. At age 18 the Junior ISA becomes an ordinary ISA and ownership will revert to the "child" automatically - which could be a downside for some people who may wish to retain more control over the timing of passing the money to the child.

ISAs
Cash ISAs are available to those aged 16 or 17, otherwise ISAs are only available to individuals aged 18 or over. If parents or grandparents wish to help adult children save for their future, or possible property purchase then investments into a Lifetime ISA will benefit from the addition of Government top ups. Of course, an adult relative could take out an ISA in their own name, with a view to using the proceeds for the child's benefit at a later date.

Investments Within Trust
A bare trust can be established for the child's benefit and investing in investment funds or an investment bond to use the child's own CGT or income tax allowance when they are encashed can be very efficient. Once again this will be passed to the child at age 18. To retain more control over the timing of the transfer, a discretionary trust could be used, which may also bring some income tax benefits.

Pensions
Setting up and paying into a pension for the child, can also be an attractive option, although access to funds will not be until age 55 as things currently stand (this is set to increase to age 57). This may be a good way of setting some money aside for children for much later in life. Tax-relievable pension contributions would usually be restricted to £3,600 gross per annum and will be paid net of basic rate tax (£2,880 net). There would be no further tax relief available unless the child were themselves a higher rate taxpayer!

Premium Bonds
You can invest from £25 up to the maximum of £50,000 for each child. A parent or guardian will be nominated to look after the bonds until the child is 16 when the bonds are held in the child's own name.

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