TPO Insight

SUMMER 2019

HOW TO GET BETTER RETURNS THAN NS&I OFFERS

BEHAVING YOURSELF

CHILD BENEFITS: WHY YOU SHOULDN'T OPT OUT

MARKET OVERVIEW

tpo
the private office

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Welcome to our summer newsletter

Welcome to the latest edition of our Insight newsletter, bringing you news, features and opinion from The Private Office (TPO) and the world of money and finance.

In this edition, we are continuing our financial planning for businesses series, this time looking at how to protect surviving shareholders in the event of death. Other articles include:

- A look at how to get better returns than NS&I offers;
- The first in a two-part series discussing behavioural investing;
- An explanation of why child benefit should still be claimed, even if you aren't entitled to keep it;
- An article about the new restrictions on the peer-to-peer sector that will be in place by December.

Our regular features include the usual savings rates tables with data from our sister company Savings Champion, along with the investment market update from Robert Morse of the TPO Investment Committee. Janet van der Hoven also takes us through a day in the life of a newly qualified adviser.

As mentioned in our Marketing Director's week in the life of feature in the previous newsletter, next month we will be launching our new website. The changes we have made are not just cosmetic; we are also introducing new sections dedicated to specialist topics with all of the relevant articles and guides, and giving the existing pages a much-needed update. We have kept our clients at the heart of all of the decisions we have made and we hope that you find the website much improved and easy to use.

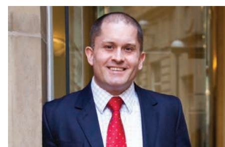
Recently, we sponsored the financial website SavvyWoman.co.uk's 'ISAs explained' event in London, where Savings Champion's Anna Bowes and TPO's Becky Bonner shared their knowledge of ISAs with the SavvyWoman audience. It is a pleasure to be involved with events like this, and to be able to talk to more people about their financial planning needs.

Coming up in October, we will be running more of our breakfast seminars for prospective business clients, offering information on a number of different business-related financial planning topics for privately owned businesses. If you or your family and friends would like to attend or would like more information, please email **marketing@theprivateoffice.com**.

Finally, we would like to take this opportunity to remind you of our work with the Penny Appeal, where for each new client that you refer we will sponsor a clean water well in one of the many water deficient countries around the world. We are proud to continue to support this and other organisations that have such a positive impact on people's lives. If you feel the services and advice we give could benefit someone you know, we would love the opportunity to be introduced. Please contact your adviser or one of our team.

We hope you enjoy this edition of Insight and we welcome any feedback you may have.

Best wishes,



Stuart Phillips
CHIEF EXECUTIVE
THE PRIVATE OFFICE

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Market overview

ROBERT MORSE
SENIOR PARTNER
TPO INVESTMENT COMMITTEE

It was not the announcement of a 25bps (basis points) rate cut and the premature ending of quantitative tightening that has worried the markets, as both were pretty much baked into most people's expectations. It was what Powell said afterwards. Along with saying that they don't consider political implications in their deliberations (a pointed rejection of the Trump tweet fest); that they remain data dependent; and that this was a mid-cycle policy insurance measure to ensure that economic recovery remained on track; he also said that this was not the start of multiple rate cuts. Up until that point in the press conference the markets, both equity and currency, remained unmoved. This was what they were waiting for and it wasn't the message they wanted.

By the end of the day the S&P 500, an American stock market index, had fallen by 1% and the dollar had risen by a similar amount; all of which can be reversed in the blink of an eye. Trade negotiations with China are reaching a critical stage and a few concessions on both sides could see an "agreement" reached which would put the algos (algorithmic trading accounts for 70% of traded equity volumes) back into buy mode. On the other hand, a piece of bad news, the scope for which is large and varied, could result in a downward cascade.

There is another issue that is bubbling away under the surface that may yet force the Fed's hand to become much more accommodating. A week ago, Congress agreed to remove the debt ceiling until after the elections in November 2020. The ceiling has not been raised - it's been removed - so theoretically Trump could spend his way to a second term. An unintended consequence is that the US Treasury can now rebuild its emergency reserve fund. This fund is put aside to be used in the case of national emergencies such as hurricane relief and also to pay government workers when previous debt ceiling limits have been reached. Currently this fund is sub-$200 billion and, by law, once the debt ceiling is removed the Treasury are obliged to build it back up again which they do by issuing Treasuries and then parking the cash with the Federal Reserve. This has a very similar effect to quantitative tightening, which the Fed has just ended, in that it removes money from the system and adds to the current shortage of dollars.

This is important because without this liquidity there won't be enough buyers of US Treasuries, which are going to be issued, not just to raise the emergency fund, but also to pay for the ever-increasing budget deficit. Foreign buyers, notably China and Russia, have been long absent from this market, and whilst the rate cut has flattened the yield curve, i.e. short-term rates and 10-year Treasury yields are at much the same level, this does not present buyers with a reasonable risk / return trade off. We suspect markets may well force the Fed's hand; a "crash" will not go down well in the White House so political pressure will be brought to bear too, despite Powell's assertion that they don't consider politics in their decisions. This could signal the expected continuation of quantitative easing, which would put renewed energy under risk assets and weaken the dollar. A market shake-out ahead of such an event will be concentrated in the current leaders of the rally, notably quality growth stocks and tech, so we are anticipating a renaissance for value stocks, including precious metals and emerging markets both beneficiaries of a weaker dollar.

To read our full monthly market commentary please visit www.theprivateoffice.com/marketcommentary

The table below shows our current view across all asset classes in terms of the relative weighting of each asset class against our own strategic asset allocation:

TPO VIEW
ACROSS ALL ASSET CLASSES

ASSET CLASS VIEW		TPO VIEW	LAST MONTH	NOTES
Government Bonds	Developed market conventional	⇔	⇔	Central bank narrative suggesting that the tightening bias maybe over. Keep a watchful eye as ever.
	Developed market inflation linked	⇧	⇧	A hedge against future inflation? But be mindful of duration risk.
	Emerging market conventional	⇔	⇔	Approaching fair value again.
Corporate Bonds	Investment Grade	⇩	⇩	Too expensive, even with the Draghi "put" in place for European corporates.
	High Yield	⇩	⇩	Yields too low to justify risk other than very short duration issues.
Equities	UK	⇔	⇔	A Brexit deal may provide a short-term boost but likely to be short lived.
	US	⇩	⇩	Markets are still very expensive, a correction anticipated.
	Europe ex-UK	⇔	⇔	Cheaper than it was but still a lot of issues to contend with.
	Asia ex-Japan	⇔	⇔	Attractive long-term.
	Japan	⇧	⇧	In a trading range but still upside potential especially for value stocks.
	Emerging Markets	⇔	⇔	Attractive long-term.
Commodities	Gold & Precious	⇧	⇧	The best insurance against central bank policy errors.
	Industrial	⇔	⇔	The commodity complex has not turned up yet.
Currencies	US Dollar	⇔	⇔	The Fed may shift back to a more accommodative phase. Another one to watch closely is the weak dollar as this is good for Asia and Emerging and commodities.
	Euro	⇩	⇔	Structurally challenged and recent dollar strength isn't helping but dollar weakness may eventually come to rescue.
	Japanese Yen	⇧	⇧	A likely beneficiary of more accommodative US monetary policy.

Please refer to page 22 for an additional note from our Investment Committee.

Key

⇧ Overweight compared to strategic allocation

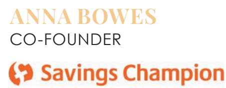
⇔ Neutral position compared to strategic allocation

⇩ Underweight compared to strategic allocation

Past performance is not a reliable guide to future performance.

How to get better returns than NS&I offers

ANNA BOWES
CO-FOUNDER



Savers with large sums of money to keep in cash face a tough decision – either to split it into Financial Services Compensation Scheme (FSCS)-sized chunks or potentially to leave some of their money unprotected. National Savings & Investments (NS&I) can be a really useful place for large cash deposits, as the full amount deposited with them is protected by HM Treasury. However, what happens if NS&I doesn't offer an account that suits these savers' circumstances – or the rate isn't competitive?

Although NS&I still accepts a maximum deposit of £1m per person into its easy access Income Bonds, and £2m per saver into the lower-paying easy access Direct Saver, the Guaranteed Income and Growth Bonds slashed the maximum deposit into each issue from £1m to just £10,000 in 2018.

So, those with large sums of money who don't need easy access and want to earn more, face a decision to either split money into FSCS-sized chunks or leave some of their money unprotected. Many will not have the time or patience to split their money, so will probably leave it residing with their high street provider and therefore earn next to nothing. Or they could search for a provider that they feel has enough financial strength to leave a larger deposit with.

If the latter is the likely option, you could look at the ratings agencies, such as Moody's and Fitch, to get a better indication of the providers' financial health, although it is no guarantee of the future security of their cash. The ratings agencies themselves are keen to point out that these ratings are just their opinions of the relative credit risk of fixed income obligations. They address the possibility that a financial obligation will not be honoured as promised. Such ratings reflect both the likelihood of default and any financial loss suffered in the event of default.

The ratings are classified slightly differently with each agency, but all generally consider that those with an A rating or above are judged to be of a higher quality. All of the top six high street banks get at least an A rating from Moody's – but offer really pitiful rates.

Should a saver with a large sum decide that they would prefer to use a provider with a minimum A rating, they could miss out on thousands of pounds if they don't also consider the rate on offer.

Easy Access

For example, if they were to deposit £500,000 into an easy access savings account with HSBC they could earn as little as just 0.15% or £750 in gross interest over 12 months (the rate is 0.20% for HSBC Advance customers).

But if they chose a more competitive rate with Yorkshire Building Society, which is rated A3 with Moody's and A- with Fitch, they could earn 1.40% or £7,000.

Fixed Rate Bonds

If they were looking for a fixed rate bond, the difference is even more striking.

Santander is offering just 0.50% for a 12-month fixed rate bond, whereas Post Office Money(via Bank of Ireland UK, rated A3 by Moody's and BBB by Fitch) is offering 1.70% gross/AER*.

That's a difference of earning £2,500 or £8,500 gross over the year, on a deposit of £500,000.

Sharia Accounts

For those happy to consider a Sharia account, there is one A rated provider (Al Rayan – rated Aa2 by Moody's) offering slightly better rates.

For example, over 12 months the expected profit rate is 2.05% gross/AER, so on £500,000 your return could be £10,250, before tax.

However, it is important to understand that rather than a fixed rate of interest the return is an expected profit rate, so is not guaranteed.

Rates correct as at 05/08/2019

Cash Platforms

Apart from scouring the whole UK savings market and opening multiple savings accounts in order to stick within the FSCS limit, with all the paperwork that come with each, there is a simpler way to earn more than the high street banks are offering but keep the paperwork and hassle to a minimum.

As we explored in the spring issue of this newsletter, Cash Savings Platforms are the latest innovation for savers and as they develop further they could be the answer for people who are cash rich but time poor.

They are savings supermarkets, allowing savers to buy off the shelf savings products (from those that are available) with one application. This gives those with larger amounts to deposit an easier way to split their cash between providers so that they don't exceed the £85,000 FSCS limit, and helps to achieve a competitive return whilst keeping cash protected in a simple, easy to use way.

How these platforms work varies from provider to provider, but the premise is the same – one application and then you have access to a variety of accounts.

On the downside, they are not whole of market, so you may not earn the very best rates available. But if they help to keep your money safe and earning more than it would languishing with your high street bank, but with minimal paperwork – both initially and going forward - then they definitely have their place.

Although NS&I is a trusted and useful institution, recent changes to what is available means that it's no longer as helpful as it once was. However, there are other options that could help to keep larger cash sums safe and earning more than the high street banks.

If you would like more information, please speak to your usual adviser.

Death of a Shareholder

IAN HAWKES
ADVISER

Since my last article in Insight, I have gone through a fairly traumatic event myself, as I broke my back in March. Going through the recovery process has led me to contemplate what could have gone wrong had my employer not had both sick pay and private medical insurance in place for me. Worse yet, had I landed harder I might not be here today, and what would happen to my wife in those circumstances?

In my case I am lucky, not just to have survived relatively unscathed (in terms of long-term prognosis), but also to know that in the event of my death my wife will benefit from a lump sum payout called death in service, funded by my employer. Surviving spouses of shareholders of small companies are unlikely to have this protection and may even inherit a handful of illiquid shares that may never generate value for them. In this article, I will explore this particular problem in more depth and talk a little about possible solutions.

What is the Problem?

Before talking about solutions, it would probably be helpful to first look at the problem in a bit more detail. In this case, let's consider the shareholder register of a small company, AMS Ltd:

	Shareholding	Current Value
Alex	1,000	£500,000
Mel	1,000	£500,000
Sam	1,000	£500,000

While all three of the shareholders are still alive, no-one has a controlling influence, therefore majority decisions will require two of the three shareholders to agree a course of action before anything requiring a vote can be implemented. This is likely to be fine for most actions needed, shareholders are typically invested in their business both financially and emotionally, with significant knowledge to call upon regarding their chosen field.

What happens if Alex dies, though?

If Alex has made no plans and if the Articles of Association allow, Alex's shares will pass in accordance with Alex's will. In this example, let's assume there is a surviving spouse, Chris. Chris now owns a third of a business that may not be in the least bit familiar. Where Mel and Sam disagree, Chris now has the deciding vote in any shareholder decisions. If Chris does not wish to act, then there is no deciding vote cast at all, meaning controversial decisions could easily end in deadlock.

Additionally, Chris may wish to sell the company shares to generate the £500,000 of value that may be needed to replace Alex's income. The other shareholders may be unwilling or unable to purchase those shares, and Chris cannot coerce a purchase.

In summary, a third of the company's shares have ended up in the hands of a non-participant, and the surviving spouse is unable to realise any value from that holding. Certainly not a great outcome for anyone.

How Can We Address This?

Some of you may now be thinking "I'm a shareholder in a small business and I don't want this problem, what can I do about it?" The good news is that there are solutions to these problems, including:

- Amending the Articles of Association
- Setting up Death Benefits
- Shareholder Agreements

Amending the Articles of Association

Your company's Articles of Association are not set in stone, though most are very rarely changed once set up. As a result, you can change the restrictions on share ownership to match your requirements. This may involve relaxing the restrictions to allow spouses to inherit shareholdings or adding restrictions, such as passing shares or voting rights only to other shareholders.

In general, this option is likely to protect the company only rather than the family of any deceased shareholder, so it cannot be considered a solution on its own.

Setting Up Death Benefits

If the shareholders are satisfied with the idea that their heirs should reap the benefits of their investment and work over the life of the company, there may be no need to change the basis for inheritance of shares. You can instead simply set up death benefits for employees, allowing a certain cash balance to be paid out to the surviving family upon death. This is usually going to be in the form of a series of relevant life policies, which are special types of insurance set up specifically for small company employees.

Relevant life policies have an added advantage of being eligible for exemption from corporation tax, income tax and national insurance contributions, while the proceeds are also tax exempt on receipt. As such, these can be a very tax efficient means of providing death benefits without any adjustment to shareholdings. As such, this addresses the needs of the surviving family to have a capital sum, but it does not solve any issues of share ownership.

This solution will generally not work in quite the same way for a non-employee shareholder, as they are ineligible for a relevant life policy. Such individuals can instead set up a life policy in their own name and pay for it themselves, but this shifts the burden onto the individual shareholders rather than the company as a whole. As such, this scheme may not be suitable for all companies.

Shareholder Agreements

Probably the most flexible option, a robust shareholder agreement addresses both major issues simultaneously. The most common approach is called a cross-option agreement, which sets out the following rights:

- The deceased's beneficiaries can, but are under no obligation to, force a purchase of their shares by the company or the surviving shareholders, and;
- The surviving shareholders can, but are under no obligation to, force the sale of the deceased's shares to them or to the company.

Where neither option is triggered, this allows the shares to be retained by the deceased's estate, exactly the default position mentioned at the start of this article. Both potential problems are dealt with though, as the surviving shareholders can trigger the agreement if they do not wish to work with the inheritor, while the inheritor can also choose not to be involved and to take a predetermined cash sum instead.

Typically these agreements are backed by insurance policies purchased by all shareholders on each other's lives and written into a business trust. This means that, upon death, there is a cash sum equivalent to that required for the share purchase in the cross-option agreement. If the option is triggered, this cash sum is extended to the deceased's beneficiaries, otherwise it can be kept by the other surviving shareholders or reinvested into the company.

How Does This Work for AMS Ltd?

Returning to our earlier example, if Alex, Mel and Sam are all both employees and shareholders, the solution is fairly simple:

- Alex, Mel and Sam each apply for £500,000 of life insurance.
- On commencement, each policy should be written into a business trust for the purpose of buying shares from deceased shareholders.
- The company should pay the premiums. This will be treated as a P11D benefit in kind but will ensure that the premiums are always paid, which stops any policy from accidentally lapsing.
- Each shareholder should then sign an agreement granting the following options (not obligations):
- The deceased's estate or the new owner of their shares can trigger a purchase of the shares for £500,000 on demand, paid for from the life insurance proceeds. The shares then transfer into the business trust and can be reallocated from there.
- The surviving shareholders can trigger a sale of the shares to the business trust for £500,000 also on demand and paid from the insurance proceeds.
- If neither option is triggered, the business trust acquires £500,000 of cash and the beneficiaries retain the shares.

If Alex now dies, Chris can now benefit from either the shares or £500,000, depending on agreement with Mel and Sam. Mel and Sam also have the ability to decide that they don't wish to work with Chris, and can trigger the share sale using only their own authority.

This now offers a far better means of protecting the company, the shareholders and the deceased's beneficiaries.

What if the Company Value Increases?

In this case, Alex, Mel and Sam hope that the company will go through a period of rapid growth, increasing the value significantly. While it is possible to incorporate a "fair value" clause into the shareholder agreement, it is not possible to add this option to insurance policies, therefore there is a risk of having insufficient funds should this occur. Instead, it is more common to simply review the agreement regularly, say every five years, and more often where significant events happen, including increase in value or a change in shareholdings.

As such, this should not be seen as a one-off exercise performed in isolation, but rather as an ongoing exercise in risk management which will hopefully never be called upon.

Conclusion

Losing a shareholder suddenly can financially ruin a business without risk mitigation. By having this discussion early and putting solutions in place, it is possible to financially protect the business and remaining shareholders while also looking after the beneficiaries of the deceased.

If you would like to discuss any of the solutions mentioned in this article, please get in touch.

Child benefits: Why you shouldn't opt out

REBECCA BONNER
ADVISER

Child benefit should still be claimed, even if you aren't entitled to keep it…

Since 2013, families where the higher earner has an income of more than £50,000 have had their child benefit entitlement proportionately reduced. Where the income of the higher earner exceeds £60,000, the entire benefit is withdrawn.

If child benefit has been claimed, the practical result is an income tax charge on the higher earner equal to the benefit to be repaid. To avoid the hassle of receiving the benefit to simply pay it back, many parents have mistakenly opted out of the child benefit system altogether.

What is the problem?

The State Pension is based on eligible credits. To qualify for a full State Pension each individual needs 35 years of credits, which are obtained through the National Insurance contribution system. In years where the individual is working and earning over a specified amount, the contribution is easy to establish as it has monetary value, however there has for many years been a credit available for parents who are bringing up children. This entitlement has been logged through the entitlement to, and claiming of, child benefit.

If a parent opts out of the child benefit system and isn't paying or being credited with NI contributions through another route, it is possible that their ultimate State Pension (such as it may be) will be adversely affected as there is no relevant contribution record for the period.

The member of the household in need of the NI credits that are available when caring for a child under 12 should ensure they claim child benefit, even if they choose not to receive the actual child benefit payments.

The solution

It is hoped that this anomaly will be rectified at some point, but in the meantime, for the avoidance of doubt, it would be safer to claim the child benefit and pay it back to secure the credit and full entitlement to the state pension. If you are certain that you will have to repay all of your child benefit you can opt out of receiving the payments when you make your application for child benefit.

A day in the life of...

JANET VAN DER HOVEN
ADVISER

I was born in South Africa and moved to the UK when I was 16 years old, and went on to read law in Bristol. I have worked in the financial services industry since university and have gained a lot of experience across a variety of roles, including consultancy work with adviser firms. I joined The Private Office as a Financial Planning Executive in September 2017, before qualifying as a regulated Adviser. I am currently studying towards becoming Chartered. This is a high accolade to have in our industry since it demonstrates a higher academic qualification and market knowledge than the norm. The Chartered Insurance Institute (CII) consider a Chartered Financial Planner as the "gold standard of financial planning" for ethics and professionals. Here I've given you a look at what a typical Monday in my life looks like...

6:10am

My alarm wakes me up at 6:10 every morning. Once I am out of bed, I pack my bag for the day, ready to cycle to work in an attempt to avoid the dreaded train journeys. I live in Wandsworth, which is next to the Thames and not too far from the city centre. I've always known that I am competitive and since I started cycling to work, I have been determined to better my time from door to door at every opportunity. I am pleased to say that I have improved my time by over 15 minutes thus far, completing the journey in less than 30 minutes.

7:50am

After my cycle and a relatively cold shower, I feel fresh and ready to start my day. I quickly go through e-mails and create a "to do" list which sets me up for the day and week ahead.

8:30am

I have my breakfast, which is usually something that will fill me up for the morning and will take me through to lunch. It's quite embarrassing when your tummy starts rumbling in the middle of a mid-morning meeting, so I try to avoid that.

9:00am

At 9am I skim through the files and any documentation in preparation for my first meeting of the day.

10:00am

I attend my meeting, which is often with a client who has come to our office near St Paul's Cathedral. This will be either a "discovery" meeting, where we find out more about each other and decide how we could work together going forwards; a presentation meeting, where we cover off our recommendations; or a review meeting, where we will cover valuations, any updates that we should be aware of, and any possible planning considerations. We often cover cash flow planning which means that a meeting in the office tends to work better since we have the necessary equipment in the office to help us do interactive lifetime financial plans.

12:00pm

I quickly record the meeting notes whilst they are fresh in my mind. I also run through any e-mails that may have come in during the morning.

1:30pm

In the afternoon, I typically prepare for my next meeting, attend a meeting or have a case discussion with one of my colleagues, be it something they are working on, or something I am working on.

5:00pm to 6:00pm

Having prepared for my next meeting the following day, I am able to leave the office at a reasonable time. My cycle to and from work is next to the Thames and I often see rowers enjoying the tranquil atmosphere. As a result, I have signed up to a rowing course for the summer to make the most of it. I have also joined a mixed touch rugby team to get to know people around Wandsworth. These activities keep me busy on a Monday, Tuesday and Wednesday evening.

Peer to Peer industry under the microscope

DAVID DODGSON
PARTNER

Crowdfunding peer to peer provider, Lendy, collapsed into administration at the end of May this year, leaving many anxious customers unsure of whether they will get their money back.

Apparently more than 20,000 customers have over £150m with the platform which has reportedly been struggling for some time with, according to press reports, more that £90m in default – some of which should have been repaid years ago.

Lendy had offered returns of up to 12% on property developments.

The term crowdfunding is used to describe ways in which people and businesses (including start-ups) raise money, typically through an internet-based platform. The platform matches those raising money with those seeking to invest.

Loan-based crowdfunding platforms – usually called peer-to-peer (or P2P) lending platforms are a way for people and institutions to lend money directly to consumers or businesses, to make a financial return from interest payments and the repayment of capital over time.

This is basically what the banks and building societies do too – but the key difference between savings accounts with banks and building societies compared to P2P lending is that money deposited with the latter is not protected by the Financial Services Compensation Scheme – a critical distinction. The concern is that many people who invest into P2P do not realise the risks involved.

In the wake of the worrying news surrounding Lendy, the FCA has confirmed that it will be introducing new rules on the industry, including one that will place a 10% limit on the amount of P2P investments that ordinary investors can hold in their portfolios. This is designed to protect new or less experienced investors and as a result will not apply to new retail customers who have received regulated financial advice.

Following a long consultation the FCA confirmed that a number of new requirements for the sector will be imposed, which Christopher Woolard, the FCA's executive director of strategy and competition, says is to "to enhance protection for investors while allowing them to take up innovative investment opportunities".

Other rules being introduced include:

- More explicit requirements to clarify what governance arrangements, systems and controls platforms need to have in place to support the outcomes they advertise with a particular focus on credit risk assessment, risk management and fair valuation practices.
- Strengthening rules on plans for the wind-down of P2P platforms.
- Introducing a requirement that an appropriateness assessment (to assess an investor's knowledge and experience of P2P investments) be undertaken, where no advice has been given to the investor. The FCA have also provided guidance on what the assessment should include.
- Setting out the minimum information that P2P platforms need to provide to investors.
- Applying the Mortgage and Home Finance Conduct of Business sourcebook (MCOB) and other Handbook requirements to P2P platforms that offer home finance products, where at least one of the investors is not an authorised home finance provider.

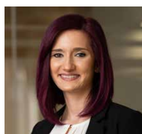
The new rules will come into force on 9th December 2019, although the final point mentioned above was required to be applied immediately (4th June 2019). It is hoped that these new rules will improve the standards in the sector.

Like anything, there will be good and bad firms in the P2P industry but the bottom line is that this type of investment carries a different risk to bank and building society accounts as your money is NOT covered by the Financial Services Compensation Scheme - and there are no guarantees that the rate you have been promised can be paid. In addition your capital could be at risk and you may not receive your original investment back.

Having said that, hopefully these new rules will have a positive impact so that those who choose to include P2P investing will do so with their eyes wide open.

Behaving yourself

IAN HAWKES
ADVISER


MERVE ORAL
FINANCIAL PLANNING EXECUTIVE

Traditional economics focuses entirely on rational action, assuming that all participants are perfectly informed and make the obvious decisions from a purely logical and mathematical perspective. On the surface this seems entirely reasonable, but all of us have a degree of irrationality; this is a core part of our personality and cannot simply be switched off. This irrationality causes us to accidentally breach traditional economic principles, giving rise to a relatively new approach, namely behavioural economics, which, put simply, marries psychology with economics. More precisely, the discipline explores the impact of cognitive and emotional biases on decision-making.

In this article we will explore some of the irrationalities which behavioural economists have identified, which may hopefully be helpful in identifying whether any of your own decisions are irrational.

Traditional vs Behavioural Economics

Much of traditional economic theory is based on the assumption that individuals act rationally and consider all available information when making decisions. Behavioural economics starts to address deviations from this approach by considering two broad sets of irrationalities that break the traditional models:

- Cognitive Errors.
- Emotional Biases.

Cognitive errors are essentially an inability to correctly or rationally process information, whether this be from a misunderstanding of what the information means or a faulty recollection of information. Our minds can and do trick us into believing we know more than we do, and it is important to recognise our failings in this area.

Emotional biases, on the other hand, are where you deviate from the cold reasoning of pure logic and act based on impulse or intuition instead. Where you "follow your gut" or "have a good feeling" about an investment or financial decision, this is a warning sign that you might be following an emotional bias.

Please note that this is the first article of two, in which we explore errors of thinking (cognitive errors). Our next article on this subject will focus on biases formed from emotion, which is an equally important area of seeming irrationality.

Examples of Cognitive Errors

Given the definition above, cognitive errors are effectively "mistakes", whether of approach or recollection. Probably the most prominent of these are:

- Anchoring and Adjustment
- Confirmation
- Representativeness
- Mental Accounting
- Availability

We will look at each of these below, together with some examples. Using these examples, you will hopefully see that these cognitive errors can be very subtle indeed, but could lead to some significant issues. Additionally, you will also see that there are sometimes very blurry lines separating the different categories, with some examples potentially fitting several cognitive errors simultaneously.

Anchoring and Adjustment

Anchoring and Adjustment is where initial estimates of value (or target value) are "locked in", making it difficult to change. This is perhaps best exemplified with house prices. Most of us don't get our houses professionally valued at any time except when we come to sell, so we generate figures in our heads. Usually this will be an estimate based on purchase price, ownership time, the value of any work done, possibly the values of our neighbours' houses if we know them, possibly adding a bit on top for good measure.

In reality of course, house prices are based solely on what someone is willing to pay for your house, and your personal valuation may well be wrong. If you firmly believe that your house is valued at £600,000 but the estate agent you employ to sell tells you that the most you can expect is £550,000, anchoring may force you

to disbelieve this valuation, or to negotiate with them to improve your valuation (even though they are ultimately not the ones that need to be negotiated with on value).

Confirmation

Confirmation bias is essentially where we ascribe more weight to sources that agree with us than those which disagree. We tend to be more attentive towards new information that confirms our own preconceived options about a subject. We also have a natural tendency to form our views first, and then spend the rest of the looking for information that makes us look right.

From an investment perspective Confirmation bias is known to be the main driver for the "momentum effect". The momentum effect was discovered in the early '90s by trend analysis, which is a technique that attempts to predict future stock price movements based on historical data. It refers to a short-term investment strategy that leads to excess returns by determining existing price trends over the last three to twelve month and reacting correspondingly – high-priced assets are acquired whereas assets with downward-trending prices are sold (Jegadeesh and Titman 1993). As traditional economics rules out technical analysis, this has been categorised as a "market anomaly". In later years, many studies have shown that the effect persists across multiple asset classes, such as commodities, currencies and even bonds. Today researchers are going even further by applying behavioural concepts in order to understand psychological factors that drive the momentum effect.

We will exemplify confirmation via the lifecycle of a market trend later in this article.

Representativeness

This irrationality stems from a tendency to place too much emphasis on one factor – such as recent performance – rather than considering all available data. In the example below, someone might be considering investing in this fund due to the strong performance they have heard about – 7% on average each year. However, on looking at the data, they see that the most recent performance is a loss of 4%, so they conclude that the fund has lost its way and no longer represents a good investment opportunity. This focus on the very short term rather than the overall picture (which includes more than just performance, incidentally) is an example of representativeness in action.

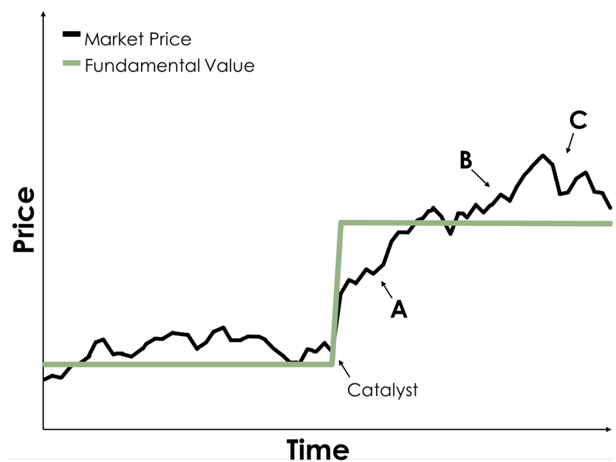
Year	2014	2015	2016	2017	2018
Return	7%	7%	10%	16%	-4%

This error can manifest in many ways. A number of good examples can be found in technical analysis of investments, where an investor may have a preferred technical indicator that they are so convinced is the only way to measure how a stock or fund will perform in future that they ignore the news that the company has suffered from major accounting irregularity in favour of the "oversold" status that their indicator suggests. See Patisserie Valerie for a recent example.

A Quick Example

Having briefly looked at Anchoring and Adjustment, Confirmation and Representativeness, we will now see how these three come into play:

How biases inflate the price of an asset



A *Under-reaction phase:*
Anchoring
This is the starting point of a trend, where the market price of an asset might be below the fundamental value.

B *Over-reaction phase:*
Herd Behaviour and Confirmation
Herd behaviour represents the preference for individuals to mimic the behaviours or actions of a larger sized group. Confirmation bias might cause an investor to move more money into the asset, supporting a trend, even when a dispassionate appraisal might suggest that the price already exceeds fundamental value. Combined with overreaction, which occurs when one reacts to a piece of news in a way that is greater than actual impact of the news, the trend continues.

Representativeness
Investors see recent price momentum and assume via representativeness that this reflects future conditions, likewise supporting the trend and inflating the value of the asset.

C Eventually, when the price extends to far beyond fundamental value, the price will revert towards its fundamental value and the trend will die out.

Mental Accounting

If you are the sort of person to divide your investments into different pots based on the original source of funds, you may be guilty of mental accounting. This can start as a fairly natural process, for example receipt of an inheritance which you keep segregated from the rest of your funds in case it is needed for funeral arrangements or other matters relating to the recent death. If you then keep that pot separate beyond this initial period, this starts to become mental accounting, where you treat the inherited money as somehow different to money that you earn from your employment.

The issue here is that in traditional economics, money is fungible, i.e. it doesn't care how it was earned, it all has the same buying power. Treating funds differently depending on where they came from is therefore irrational, but I think we can likely all identify times when we have done this.

Please note that this is very different to dividing money into pots for different purposes, which is entirely rational behaviour and indeed is an extremely good idea in many cases. As an example, your emergency fund should not be invested in the same manner as your pension which you do not expect to access for decades.

Availability

Our final irrationality for today is Availability. Availability bias is an information processing error in which people take a heuristic (sometimes called a rule of thumb or a mental shortcut) approach to estimating the probability of an outcome based on how easily the outcome comes to mind. A ludicrous example is the lottery, where the two easiest outcomes to consider are winning the jackpot and winning nothing. True availability irrationality might lead someone to grossly overstate the likelihood of winning the jackpot because it is easy to envisage, while the same individual might consider it very unlikely that they would win one of the lesser prizes.

From the perspective of an adviser- client relationship, availability bias is typically the first question or issue that needs to be addressed. In some cases, clients seeking financial advice can have a quite negative attitude towards investing and financial markets. This is likely due to the fact that individuals unconsciously associate investing with a recent financial crisis or crash and fear its reoccurrence. Simultaneously, they are aware that they need to plan and make a financial provision for the future, but are uncomfortable with at least some of the accompanying requirements.

Conclusion

Hopefully the conclusion you draw from this is the same as for us – irrationality pervades our thinking, not because we are flawed but because we are human, and "to err is human". Unfortunately, erring with investment decisions can have very poor results, as we have seen with any investors who followed Neil Woodford and invested in his new funds only to find them recently suspended following poor performance (representativeness, anchoring and availability all likely played their parts in this decision).

Investment should be rational, and as you will see from this article it is difficult for us as humans to be rational at all times. Our investment process here at TPO is committee-driven and cross-checked by external parties for a reason – more minds gives a greater opportunity to identify and challenge irrational decisions. We have put together a robust investment process designed to strip out many of the opportunities for these cognitive errors to creep in.

In the next article on this subject, we will explore some of the emotional biases that can come into play when making investments. These are the other side of human irrationality, the counterpoint to errors in reasoning. Hopefully you will find that article as interesting as this one.

If you would like more information please speak to your usual adviser.

The value of an investment and the income from it could go down as well as up. The return at the end of the investment period is not guaranteed and you may get back less than you originally invested. Past performance should not be used as a guide to future performance.

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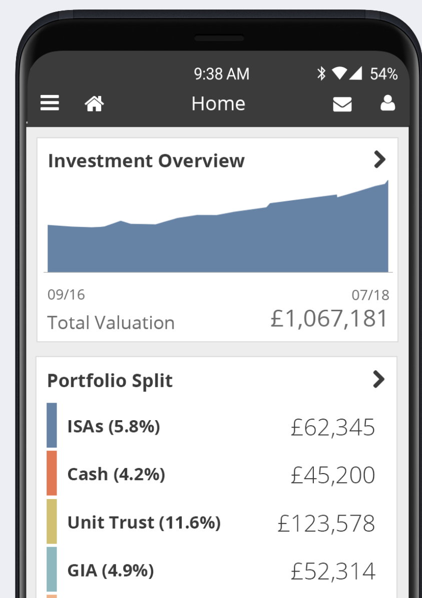


Stop press

More changes on the way for Trustees

The Government are consulting on more changes which will directly impact Trustees.

At the moment, Trustees only have to engage with the online reporting system if they are managing a Trust which was established in writing (an Express Trust) which incurs a tax liability – this can be a liability to income tax, capital gains tax, stamp duty land tax or inheritance tax.

Under proposed new legislation, registration on the Trust database will be extended to most Trusts, not just those Express Trusts which have a tax liability. This will potentially include Life Policies which have been written under Trust – perhaps for inheritance tax purposes - and policies taken out to support a Cross Option agreement between shareholders.

The consultation document also suggests that Trustees will not be able to access regulated financial advice unless they can provide proof of registration.

We are monitoring developments closely and will keep you updated.

Maturing Child Trust Funds to retain tax-advantaged status

Draft regulations have been published for consultation.

A Child Trust Fund (CTF) is a tax-advantaged savings account that provides children born between 1 September 2002 and 2 January 2011 with an asset when they reach adulthood. The Trust Funds will begin maturing in September 2020 when the first children reach 18, but without legislative change, the investments will lose their tax-advantaged status at maturity.

The regulations will be changed so that if the account holder has not given instructions about the future of the investments by the time the account has matured, the investments will be placed in a 'matured account' pending instructions. The 'matured account' can be a continuing CTF account, a cash ISA, or a stocks and shares ISA, offered by the original CTF provider.

The funds in the 'matured account' will keep their tax advantaged status and the terms and conditions which applied before maturity. No subscriptions can be made to the account, which must be kept by the original provider.

The ISA Regulations will be amended so that funds transferred from a CTF or matured CTF account will not affect the overall ISA subscription limit. Funds transferred to a Lifetime ISA will be subject to the Lifetime ISA payment limit. This is consistent with the approach taken for maturing Junior ISAs and ensures a level playing field with those accounts.

30-day CGT payment deadline for property disposals – The clock is ticking!

Her Majesty's Revenue and Customs (HMRC) is taking special care to make sure that taxpayers are aware of new rules taking effect in April 2020, which will mean that the capital gains tax bill on residential property disposals has to be paid within 30 days of completion.

Currently, capital gains tax due on property disposals does not have to be reported or paid until the deadline for submitting a self-assessment tax return, which can be up to 22 months after the disposal. Those particularly at risk of being caught out are those who gift property to a family member (or similar) and do not realise a tax charge arises because no money has changed hands.

Although two years' grace has been allowed between the announcement and the implementation of the new time-window, it is likely that many taxpayers, especially holiday home owners and small-scale landlords, will not be aware of them in time. HMRC wants to avoid a repeat of the recent cases in which late-filing penalties imposed on non-resident sellers of UK property have been overturned at tribunal because the reporting regime had not been sufficiently well publicised.

HMRC has now published a report of research conducted to find out how best it can warn taxpayers of the new 30-day payment window before it affects them.

The Financial Conduct Authority does not regulate Tax and Trusts.

A note from the TPO Investment Committee (TPOIC)

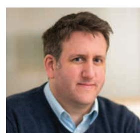
Corporate actions

The committee would like to reassure you that it monitors actions initiated by investment houses which may have an impact on your investments (known as corporate actions) on an ongoing basis. Rather than contact you directly about each and every action, there is a dedicated section on our website, to which all updates will be posted, accessible via the following link which may be typed into your browser:

http://www.theprivateoffice.com/site-services/key-investor-information/corporate-notifications

Whilst all corporate actions are posted on the website, we will take additional steps to highlight any changes which we believe are potentially significant, or require you to take action.

Latest savings rates



TOM ADAMS
HEAD OF RESEARCH

Each quarter we bring you a review of the best rates for cash deposits on behalf of our sister company, Savings Champion. Please note that as well as personal and business accounts, Savings Champion also offer services for both charities and trusts.

For more information visit **www.savingschampion.co.uk** or contact Tom Adams on **0800 321 3581**.

Personal Accounts

Account	Provider	Minimum	Gross	AER	Notes
Easy Access Account	Marcus by Goldman Sachs	£1	1.49%	1.50%	Apply and access online. Easy access. Rate includes a 0.15% bonus for the first 12 months.
Notice Account	Charter Savings Bank	£5,000	1.81%	1.81%	Apply and access online. Withdrawals are subject to 95 days' notice only; no earlier access is allowed.

Personal Fixed Rate Bonds

Account	Provider	Minimum	Gross	AER	Notes
1 Year Term	Charter Savings Bank	£5,000	2.01%	2.01%	Apply online or by post. No access within the term.
2 Year Term	The Access Bank UK Limited	£5,000	2.10%	2.10%	Apply online or by post. No access within the term.
3 Year Term	Arbuthnot Direct	£10,000	2.32%	2.32%	Apply online. No access within the term.
5 Year Term	RCI Bank	£1,000	2.40%	2.40%	Apply online. No access within the term.

Personal ISAs

Account	Provider	Minimum	Gross	AER	Notes
Easy Access Account	Charter Savings Bank	£5,000	1.44%	1.44%	Apply and access online. Easy access. Transfers in of previous cash ISAs are allowed.
Notice Account	Charter Savings Bank	£5,000	1.48%	1.48%	Apply and access online. Withdrawals are subject to 95 days' notice or loss of interest. Transfers in of previous cash ISAs are allowed.

Personal Fixed Rate ISAs

Account	Provider	Minimum	Gross	AER	Notes
1 Year Term	OakNorth	£1,000	1.61%	1.61%	Apply online. Withdrawals are allowed, subject to 90 days' loss of interest. Transfers in of previous cash ISAs are allowed.
2 Year Term	OakNorth	£1,000	1.77%	1.77%	Apply online. Withdrawals are allowed, subject to 180 days' loss of interest. Transfers in of previous cash ISAs are allowed.
3 Year Term	Charter Savings Bank	£5,000	1.87%	1.87%	Apply online. Withdrawals are allowed, subject to 210 days' loss of interest. Transfers in of previous cash ISAs are allowed.
5 Year Term	Newcastle Building Society	£500	2.12%	2.12%	Apply online or in branch. Withdrawals are allowed, subject to 365 days' loss of interest. Transfers in of previous cash ISAs are allowed.

Business Accounts

Account	Provider	Minimum	Gross	AER	Notes
Business Easy Access Account	Saffron Building Society	£10,000	1.02%	1.02%	Apply and access online. Easy access.
Business Notice Account	Redwood Bank	£10,000	1.55%	1.55%	Apply online or by post and access online, by post or by telephone. Withdrawals are subject to 95 days' notice only; no earlier access is allowed.

Business Fixed Rate Bonds

Account	Provider	Minimum	Gross	AER	Notes
1 Year Term	United Trust Bank	£5,000	1.90%	1.90%	Apply online or by post. No access within the term.
2 Year Term	Hampshire Trust Bank	£5,000	2.00%	2.00%	Apply online or by post. No access within the term.
3 Year Term	Hampshire Trust Bank	£5,000	2.10%	2.10%	Apply online or by post. No access within the term.
4 Year Term	Masthaven	£5,000	2.18%	2.18%	Apply online. No access within the term.
5 Year Term	Cambridge & Counties Bank	£10,000	2.50%	2.50%	Apply by post. No access within the term.

All information is correct as at 5 August 2019

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