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Wealth Management
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Hillier Hopkins LLP ran a workshop in February on wealth management matters. The feedback from attendees made it clear that most would welcome some further information on some specific areas.

1) What is going on in markets now?

The readers of this article will know what is going on in world markets. The UK market is 10% off its 2007 peak, so is the US market along with many other major indices. Commercial and residential property markets have slumped. Gilts have performed tolerably well but other debt has been rudely revalued as a result of the sub prime crisis. Emerging markets are the only super performers of the last 12 months, and they have been pretty volatile.

The real question is "What should we do given the difficult market conditions?"

Looking backwards is not always a good route planning technique but we might be able to get some clues from examining history for similar circumstances. Two of the key assets that are required for capitalism to work are property and capital. A central part of our advice is that in the long term investors in capital (stockmarkets) and property will reap a superior reward compared to investors in deposit accounts for example. Right now both of these markets are having tough times. It is unusual however for equity and property markets to be closely correlated. We have to be careful of the data sources here – too many articles fudge the difference between property and property companies, and virtually all the index data is appraisal based; but long-term analysis suggests that the current level of correlation is unusual. We continue to maintain that clients should have an exposure to property and equities. Most clients should have a much larger exposure to equities than property

The returns on most asset classes have been poor for some time. We design portfolios that are carefully diversified by geography, sector and type of company. However when equity markets are (with a few exceptions) all down this diversification does not protect the portfolios. Our portfolios are further diversified by asset type but property is also down. The only asset classes that have performed tolerably well are short-term high quality company debt and gilts. A deposit account has produced some of the best returns available over the last twelve months.

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However, leaving money on deposit has historically produced lower returns than investing in property or equities; and we have argued for years that there is very little evidence that anyone can time when to invest or disinvest successfully. **The poor returns suffered during some periods of equity investment are an absolutely necessary part of equity investment.** If this risk did not exist, if investors had not experienced loss, then the markets would force down the expected return of equity investors.

History does not repeat itself. If it did then we could predict for how long markets would be up or down. But economics and history do suggest that we have been through similar periods in the past. In 1973 and 1974 property and equity prices went through desperately tough times. The UK market lost about 65% over the two-year period. This return was delivered via 14 losing months and 10 winning months. In reality of course a huge number of investors sold during 1974 and thus missed out on the worst losses – **but they missed out on the best gains as well.** In 1975 the UK stockmarket had its best post WWII return – 151.4% up.

The rest of the statistics re: 1973 and 1974 are in the workshop notes along with further data covering Black Monday in 1987 and 2000 to 2002. The key message seems to be to stay invested, particularly when all others are telling you to sell. We are seeing a great deal of money being pulled out of the markets by retail investors. UK retail investors are as a group a poor example to follow. Those Hillier Hopkins clients who have had recent reviews have received the opposite advice. In essence we have been suggesting to clients that they take some of the limited gains available from Emerging Markets and gilts and reinvest in the major stockmarkets. This is merely the rebalancing with which nearly all readers are familiar. It does have the merit of forcing one to behave counter intuitively – to sell winners and buy losers.

A further difficulty is humans' activity bias. Most of us believe that when we are in difficulty we should do something about it. This gut feel is hard to counter – we are generally predisposed towards taking action when in difficulty. Sometimes, particularly in the context of investments, taking action feels an awful lot better than not taking action but produces a far worse long term result than doing nothing. Our advice (and yes David and I do take our own advice) is not to make any major changes but to stay with the original plan. Rebalance regularly, ensure that there is sufficient liquidity in your overall position to avoid being a forced seller, and await the returns that are due to property and equity investors.

2) How are your strategies performing?

Every portfolio is unique but each one is based on a model portfolio. Our 100% equity strategies are showing losses. Equity markets as a whole are down and small companies and value companies have lost more money than main market investments. The only shining light has been emerging markets but we only recommend a small exposure to this volatile area. However the majority of clients have an equity weighting of between 40% and 80%. These portfolios have also lost money over the last 12 months but have been slightly bolstered by the returns on high quality fixed interest securities including gilts. We did not in any way foresee the global credit crunch, but our philosophy of only investing in high quality short-term corporate bonds and gilts has stood us in good stead.

I am nervous of putting too much store in comparative performance – losing less than the average is hardly a cause for celebration – but comparisons with conventional retail managed funds shows us in a comparatively good light. The events of the last year are exactly the circumstances when actively managed multi asset funds should perform well according to their own marketing literature. They should use tactical asset allocation and careful stock selection to avoid some of the losses that the wider market is suffering. As a group they have singularly failed to achieve this aim and have on a like for like basis generally lost more money than our funds. This is not just due to our belief that timing markets and stock selection are almost impossible but also due to the very substantially higher total costs that these funds suffer.

3) Pensions

I am happy to confirm that at the time of writing when a widow or widower aged over 75 passes away and is using income drawdown, the only practical destination for any funds that may be left over is a registered charity or charities. The scheme administrators with whom we are familiar are simply unwilling to make an unathorised payment. Such a payment could jeopardise all that firm's clients and is not in most cases a realistic option.

Conclusion

Thank you for attending our meeting. We are investing in tough times. In the long term investment in equities and property are likely to produce the biggest rewards. We advise you to strongly resist the urge to trade more regularly or adjust your portfolios based on yesterday's news. Scientific rebalancing and keeping your head when all around you are losing theirs' is the best technique we know of securing your personal investment goals. Always consider the taxation consequences of any action but remember that a taxable gain is more fun than a tax free loss. We do not know for how long poor returns will continue, but we do know that historically the frantic speculators lose money that ultimately accrues to the long-term investor.

Ben Sherwood – Wealth Management Principal

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