EQUINOX

NEWS, INSIGHTS AND EXPERT FEATURES

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Money equals happiness, or does it?

EQUINOX | SPRING 2024

Welcome

Over the last few years, we have gone straight from the Covid crisis into the cost-of-living crisis and it's a great relief that the latter appears to be to be easing somewhat. Inflation is falling rapidly, interest rates are expected to fall shortly, and portfolios have recently bounced back strongly.

I would like to thank all those clients who have recommended us to family and friends, ensuring that our business continues to grow at a steady pace. I appreciate that it can sometimes be tricky to make recommendations, especially when it comes to financial matters, so we are really grateful when clients do so. We now have a range of propositions that allow us to deliver a fantastic service to people at every stage of life. If we can help someone you know, then please do mention us.

Our masterclass programme has continued to expand and the feedback from the 363 attendees to date has been outstanding. We have six new topics under development, the first of which will be launched shortly. Please visit equilibrium.co.uk/events for our current topics and dates, and to book your place if you are interested in attending. You are, of course, welcome to bring a guest.

I hope you enjoy this edition of Equinox and, as always, please feel free to contact me directly with any comments or questions.

Colin Lawson
MANAGING PARTNER

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Controlling the narrative?

Mike Deverell looks at why a great story can often be a poor investment and why, as evidence-based investors, we look for data rather than narratives.

Human beings love a great narrative.

Investors are often drawn to stories about the "next big thing" that will change the world.

Sometimes, those "next big things" do turn out to be revolutionary but that doesn't always make investing in them easy.

In July 1995, as internet use moved into the mainstream, a little online bookshop, now known as Amazon, was launched. Initially operating from the garage of a house in Seattle, by October that same year, Amazon.com had sold books to all 50 states of the US and to 45 other countries.

In May 1997, the company floated on the Nasdaq index. Had you invested £100 at that point, your investment would currently be worth a cool £157,909.[1]

A great story and a great investment, right? Whilst Amazon was at least founded on sound business principles – they actually sold stuff (!) – in the late 1990s, many other web-based companies were launching without much of a plan for making any money. And investors were bidding up anything with dotcom in its name.

As the Wall Street Journal reported in May 1999:

"One of the sacred tenets of business – you have to make money – suddenly looks almost like a quaint artefact of an outdated era."

From 1 January 1998 to 27 March 2000, the tech-heavy Nasdaq 100 index went up by 253.73%.[2]

Then, the bubble burst. It's difficult to say why. Perhaps investors just came to their senses. Regardless, from 27 March 2000 to 7 October 2002, the Nasdaq fell by a total of 82.9%.[2]

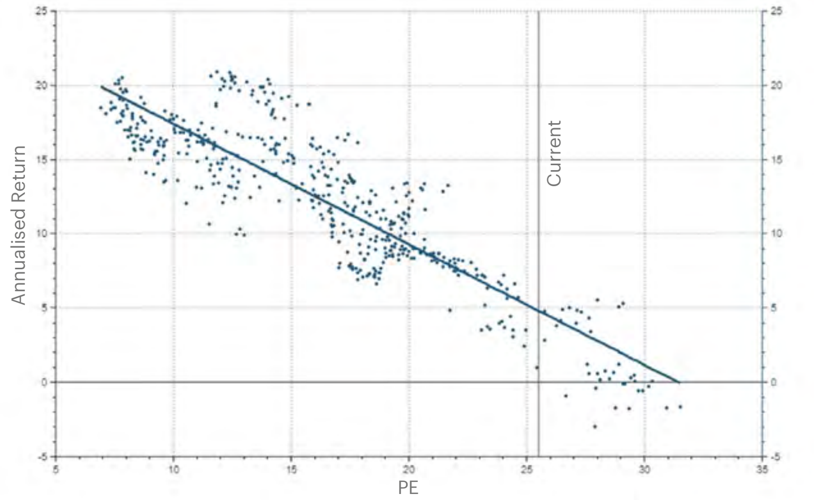
Had you invested in the Nasdaq in March 2000, it would have taken you until 2015 to get back into the black.

And Amazon? From 1 January 2000 to 28 September 2001, it dropped a massive 92% and it took until 2007 to make back those losses.

And what about the other market leaders from back then? Where are AOL and Yahoo these days?

Investing in stories is hard. Investing in the right companies, at the right time, is even harder.

Chart one: P/E ratio of the US market vs 10-year subsequent returns



Source: LSEG Datastream/Equilibrium investment team

Evidence-based investors

Investors who looked at the data back then would have most likely reacted differently to those who followed the narrative.

As of January 2000, the S&P 500 (the main US stock market) traded at a price/earnings (P/E) ratio of 30. This means that the total value of the 500 companies was 30 times the annual profits they made at the time.

The average P/E ratio between January 1973 and December 1999 had been 14 times earnings, so the market was more than twice as expensive as usual. A wise investor might have looked at this and decided that, whether or not the internet might change the world, 30 times was just too much to pay for the chance to participate.

After the bubble burst, valuations went back to more normal levels.

The P/E of the US market didn't get back above 30 times again until late 2020, peaking at 35 times earnings in mid-2021.[3]

During 2022, the S&P 500 fell by over 24% from peak to trough, from 1 January to 12 October 2022.

The valuation of the market tells you a lot about future returns, but often you need a long-term perspective. In the short term, markets often overshoot what is rational by a huge margin, both when they go up and when they go down.

Chart one shows the relationship between the P/E ratio of the US market, relative to 10-year subsequent returns. Each dot is a different 10-year period in history, and the higher the dot, the higher the return over that period.

Along the horizonal axis is the P/E ratio of the market at the start of that 10-year period. Cheaper valuations are to the left, and more expensive ones are to the right.

The dots tend to be a lot higher when you start with a cheap market, and a lot lower when you start with an expensive market.

"Investing in stories is hard. Investing in the right companies, at the right time, is even harder"

Start at 30 times earnings, and you've never made money over 10 years.

Investing is easy, right?

Rise of the robots

In 2023, the narrative for investors was all about artificial intelligence (AI).

Like the internet which came before it, as AI became mainstream through the launch of services like ChatGPT, investors became excited about the prospects for those companies thought most likely to profit.

But unlike the tech bubble, this time investors think that some of the largest companies in the world are those most likely to benefit.

The so-called "magnificent seven" big tech stocks in the US went up a cool 96% in 2023.[4]

By the end of the year, these seven companies represented nearly 30% of the S&P 500,[5] helping to drive the market up 18.58% during the year.[6]

Reading this, you may ask: "If nearly a third of the market pretty much doubled, shouldn't the market be up 30%+ rather than 18%?"

What this tells you is that the other 493 stocks in the index haven't done nearly as well.

For example, an equal-weight version of the S&P 500 – where you invest the same amount in each of the 500 companies – was only up 6.7% over the same time period.

2023 was a good year for US equity investors, but the leadership was extremely narrow.

The price/earnings ratio of the top seven is now 48 times reported earnings.[7] The market as a whole is on 24 times, still pretty expensive, but skewed by the big seven.

AI may change the world. It may make us all much more productive, and allow certain tasks to be completed more quickly, without human intervention. But we have yet to see much evidence of increased revenues for most of these companies as a result.

We do not know what will happen next, but the evidence from history says we should be cautious.

Golden rules of investing

We have a list of our "golden rules of investing."

The investment team will frequently refer back to this list and we find doing so really helps our investment decision-making. In particular, it helps us avoid what look like attractive investments on the face of it, but where something doesn't quite stack up.

Here are just a few of our golden rules, some of which you'll already have worked out from this article:

- Decisions must be evidence-based. Most asset classes have some valuation indicators that give you a broad idea of the future. Our advice is to use them.
- Look forward not back – allocate based on the likely future return, not past returns.
- Diversify your portfolio widely because you will often be wrong.
- Outperformance comes from being right more than you're wrong and, more importantly, making more money when you're right than you lose when you're wrong.
- Utilise known advantages. There's a vast amount of academic research out there showing what drives markets. For example, this shows that small companies will outperform large companies over the long term and that exposing your portfolio to greater growth drives long-term portfolio growth (e.g. emerging markets).
- Past performance is no guide to the future – but past behaviour is often a guide to future behaviour.

In summary, we like to construct diverse portfolios, exposed to lots of different asset classes, sectors and currencies, with a bit more than most in smaller and emerging companies.

Our portfolios did fairly well last year, but perhaps we could have done better had we ignored these rules! What you ideally wanted last year was a concentrated portfolio of large companies, in

Table one: Top 10 stocks in the S&P 500 (1980 – 2023)

2023	2010	2000	1990	1980
Apple	**Exxon Mobil**	General Electric	IBM	IBM
Microsoft	**Apple**	**Exxon Mobil**	**Exxon**	AT&T
Amazon	**Microsoft**	Pfizer	General Electric	**Exxon**
Nvidia	**Berkshire Hathaway**	Citigroup	Philip Morris	Standard Oil, Indiana
Alphabet	General Electric	Cisco	Royal Dutch Petrol	Schlumberger
Tesla	Walmart	Walmart	Bristol-Myers	Shell Oil
Meta	**Google**	**Microsoft**	Merck & Co	Mobil Corp
Berkshire Hathaway	Chevron	AIG	Walmart	Standard Oil of Cal
Exxon Mobil	IBM	Merck & Co	AT&T	Atlantic Richfield
United Heath	Procter & Gamble	Intel	Coca Cola	General Electric

Source: S&P 500 Dow Jones / awealthofcommonsense.com

one sector, in one region and one currency (US large tech).

So, should we throw our golden rules in the bin?

Are we entering a new paradigm where a few big companies will dominate forever?

We don't think so, as the evidence from history suggests this is rarely the case.

Table one shows the current top 10 stocks in the S&P 500, along with the top performers at various times in the past.[8] Those in green text show the companies who remain in the top 10 today.

Looking back at 2010, five of the top 10 are the same as now, but of those at the top in 2000, only two remain. Of the top 10s from 1990 and 1980, only Exxon remains.

Where are General Electric, AT&T, or IBM today? These were massive incumbents in industries with huge barriers to entry. Where are the likes of Kodak or Blockbuster Video?

Capitalism works. New companies will produce new products and displace the old. Inefficient companies will go bust. Unfortunately, it's very difficult to know in advance which companies will be which!

That's why we believe that our golden rules continue to be as relevant today as they have been in the past. By looking for evidence and ignoring stories, by diversifying portfolios and not trying to be too clever, we think we can avoid making the same mistakes that many investors have made, over and over again.

This article is intended as an informative piece and does not constitute a solicitation of investment advice.

Past performance is for illustrative purposes only and cannot be guaranteed to apply in the future.

*To speak with one of our experts, call us on **0161 383 3335** or by reaching out to your usual Equilibrium contact.*

(1) Amazon returns LSEG Datastream
(2) Nasdaq returns, FE Analytics in US dollars
(3) LSEG Datastream, total US market
(4) FE Analytics 01/01/2023 to 31/12/2023. Equal weight portfolio of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla, rebalanced quarterly
(5) S&P Dow Jones 01/01/2024
(6) FE Analytics 01/01/2023 to 31/12/2023
(7) LSEG Datastream / Equilibrium Investment Management 01/02/2024
(8) S&P Dow Jones/awealthofcommonsense.com

“Where is General Electric, AT&T, or IBM today? These were massive incumbents in industries with huge barriers to entry”

The power of compounding

Compounding essentially means earning interest on interest, so the earlier you can start to reap its reward, the better. Chartered team member, Mark Barlow highlights the impact it can make.

"The first rule of compounding, never interrupt it unnecessarily." - Charlie Munger, former Vice Chairman, Berkshire Hathaway

This timeless advice holds true even today, resonating with the legendary investment guru's career that began in 1962.

Compounding is deemed so powerful that Albert Einstein once described it as the "eighth wonder of the world." Unsurprisingly, compounding was not in the running when Angkor Wat in Cambodia recently beat Italy's Pompeii to be bestowed with the title.

Munger's friend and business partner Warren Buffett agrees with its almost mythical power and has commented: "My life has been a product of compound interest!"

One cannot dispute this statement when witnessing the growth of Buffett's wealth, from his first investment at the tender age of 11, to his active involvement at the age of 93. Perhaps his daily consumption of five cans of Coke is not as detrimental as one might think; after all he became Coca-Cola's largest shareholder by turning a $1 billion investment in 1988 into $23 billion by December 2023.[1]

Astoundingly, 90% of Buffett's fortune was accumulated after he turned 65 (as seen in **Chart one**), and according to Forbes, his net worth in January 2024 is $121.5 billion, making him currently the sixth richest person in the world.[2] This is even more remarkable considering that his recent investments have closely followed the performance of the S&P 500. This clearly demonstrates the impact of long-term investing and the significance of early success.

Now, let's imagine if Buffett had not started his investment career until the age of 25. By delaying his investment journey through his teens and early 20s, his fortune in 2019 would have amounted to £9.2 million, a mere 0.013% of its actual worth.

Buffett serves as a prime example of how compound returns from investing can yield great benefits. While not everyone may amass billions, achieving a good return on your money rather than letting inflation erode it is crucial. This means allowing your existing funds to work towards your goals, and the longer they are left to grow, the more you will ultimately benefit.

The Rule of 72

The Rule of 72 is a valuable tool for investors seeking to estimate the growth of their investments in the future. Luca Pacioli, an Italian mathematician, is often credited with the development of this simple rule. It enables even novice investors to predict how long it

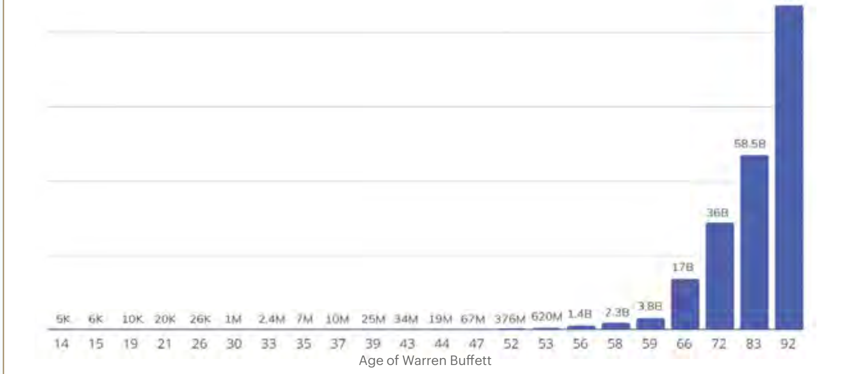


Chart one: Net worth of Warren Buffett over his lifetime

Source: Finmasters – Warren Buffett's net worth over the years

Chart two: Performance of Equilibrium funds (01/01/08 - 31/12/19)

- A - EQ Global Equity Fund (143.84%)
- B - EQ Adventurous Fund (121.41%)
- C - EQ Balanced Fund (110.50%)
- D - EQ Cautious Fund (102.08%)
- E - Consumer Price Index (30.72%)

Source: FE Analytics / Equilibrium Investment Management 01/01/2008 – 31/12/2019. Global Equity long-term returns based on back tested portfolio as it was not launched until 5 June 2020.

will take for their investments to double.

For instance, if an investment yields an annual return of 5%, the time required to achieve a 100% return can be calculated using the Rule of 72 as follows:

72 ÷ 5 (% annual return) = 14.4 years

While it is impossible to accurately predict the exact return, historical data can serve as a useful guide.

At the start of 2008, Equilibrium became discretionary fund managers, allowing us to make changes to clients' investment portfolios without seeking prior consent within certain parameters. Unfortunately the timing could not have been worse as the "credit crunch" wreaked havoc on global stock markets.

By October of the same year, the Equilibrium Balanced portfolio had declined by over 15% (compared to the FTSE 100's 38% fall), dimming prospects of doubling investments anytime soon; however, as history has shown, markets eventually rebound. By August 2009, investors would have recovered their losses.

By the end of 2019, all Equilibrium portfolios had at least doubled since January 2008 as shown in **Chart two**. By applying the Rule of 72 in reverse, this provides a useful gauge for estimating future returns.

The results highlight that investors are rewarded over the long term for taking on more risk and the effects that compounding can have in accelerating returns.

So, what does all this mean for you?

Undoubtedly, compounding can have a profound impact, and the earlier you start, the better the outcome. Long-term investing is particularly crucial when it comes to retirement planning, whether for yourself, your children, or your grandchildren. The key is to start saving early and maintain a consistent approach, whilst avoiding the temptation to withdraw savings before retirement.

While it may seem distant for some, retirement offers the best opportunity to earn compound returns on your investments due to its extended time horizon. Compound returns not only provide financial security but also the potential to enjoy retirement earlier for you and your loved ones.

This article is intended as an informative piece and should not be construed as advice. To speak with one of our experts, call us on ***0161 383 3335***.

(1) Investopedia.com: Why did Warren Buffet invest heavily in Coca-Cola in the late 1980s?
(2) Forbes.com: The real-time billionaires list.

BY MARK BARLOW

Quintessentially Equilibrium

Yes, anyone can receive financial advice and no, you don't have to be retired. Hear about our latest services.

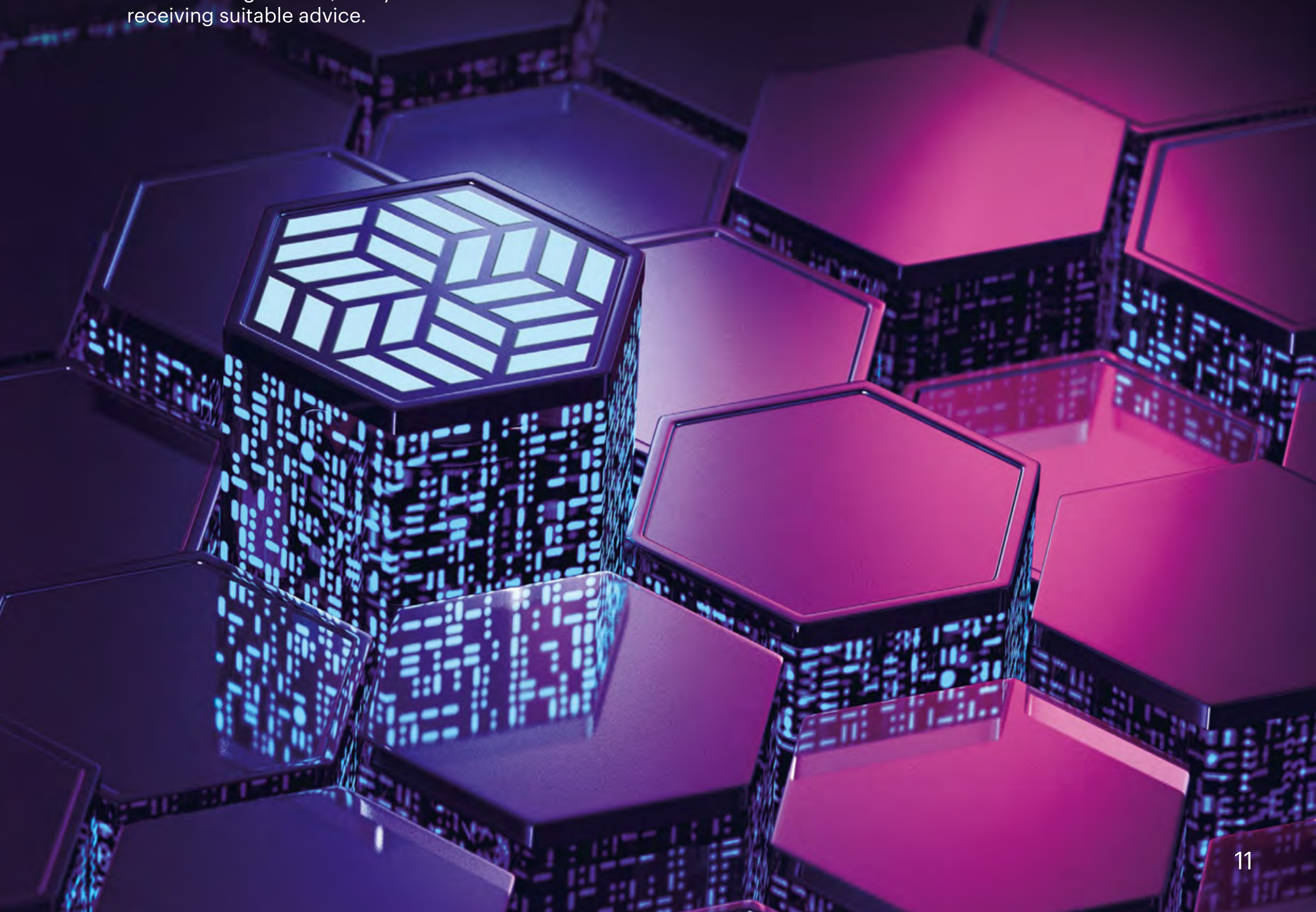
In 2017, Equilibrium launched "Libby's Big Adventure", a workbook and lesson plan training package, with the sole goal of helping children aged 9 and 10 develop their financial, literacy, and numeracy skills.

The program was a huge success, expanding into multiple schools and continuing to thrive today.

However, during our research prior to launching the scheme, it became apparent that although the children's parents appreciate and understand the need for financial guidance, many themselves were not receiving suitable advice.

A recent survey by Yonder (2023), conducted among 2,000 adults in the UK, found that 72% of respondents believe that getting financial advice is important, rising to 81% among those aged 18-34.[1]

Worryingly though, whilst many young people identify the need for financial advice, only about a quarter of those deemed as Millennials and Gen Z (born between 1981 and 2012) use a financial adviser.[2] Of those born from 1997, 67% now take advice from TikTok and YouTube compared to 24% from financial advisers.



"The aim of the Essentials service is to offer a tailored solution to match a client's needs, whilst bringing a simplified approach to a complex world"

While engagement in investing should be applauded, the Financial Conduct Authority (FCA) has set out new social media guidance targeting unregulated "finfluencers" selling crypto schemes and financial products online.

According to research carried out by Cover Magazine (in collaboration with Scottish Widows), the major stumbling blocks identified by young professionals looking for financial advice were: where to begin, cost, and confusing jargon. Furthermore, the average age of a financial adviser in the UK is 58 which doesn't discredit these advisers by any means, but it does make it that much more difficult for today's 20-somethings to find a connection.

On top of this, many financial advisers don't actively seek young clients as they are perceived to have low asset values and therefore not typically as profitable.

An 'Essential' service

Recognising the need for accessible financial planning services, we recently launched our Equilibrium Essentials service offering affordable advice for those with investable assets below £200,000. This service aims to appeal to clients who may not need our full service whilst in the infancy of accumulating wealth.

"The aim of the Essentials service is to offer a tailored solution to match a client's needs, providing much-needed support at the very start of the financial planning journey." explains Ben Harrison who qualified as a chartered financial planner two years ago aged 27, and is now responsible for Essentials.

For prospective clients, each will experience the same thorough analysis and discussions at outset to enable us to determine which service proposition is most appropriate. It is only then that we can make our recommendation and this will very much depend on individual circumstances.

So, what do you get with Equilibrium Essentials?

Your own dedicated financial planner

During the initial stages, you will work with your planner on your personalised life plan forecast using our Voyant cash flow software. This will include a review of your current position and any changes you expect in the short, medium and long term. Initial advice will then be provided and implemented as agreed.

You will have an annual review meeting (either virtual or in person) to discuss your current circumstances and to reassess what the future looks like. During the review, your cash flow forecast will be revisited to determine whether your financial life plan still looks achievable, and if not, what changes could be made to remain on track and achieve your goals.

As a matter of course, your planner is contactable at any time for no additional cost outside the ongoing fee. This is particularly useful in the early years when you may need to make quick decisions regarding mortgages, childcare, pensions, life cover and investments. It is key that all options are discussed to give you financial confidence as life evolves.

"The goal is to ensure that those who need financial planning advice can access it without being prohibited by cost"

Investment expertise

If suitable, clients will have exclusive access to the Equilibrium range of funds at no initial charge. These are managed by our in-house investment team who have a vast wealth of knowledge, experience and qualifications.

In addition, you will receive our monthly investment newsletter known as 'The Pulse', so you can keep up to speed with our views and outlook.

Valuations

You will have access to the Equilibrium portal where you will be able to view the current value of your portfolio at any time.

Client events

Whether it's our quarterly investment briefings or topical masterclasses, rest assured you will get an invite, or you can watch online.

Affordability

The fee we charge for the Essentials service is reflective of the work we do. The goal is to ensure that those who need financial planning advice can access it without being prohibited by cost and as a result, are not restricted to unregulated TikToks.

Insuring for the future

As part of our holistic approach to financial planning, we not only review a client's personal protection needs, but we now make recommendations and can arrange suitable protection policies.

There are three main areas to be considered when reviewing the level of protection:

Death

This will be highly relevant in the early years of those with a young family, to ensure the mortgage is repaid should the worst happen and help alleviate the financial burden at a very emotionally sensitive time.

Serious illness

Like life insurance, this will give families the peace of mind that their liabilities can be met should a main income earner become critically ill.

Not working

There is always the possibility that a person(s) may be unable to work for a sustained period. Anybody is at risk of an accident that could hinder their ability to work, so it is key that during this time of recuperation, all regular bills can be met.

We're here to guide you every step of the way. By offering these services at crucial life stages, we can provide a long-term, holistic approach, giving you the financial confidence you deserve, now and in the future.

Past performance is for illustrative purposes only and cannot be guaranteed to apply in the future. Investments will fall as well as rise.

1) Condcted by Yonder on behalf of Scottish Widows
2) smartasset.com

Speak to Ben

If you would like to know more about our Essentials service or are looking for some advice about what protection you may need, drop Ben a line at **ben.harrison@equilibrium.co.uk**.

AIM - on sale!

The Equilibrium Alternative Investment Market (AIM) portfolio invests in companies that we believe qualify for Business Relief, which has inheritance tax advantages. Portfolio Manager, Neal Foundly, explores why he thinks they look such good value at present.

The stock market is not efficient. Despite the trillions of pounds, the supercomputers, armies of analysts and the Nobel Prize winning geniuses that make up the market, prices swing around and often do not reflect the true value of companies.

It should be quite simple. Shareholders participate in the profits of a company after it has paid the government for taxes and paid its lenders interest on its loans. The share price, therefore, should roughly track the net profits of a business. And yet, it doesn't.

A company's share price can deviate massively from its expected profits (investors invest for future returns and it is the future profits that count, much more than past profits). This is particularly the case for smaller companies, such as those that we hold in the Equilibrium AIM portfolio, which are not well covered by research analysts and where prices are more sensitive to large buy or sell trades.

Why should this be?

If a crystal ball could predict, for instance, the holidays and airline operator Jet2's earnings for the upcoming year, it would sadly not be a reliable indicator of share price returns. A key factor is what value investors put on those profits.

What do we mean by that?

The 'market' is expecting Jet2 to make 168p of earnings per share (total net profits divided by all the company's shares) when they report their figures in June of this year.[1]

Now, with Covid out the way and no signs of an imminent recession, many people are understandably wanting to get away for a holiday break and therefore it is reasonable to assume Jet2 might make those profits – they might even beat them. With the share price currently at 1330p, the 'value' that investors are putting on these profits is about eight times.

i.e. 168p (earnings per share) x 8 = 1330p (the share price)

However, what if there was, say, a rumour of a new Covid-type disease developing? Investors may well take a negative view and put a much lower value on the profits. If they put the shares on five times multiple, this would imply the shares would go down to 840p (168p x 5), a fall of 37%.

Remember, Jet2's profits might still be 168p per share if the rumour is untrue or the outbreak has zero effect on the company, and yet the shares have lost over a third of their value.

Thus, knowing what profits a company is going to make is not necessarily going to tell you what the shares are going to do. Of course, over longer time periods there should be a link.

For example, **Chart one** is a 10-year chart of one of our AIM portfolio holdings, Keywords Studios, a video game company.

It shows the share price in the black line and the expected earnings per share for the year ahead in the orange line (both rebased back to zero 10 years ago). As you can see, the company has had nice, consistent growth in profits over that time, but the shares have fluctuated pretty widely around the earnings line and now stand at a very low level relative both to earnings, and to the price of a couple of years ago.

In the Equilibrium AIM portfolio, there are many examples like this where the share prices are significantly below the expected earnings line, which is why we believe there is plenty of underlying value yet to be realised in the portfolio. There are several reasons why small companies have been left behind, not least the growth in index tracker funds that focus on large stocks.

One way in which you can see a rapid closing of the gap between the share price and earnings is when there is a bid for the company.

Chart one: Keywords Studios share price v earnings per share (10 years)

Source: LSEG Datastream / Equilibrium Investment Management, 01/02/14 - 01/02/24

Chart two: Smart Metering Systems share price v earnings per share

Source: LSEG Datastream / Equilibrium Investment Management, 01/02/21 - 01/02/24

A recent example of this was the bid by the large private equity company, KKR, for one of the portfolio holdings, Smart Metering Systems. KKR launched an all-cash bid at a 40% premium to the share price in December 2023.

You can see from **Chart two** that prior to the bid, the share price (black line) had fallen significantly compared to the earnings but the bid, shown as the sharp vertical line at the end of 2023, in large part narrowed this gap.

In total, around 8% of the quoted UK small companies were bid for over the year.[2]

Going forward, we would not be surprised to see this trend continue as prices remain extremely low and as interest rates fall, the cost of borrowing drops, making the opportunities in small companies even more appealing.

Small companies have proven themselves to be the lifeblood of the UK economy, with stronger growth over the long term compared to large companies, and yet they stand at low valuations that provide a great opportunity for investors.

This article is intended as an informative piece and does not constitute a solicitation of investment advice.

Past performance is for illustrative purposes only and cannot be guaranteed to apply in the future.

(1) Refinitiv as at 5 February 2023
(2) Bloomber

Find out more

To learn more about our AIM portfolio, contact us on **0161 383 3335** to speak to one of our experts or by reaching out to your usual Equilibrium contact. Scan the QR code to view our article Under The Bonnet: Alternative Investment Market (AIM) at equilibrium.co.uk.

Trust me, I'm a Portfolio Manager

Meet Portfolio Manager, Neal Foundly, a prominent member of our investment team, renowned for his behaviourist approach in shaping investment decisions.

"In the world of business, the people who are most successful are those who are doing what they love."
– Warren Buffett

Having managed multi-billion-pound portfolios over a three-decade career, Neal has undoubtedly experienced the highs, lows, and exciting times of investing. Since joining Equilibrium in 2014, not only has he been instrumental to several fund launches, but he has also helped grow assets under management to over the £1bn mark and gets a buzz from helping clients get the returns they are aiming for over the long term.

Here, we uncover the mind behind the milestones...

During your career, what has been your biggest motivator?

"No-one has the monopoly on investment performance – if you have capital to invest, you have as good a chance as anyone to get good returns.

"If I can achieve better returns for clients each year, this can then make a really big difference over, say, 10 years. Our approach is to compound decent returns rather than shooting for obscene returns which comes with unnecessary risk.

"I really enjoy meeting our clients as they all have stories to tell, and their feedback is valuable. It's important to know if we are meeting or indeed exceeding their expectations."

Are there any investment decisions you regret?

"I recall in 2010, a BP-operated oil rig named 'Deep Horizon' suffered a huge explosion, leading to one of the largest environmental disasters in world history. At the time, I was running £2bn of portfolio, and BP lost half its value, causing a £63m loss to our portfolio.

"Looking back, there were signs that BP were not investing enough in their health and safety. This was an important lesson to always do some deeper digging."

What experience has made the biggest impact in your thinking?

"I was and still am an early adopter of technology. In 1999, a former colleague and I set up a company after buying AI technology from Manchester University. We eventually sold it to a large company in California, which was later taken over by IBM for their AI focus on healthcare. Building and starting a business gives you a lot of appreciation when it comes to investing, and today's advancements mean we now have better access to data.

"Obviously I have more experience now, but one thing that I do not deviate from is that I always need to be able to support my investment decisions with three good reasons to trade such as new management, or improved fundamentals."

Do your personal and work investment decisions differ?

"No, I take the same approach – it's consistent and saves energy. I would say I'm a calculated risk-taker. Almost all my money is in the Equilibrium funds – 'skin in the game,' as they say. If a client is hurting, I am hurting as well, but I back myself."

What is your opinion on investment bots?

"Markets are intricate, complex systems that can adapt, but bots are limited to handling regular situations, which are rarely normal. For instance, a bot would find it difficult to handle unforeseen incidents like 9/11 or the Covid pandemic."

What is the most niche part of your role?

"I run the Alternative Investment Market portfolio, where the investments are directly linked to companies, which is very different from managing our Equilibrium funds. It's an exceptional service for our clients that would otherwise be very expensive if managed externally."

How quick are you to react to market news?

"Not very... trade in haste, repent at leisure. My method is behaviourist, an observer rather than a reactor."

How does the investment team set themself apart from competitor firms?

"We are evidence-based investors. We work on the basis of finding good fundamental reasons to trade, but you need the data and evidence of something to base it on.

"We continue to be vigilant about what others are doing but we do not compete or copy. Also, our team's flat organisational structure allows us to work together to make decisions and, if necessary, carry out each other's responsibilities."

What has been your biggest inspiration?

"In the mid-1990s, I became aware of Warren Buffett. At that time, the city was dominated by public school old boys or hard-bitten MBA investment bank types – I fall under neither camp.

"I felt an instant connection to this guy from Omaha who didn't fit the mould yet was making a real success. I knew I could apply something different with my use of technology."

Do you think there will be any fundamental changes to the investment world in the next 20 years?

"In terms of markets, I think the UK and other markets will be subsumed into a non-US global index. There will be a US index, and then the UK will be part of a global index.

"I also think significant trends such as cash becoming obsolete, renewable energy dominance, advances in healthcare, and innovation and behavioural changes in areas like education and housing, will influence investment decisions in the coming decades."

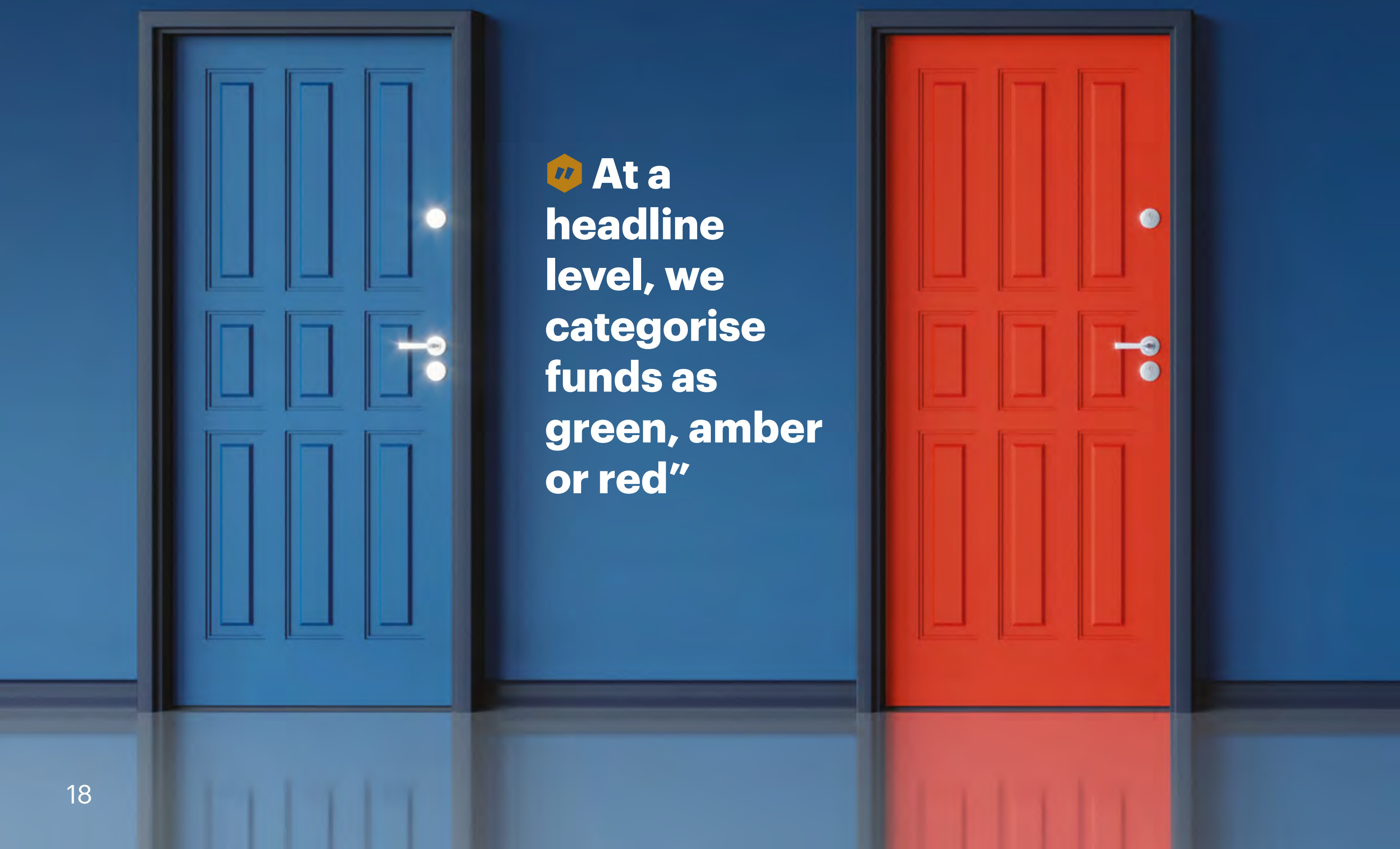
Speak to us

If you have any investment questions or would like to know more about our AIM portfolio, please call us on **0161 383 3335** or by reaching out to your usual Equilibrium contact.

BY JAMES CARR

Under the bonnet: Finding funds

Portfolio Manager, James Carr, tells us the 'how' and 'why' behind our fund selection.



> **"At a headline level, we categorise funds as green, amber or red"**

One question we often get asked on the investment team is: "What do you spend all day doing?"

Although our holdings may not look like they change month to month, we are always rebalancing in response to changes in the market, fund flows, and daily headlines.

What does that involve?

Once a year, we compile our long-term investment assumptions (equilibrium.link/EquinoxS24-long-term-investment-assumptions), using historical data combined with our own and external assumptions, to forecast the potential range of returns from each market. This guides our asset allocation and how we construct portfolios to achieve the target returns of each fund.

As an example, the last fund we added was a Japanese fund. We increased our exposure to Japan as we view the market as attractively valued - they are undergoing corporate governance reform leading to margin improvement and earnings growth has remained strong. The process can therefore guide us to where we might consider adding a new idea or where, based on current forecasts, returns from a certain region or asset class may disappoint.

Throughout the year, we will meet with fund managers in our office, attend conferences, and listen to webinars in order to build a list of funds which we want to explore further.

Strong signals

At a headline level, we categorise funds as green, amber, or red. Green signals a need for further analysis with a view to including it, amber is not one for right now and red is excluded.

We use the same traffic light system during our quarterly fund reviews but with a slightly different criteria. Here, we ask the question: "Is this fund behaving as we would expect it to?"

When we invest in a fund, it will normally be specialised in one part of the market, such as UK Smaller Companies. Here, it's vital to judge the fund against others with the same investable universe rather than comparing it to what is happening in another part of the market, where there will often be divergences in performance.

Our fund selection is a combination of quantitative and qualitative factors, with both sides being equally important. On the quantitative side, while past performance is a part of the decision-making process, evaluating how the fund has behaved relative to the market backdrop in which it operates is much more useful. This demonstrates the repeatability and robustness of the process.

It's a balancing act

Two key factors we focus on when assessing a fund are size and cost.

Fund size is important as we need a fund to be large enough so that we do not own a disproportionate part of it, yet not so big that it limits what the fund can invest in.

This consideration holds particular importance for certain asset classes, such as smaller companies, where the larger the fund is, the smaller and more limiting the investable universe will be, as they are either forced to own a bigger percentage weighting of the companies or have a greater number of holdings.

The direction of travel for a fund's assets is also important as funds in outflow mode (when investors are redeeming holdings) may be forced to sell the most liquid or best-performing parts of the portfolio leaving investors with what is left.

Costs also form a key part. With so many markets accessible cheaply through passive index trackers and asset allocation responsible for the bulk of long-term returns, if we can keep costs to a minimum, this will help maximise our chances of achieving our targets.

One point to note is that low fees do not always equal good value, as certain asset classes are priced differently to others, based on how scalable and unique the underlying assets are. For example, an active private equity fund engaging with a company is harder to replicate, so would charge a higher fee than say a government bond fund.

Adding value

One recent fund switch we made was adding in the Gresham House Multicap Income Fund in September 2023, a fund we originally met with in early 2021. We were impressed with the team and their process at the time; however, the fund was too small at sub £100m. Since then, assets have grown, performance has remained consistent with expectations, and we particularly liked how they used a private equity lens for investing in public companies.

While an incredibly short period to judge performance over, since our investment, this fund has remained comfortably ahead of the sector and index.

One thing that we have discussed internally is the undervaluation of small and medium-sized companies in the UK and how this value can be realised by shareholders, with an increasing number now being taken private at a premium to market price. By adding a fund focused on these metrics from a private equity background, we are aligning our evidence-based approach with theirs.

There is no single way to identify funds for investment, however, we believe that blending the quantitative numbers of a fund with the human aspect of the people running the funds, gives us the best chance of identifying the ones that can deliver strong returns over meaningful time periods.

Past performance is for illustrative purposes only and cannot be guaranteed to apply in the future. Investments will fall as well as rise.

This article is intended as an information piece and does not constitute a solicitation of investment advice.

For more information or to speak with one of our experts, call ***0161 383 3335*** *or by reaching out to your usual Equilibrium contact.*

One point to note is that low fees do not always equal good value"

Inside the world of high-yield bonds

Investment Analyst, Nathan Lingham, navigates the high-yield bond opportunities.

Overview

In the last edition of Equinox, we took readers for a walk down Bond Street, unravelling fixed-income complexities and highlighting why we believe bonds offer a great opportunity in the current market.

This article focuses on a specific sector – high-yield bonds.

Bonds are essentially a loan. By buying a bond, you are lending your money typically to a company or a government. They will pay you interest during the term, and then repay your loan when the bond matures.

The interest rate, or yield, that the lender receives will largely depend on the perceived risk of the borrower (i.e. the company issuing the bond) and the chance of them not returning the principal at maturity. The greater the risk of default/non-payment, the higher the demanded interest rate (yield).

A high-yield bond is the name we give to a loan to a company with a lower credit rating.

Given the associated risks, it is crucial that our high-yield fund managers complete detailed market, credit and financial analysis. We have a very strong suite of high-yield funds, including the Aegon High Yield Bond Fund, managed by experts in this field, Thomas Hanson and Mark Benbow.

The fund

Unlike active equity funds, where it's common to see only 35-45 holdings, bond funds tend to have more holdings and smaller positions.

The average high-yield bond fund currently has 262 holdings, and the index has 3,337 (ICE BofA Global High Yield Constrained Index).[1] The Aegon fund is markedly different to both the index and sector with just 136 positions, meaning each position has a much bigger impact on the returns achieved. This high-conviction approach is something we favour.

Also, unlike equities, where most indices are market cap-weighted (meaning the biggest firms have the largest weight in the index), bond indexes are weighted in correlation to the amount of outstanding debt. The bigger the company's debt, the bigger the proportion of the index.

Read more

Scan the QR code or visit:
equilibrium.co.uk/take-a-walk-down-bond-st - 4 min read.

This doesn't seem to make much sense to us. Why would you want to track an index where you lend more money to the most indebted? We are not too sure either.

That's why we favour the active approach. Aegon's unconstrained, flexible mandate means they are index agnostic, free from index biases and can avoid forced selling. Ultimately, giving the fund managers the freedom to take advantage of all the available opportunities that they find, without being tied to the seemingly illogical nature of the index.

The team behind the fund

Before we invest in any active fund, we always meet the managers. This provides us with the perfect opportunity to really dig down into their process and approach.

When we initially met the Aegon team, they gave us a comprehensive overview of their outlook, methodology and team structure. We could clearly see that they had a real passion and understanding for the high-yield market, and they happily talked through the way they conduct their analysis.

Something that particularly stood out to us was the detailed justification of their quantitative measures. Some of the metrics they explained were subsequently adopted and utilised in our other fixed income holdings.

In our discussions with the Aegon team, they expressed their willingness to invest in "good bonds" issued by "bad businesses". Businesses that the market perceive to be "bad" or riskier, will have to offer a higher yield on their bonds. While investing in "bad businesses" may not initially sound like a great strategy, when questioned, they explained they place more emphasis on the quality of the specific bond, rather than the quality of the business that has issued the bond.

They look for bonds that are secured against certain assets within the business. This implies that if the issuer is unable to repay the loan and defaults on the issue, the bond holder (i.e. the Aegon team) has a right to a certain asset.

This protective measure reduces overall risk, as bond holders have a claim on collateral that will have a value in its own right. Investing in bonds secured against an asset will normally increase the amount recovered by the bond holder in the event of a default, therefore having a greater recovery rate.[2]

The fund currently has more 'secured debt' than the index, reinforcing the team's approach to picking "good bonds" despite them being issued by perceived "bad businesses".

The current average yield to maturity on our various high-yield fund holdings is approximately 8% p.a.[3] The yield has historically been a very strong predictor of future returns,[4] which means Aegon, and our other high-yield bond funds give us strong, high-quality exposure to the asset class and allow us some predictability of returns.

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*To speak to a member of our investment team, please don't hesitate to get in touch with us on **0161 383 3335** or by reaching out to your usual Equilibrium contact.*

(1) Aegon Asset Management.
(2) Fixed Income, Derivatives and Alternative Investments, Kaplan, 2023.
(3) EIM/ the various fund managers, Jan 2024.
(4) Aegon Asset Management.

BY MARK BARLOW

Making a racquet!

Do you know your padel from your pickleball? If this makes no sense, then you might be missing out on two of the fastest-growing sports to reach our shores.

Both are low impact sports which can be enjoyed by all ages, genders and skill levels"

Up the creek without a padel!

At Equilibrium, padel tennis has been the biggest craze of the last 12 months with colleagues of all ages and sporting abilities taking part. Venues have been popping up at a rate of knots in the local area including courts at Total Fitness Wilmslow, Alderley Park, Mottram Hall, and Hale Country Club.

David Beckham is known to be a big fan, as is Hugh Grant. So, what exactly is it?

In 1969, Señor Enrique Corcuera from Acapulco had become bored with tennis and squash so set about combining the best elements of both these racquet sports. He wanted to create a sport that could be more fun, more social, and easier to learn than any other racquet sport, and padel was born. Drawing from tennis, you'll find yourself smacking a furry ball over a net and following the same scoring system. And from squash, the back wall is fair game as long as the ball bounces on the ground only once.

It is typically played as doubles, increasing the social aspect and there is a lot of teamwork, strategy, and emphasis on positioning, meaning you can still enjoy it without moving too much.

Caught in a pickle?

In the US, the same conversations are taking place about an existential threat to tennis. But the tennis-adjacent disruptor sport over there isn't padel, it's pickleball.

According to recent data, there are now 36.5 million pickleball players in the United States[1], with many A-listers wanting in on the action too, from Bill Gates to Kim Kardashian.

Pickleball and padel share some similarities, not least in their origin stories. Pickleball was born in 1965 in Seattle. It was the invention of three dads including the future US congressman Joel Pritchard, who came home after a game of golf and found their families sitting at home with nothing to do. Pritchard had a badminton court, but no kit, so they started hitting a perforated plastic ball over the net with ping-pong bats. The following weekend, they lowered the net to roughly the height of a tennis net. The Pritchard family had a dog named Pickle who loved chasing the ball, and thus, pickleball allegedly got its name.[2]

Why the explosive growth?

The exponential growth in both sports in recent years can be linked to the lockdowns during the COVID-19 pandemic. Both sports are typically played outside and involve no physical contact so weren't as restricted as team sports.

When it comes to future growth, pickleball has a crucial advantage; padel courts need to be purpose-built, and with the playing surface, glass and lighting, can cost up to £25,000[3]. Pickleball courts, meanwhile, can simply fit on existing badminton courts in leisure centres and village halls or by repurposing existing tennis courts.

Such has been the growth of both sports there has been somewhat of a backlash from the tennis aficionados including Martina Navratilova who tweeted on X (previously known as Twitter): "I say if pickleball is that popular let them build their own courts."

Growth in padel is no doubt still on the rise in the UK, but it might be worth taking a cautionary note from Sweden which went from having 300 padel courts to 3,500. Padel centres in the Nordic country are now being converted into warehouses and budget grocery stores after the sport's pandemic boom turned into a bust.[4]

The benefits

Both are low-impact sports which can be enjoyed by all ages, genders, and skill levels, which makes them perfect for group activities.

The social benefits of each are plentiful and playing with a group can help to reduce stress, boost your mood, and increase your social circle. It's a great way to stay connected with friends and family, as well as meet new people.

(1) Data released by the Association of Pickleball Professionals (APP) January 2023
(2) Wikipedia – Pickleball
(3) Padelathletes.com
(4) Bloomber.com/Sweden holds warning for potential crash of the $4billion padel craze

Find out more

If you would like to try either sport, we recommend visiting **playtomic.io/** for padel or **pickleballengland.org** for pickleball, where you can search for local clubs and book to play with friends or players of a similar ability.

Which game are we playing?

It is only natural to compare performance with others, but surely it only works when comparing apples with apples?

"My friend's portfolio has returned double digits."

This statement is something we come across on a regular basis, and is such a throwaway comment without context, that it creates more questions than answers.

One of the first questions we pose is, how long has it taken to achieve this? Such a return over a single year is impressive, but is the same true, say, over 5 years?

Even beyond this, if a client achieves a 10% return the year after a 10% loss, they will have less than they started with!

Comparing apples with pears

Historically, we have been our own worst enemy when it comes to reporting performance. For years, we have been sending clients their portfolio returns, along with the return of the FTSE 100 over the same period. This was done with the best of intentions, to help our clients relate to a market they already understood.

However, instead of it being used purely for information purposes, a number of clients were anchoring their own returns to the FTSE 100 and benchmarking Equilibrium to the index.

So, how did this pan out? In times of falling markets, our portfolios did well, but in a rising market, the opposite was so. This is to be expected as we would be comparing an index that is 100% equity to that of our core funds which have broadly half the level of equity exposure. It is human nature to only remember the high points and it is at those points when our portfolios would always underperform the FTSE 100. Nobody tends to store the steady years in their subconscious.

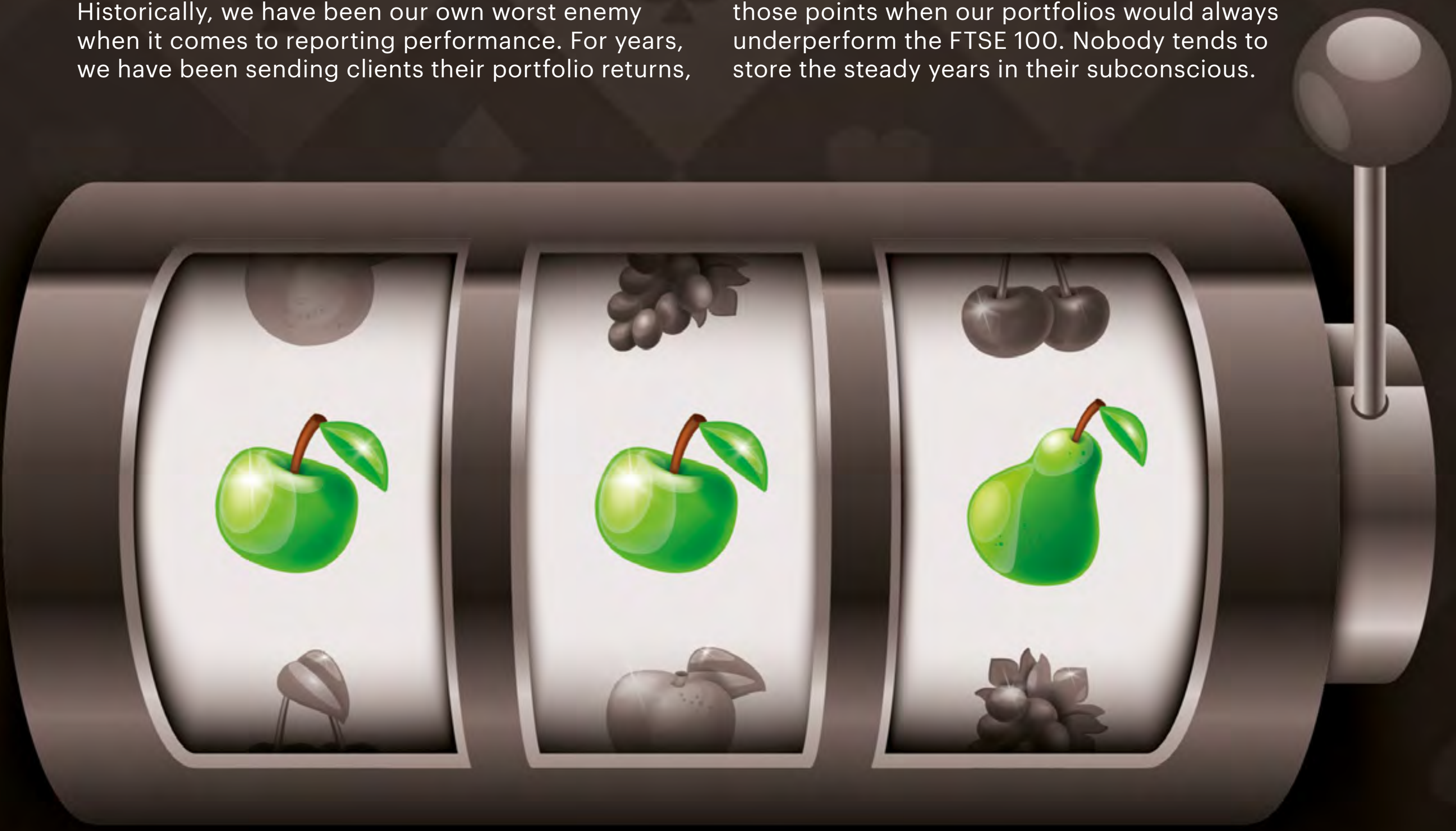

Table one: Equilibrium Balanced fund versus its comparators

Fund, index & sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Index: ARC Sterling Balanced Asset PCI TR in GB	5.79	-9.14	7.64	4.31	11.73	-5.1	6.69	8.64	1.87	4.51
Portfolio: EQ Balanced Fund (0.5%) 01/02/2022 TR in GB	6.5	-10.93	7.73	4.31	13.79	-4.12	9.75	8.93	5.53	6.43
Sector: IA Mixed Investment 20-60% Shares TR in GB	6.69	-9.24	7.65	3.48	11.88	-5.08	7.11	10.25	1.21	4.98

Source: FE Analytics / Equilibrium Investment Management. Numbers in green indicate outperformance of at least one of the benchmarks

A relevant metric?

We agreed it was time to move away from the FTSE 100 towards one that is more comparable on a risk-adjusted basis.

When it comes to investment comparators, there are a myriad of benchmarks that could be used, but it is key to ensure we are comparing apples with apples.

The Equilibrium funds have previously been in the IA (Investment Association) unclassified sector as they were not correlated to any particular sector. As an alternative, it was felt appropriate to have fund objectives linked to the base rate or inflation. For example, the objective of the Equilibrium Balanced Fund is that it aims to deliver returns greater than inflation over a minimum of 5 years (and an average of 5% per annum above CPI over any 10-year period).

While we still feel this is the key measure, we want to help clients compare our funds to competitors in a more suitable way. As the makeup of the Equilibrium funds has changed, they now have a greater correlation to particular sectors giving a relevant comparator. Using the Balanced fund as an example, the two most common measures used are IA and ARC (Asset Risk Consultants).

The IA Mixed Investment 20-60% Sector sets the parameters of how much equity can be held within a fund to meet the criteria. There are currently 433 UK funds that make up this sector, including offerings from investment heavyweights such as Aviva, Invesco and Scottish Widows. The benchmark return is simply calculated by taking an average of the returns of the constituent parts.

The ARC Indices are a set of benchmarks that harness data from more than 120 wealth managers such as Brewin Dolphin, Tilney and Coutts and are made up of literally hundreds of thousands of private client portfolios. As with the IA sector, the ARC Indices limit equity exposure but to a slightly narrower remit of 40-60%.

Keeping long term in mind

So how do we measure? We place a lot of credence on long-term investing, preferring to assess performance over a 10-year period. To remove any accusations of bias over the timeframe, we use calendar years as easily identifiable, indiscriminate reference points.

The results in **Table one** show that in 9 out of the 10 years, our Balanced fund outperformed at least one of its comparators (the IA sector or the ARC Indices) which, as active investors, would typically please most clients. However, recency bias is evident amongst clients due to the latest calls made by the investment team and the subsequent impact. While these decisions may have slightly affected short-term performance, their aim is to deliver long-term outperformance.

Playing your game

At Equilibrium, our core message is excessive risk is unnecessary and the strategy within our funds reflect that approach. Given the varying risk profiles within the fund range, we are confident we can blend them together to meet a client's needs and ultimately achieve their goals. However, with a dedicated in-house investment team, we can also cater to bespoke requests from clients.

If asked to create a portfolio with the potential to outperform the FTSE 100 over a 10-year period, for example, the investment team would willingly take up the mantle.

To illustrate this, we might look to blend our Defined Returns contracts with a FTSE Tracker and then take an overweight position in either a specific geographical region or specific sector. These three components not only offer the potential to outperform but the investor also experiences less volatility.

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Read more

To find out what six attributes you need for investing, visit **equilibrium.co.uk/a-response-able-investor** or scan the QR code.

The magnificent seven: A cautionary tale

The technology sector's 'magnificent seven' may look appealing but what lies beneath the glitz and glamour?

In recent years, the technology sector has witnessed a remarkable surge in growth, giving rise to a select group of stocks collectively known as the "magnificent seven." These seven tech giants, Alphabet (Google), Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla, have dominated the market. However, beneath the glitz and glamour, there is growing concern that these tech stocks may be overvalued.

Let's explore the reasons behind this scepticism and why investors should exercise caution.

Sky-high valuations

One of the primary reasons for the overvaluation of tech stocks is their sky-high price-to-earnings (P/E) ratios, a metric used to compare the relative value of a company's stock price to its earnings per share. Investors have been willing to pay a premium for these companies, driven by their growth potential. However, when P/E ratios become disconnected from underlying fundamentals, it raises concerns about sustainability and the potential for a market correction.

Intense competition

The tech industry is highly competitive, with new players constantly emerging and disrupting traditional business models. This intense competition poses a threat to the long-term growth prospects of even the most established tech giants. A stark example of this dynamic is the meteoric rise of Netflix, which toppled the once-dominant Blockbuster video rental chain. However, even Netflix is now contending with an intense "streaming war", facing stiff competition from rivals like Disney+ and Amazon Prime Video. As a result, investors should carefully evaluate a company's ability to maintain its competitive edge and adapt to changing market dynamics.

Regulatory risks

Tech companies have come under increasing scrutiny from regulators worldwide. Concerns over data privacy, antitrust violations, and monopolistic practices have led to potential regulatory crackdowns. Any adverse regulatory actions could

significantly impact a company's profitability, leading to a reassessment of its valuation. Even Meta's share price took a slight hit this year, falling by 0.6%, following a record $1.3 billion fine imposed by European Union regulators for unauthorised data transfers to the United States. (Source: Barrons).

Market saturation

The law of diminishing returns applies to the tech industry as well. As markets become saturated with products and services, the potential for exponential growth diminishes. This saturation, coupled with a limited addressable market, suggests that lofty growth expectations may not be sustainable in the long run.

Economic downturns

Tech stocks are not immune to economic downturns. During periods of economic uncertainty, consumer spending on technology-related products and services may decline. This can have a profound impact on the revenue and profitability of tech companies, leading to a re-evaluation of their valuations.

While the magnificent seven tech stocks have undoubtedly showcased tremendous growth, it is crucial for investors to approach these investments with caution. Overvaluation concerns, intense competition, regulatory risks, market saturation, and economic downturns all contribute to the scepticism surrounding the valuations of these stocks. Prudent investors should carefully analyse the fundamentals, evaluate the risks, and consider diversifying their portfolios beyond the tech sector to mitigate potential losses.

This article is intended as an informative piece and should not be construed as advice.

If you have any further questions, please don't hesitate to contact us by reaching out to your usual Equilibrium contact or alternatively call 0161 383 3335 for all new enquiries.

Going against the herd

Going against the herd in investing can be intimidating, but it often pays off if you stick to the key principles.

A common benchmark for many portfolios is the MSCI World Index, a market capitalisation-weighted index of developed market equities.

A company's market capitalisation is essentially its size. For example, the world's biggest company by this measure is Apple. Its market cap – the number of shares multiplied by the share price – is currently $2.84 trillion.[1]

A market cap-weighted index allocates the most amount to the biggest companies. Apple has the biggest weighting currently, followed by Microsoft.[2]

When funds are benchmarked, and their performance is judged relative to an index, they often stick quite closely to it. They might have a bit more or less in Apple, for example, but they won't deviate too far in case they get it wrong.

The problem is that relative performance doesn't pay the bills. If the index falls 30%, but the fund only falls 28%, it has outperformed. However, the portfolio has still lost money, so we wouldn't call that a successful investment!

Diversification or di-worse-ification?

One of our key investment principles is to be highly diversified – encompassing various asset classes, sectors, regions, and currencies. Many academic studies show that this approach is the most effective way of reducing risk.

However, the MSCI World is far from diversified, with 70% allocated to the USA. Most of these stocks are technology related. Nearly a quarter (23%) of the index is in information technology, whilst 7% is in communication services

(including Alphabet - the parent company of Google, and Meta - the owner of Facebook and Instagram). Amazon is classed as 'consumer discretionary.' Therefore, in our view, the true "tech" allocation is closer to 40%.

Whilst the index allocates more to the biggest companies, research tells us that you can typically expect higher returns over the long run from smaller companies.

Smaller companies can easily double in size if they are successful. For Apple to double, it would have to increase its size by another $2.84 trillion.

For context, this is more than the annual economic output of France ($2.78 trillion in 2022).[3]

Emerging market equities aren't included in this index, and again, these have been shown to outperform over time. Since 1987, the MSCI Emerging Market Index has returned 923.74%, whilst the MSCI World was up 676%.[4]

Of course, in the short term, things can be very different. Recently, big US tech stocks have performed phenomenally well due to excitement about artificial intelligence.

But the MSCI World Index hasn't always been so US-centric. Back in 1987, the biggest weighting was to Japan, accounting for 40% of the index, with only 32% in US stocks.[5]

However, over the last 36 years (31/12/87 to 31/12/23), the MSCI Japan Index is up just 16%!

Currently, Japan represents only 6% of the MSCI World Index.

Investing heavily in the winners of the past can be a dangerous game, and that is what you are doing by buying a market cap weighted index.

Credit where credit's due

In the bond or credit markets, index providers again allocate based on size, with the most amount of money allocated to the biggest bond issues.

This ensures the indices remain relatively liquid with the biggest bond issues generally the most easily tradable. This is important as most bond trades don't take place on an exchange like equities, but rather are carried out "over the counter" where trading costs can be significantly higher.

But allocating money in this way has another problem. When you buy a corporate bond you are lending money to a company, and this comes with credit risk. If the company goes bust you can lose some or all of your investment.

> **"We spend a lot of time making sure we keep the cost of investing as low as possible"**

By allocating the most to the biggest bond issues, what the index providers are essentially doing is putting more money with the companies with the most debt! That doesn't seem like a sensible strategy in our view.

In both bonds and equities, we do use index tracking funds on a selected basis. We tend not to use them for corporate bonds for the above reasons, but we do use them for government bonds where we are less concerned about credit risk.

Index tracking funds can be a cheap and effective way of gaining access to a broad asset class when used sensibly.

In equities, we would advocate tilting exposure a little bit towards smaller companies and diversifying globally, which has been shown to aid returns over time. This can be done via actively managed funds, but we also do this by using index funds.

For example, in US equities we hold two "alternative" index funds alongside our S&P 500 tracker. One tracks a small cap index of stocks outside the top 500.

The other invests in the top 500 but does so in a different way. Rather than putting the most into the largest companies, this fund puts an equal amount in each stock.

Again, over the long term this has been shown to outperform. From 31/12/1998 (the earliest we can take this back) to 31/12/2023 the equal weight version of the S&P 500 index has returned 1,005.21% compared to the cap-weighted at 601.1%.

We spend a lot of time making sure we keep the cost of investing as low as possible. Using index trackers sensibly is an important part of that, but also important is negotiating with active managers where we use them. By doing so, we can often achieve significant discounts on the headline costs.

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(1) LSEG Datastream 15/02/24
(2) MSCI
(3) Trading Economics
(4) LSEG Datastream 31/12/87 to 31/12/23
(5) Researchgate

Student loan or student tax?

Chartered Financial Planner, Sam Patterson of The Patterson Group, reveals the hidden tax that will affect the wealth of future generations.

"The student loan, for all intents and purposes, is a student tax."

Not many people realise that the student loan, or student finance, underwent the biggest change in a decade from August 2023 – the maximum term for repayment was extended from 30 to 40 years!

This slipped under the radar for a couple of reasons. First, the student loan isn't actually treated as a loan in the sense that the amount you repay isn't based on the outstanding loan, but instead based on the amount you earn. The student loan, for all intents and purposes, is a student tax.

The second reason this change may have been missed is simply because the terms have already been amended so much in recent years. As a sort of 'back-to-basics', I've summarised the three main types of student loan in **Table one** as at 2023/24 academic year.

You may be wondering: "What about plan 3 and plan 4?" Well, plan 3 is applicable to postgraduates and plan 4 is applicable to students in Scotland, so, to keep things concise, I've narrowed it down to the most commonly used plans.

According to gov.uk forecasts[1], on average, full-time undergraduate higher education borrowers are expected to take out loans for three years and, for those who started in academic year 2022/23, will borrow on average £42,100 over the course of their studies. While most borrowers will repay at least some of their loan, the income contingent nature of the loans means that only 27% of full-time undergraduate higher education borrowers are expected to repay their loan in full.

However, with the term of repayment being extended and the lowering of the salary threshold to £25,000, the government are expecting this to increase to 61% of full-time undergraduate students in the 2023/24 cohort to repay their loan in full.[1]

Given there is now a greater chance that your child or grandchild will have to repay their student loan in full, I thought it beneficial to highlight its impact when they start their working life.

Let's consider someone earning a salary of £30,000. This level of income is subject to basic rate income tax of 20% and National Insurance contributions of 8% on earnings above £12,570. In addition, student loan repayments are also owed on earnings over £25,000. In this example, the marginal rate of tax (which is the rate of tax due on every £1 earned) would be a staggering 37% on earnings between £25,000 and £30,000.

Table one: The three main student repayment plans

	Plan 1	Plan 2	Plan 5
University start date	Sept 1998 – Aug 2012	Sept 2012 – July 2023	After 1 Aug 2023
Salary threshold	£22,015	£27,295	£25,000
Repayment	9% of income above threshold	9% of income above threshold	9% of income above threshold
Maximum term	25 years*	30 years	40 years
Interest rate	RPI or BoE base rate + 1%, whichever is lower	RPI + 3% or a cap based on average commercial rate	RPI or a cap based on average commercial rate
Interest applicable in 2023	6.25%	7.6%	7.6%
Tuition fees	£3,000 per year (Sept 2006 onwards) / £1,000 per year (1998 – 2006)	£9,000 per year	£9,250 per year

*If university was started prior to 2005/06 academic year, the term is until age 65.

Source: The Patterson Group

In addition, if you consider the impact of pension contributions at 5%, marginal take-home pay is reduced even further.

Should your child or grandchild work their way up the ladder and earn a salary of £65,000, their marginal tax rate would be a staggering 51% (40% income tax + 9% student loan + 2% National Insurance under the new rules). This is without accounting for pension contributions, or the impact of benefits lost, such as Child Benefit, which is reduced on a sliding scale for anyone earning over £60,000.[2]

You may be wondering what is the point I'm making? I'm simply making you aware of the impact the student loan can have on your child's / grandchild's finances over the course of their career.

I was a client manager and team leader at Equilibrium for almost 5 years and have since acted as a consultant for several financial planning firms, qualification bodies and other organisations. Through these roles, I've come across countless clients who were in the fortunate position to be able to consider funding a child's or grandchild's university costs as part of their intergenerational planning.

Prior to August 2023, when asked whether it was worth paying university fees, the answer was usually: "No". Only 27% of students were expected to fully repay their loan and given the outstanding balance was due to be wiped out after 30 years, the loan would be gone before the vast majority were even considering retirement.

But with the maximum term extending to 40 years, not only will the student loan 'tax' be payable for longer, but it may also begin to affect future retirement. The forecasted average UK student loan debt is slightly over £45,000[3] and helping to fund a loved one's university costs will always depend on individual circumstances. This article is not designed to tell you how to spend your money, more so to consider how you may be able to best help the younger generation(s) at a time when they need it most.

This article is intended as an informative piece and should not be construed as advice.

*To gain more clarity and confidence in how you could look after those you love, call us on **0161 383 3335**.*

(1) gov.uk/find-statistics/student-loan-forecasts-for-england
(2) gov.uk/high-income-child-benefit-charge
(3) commonslibrary.parliament.uk

Money equals happiness, or does it?

For those managing money for the first time, our new Rapid responsibility masterclass could be the most empowering two hours you've ever experienced.

Most people agree that having money can significantly improve your life. It provides you with security and choices around how you spend your time, maximising your quality of life.

However, having money also brings great responsibility, especially when acquired suddenly and unexpectedly. This could be following the loss of a loved one, an inheritance, or a divorce for example. It is not specific to an amount but enough to take you out of your financial comfort zone.

Receiving a large amount of money suddenly can lead to feelings of isolation, fear, shock or guilt. This is known as 'sudden wealth syndrome', a term given to a psychological condition where the overwhelming pressure of unexpected and/or abrupt fortune can result in emotional and behavioural afflictions.

Equilibrium's purpose (and passion) as a business is to 'make people's lives better'. This commitment has led to the creation of our masterclasses, covering essential topics including powers of attorney, long-term care planning and cyber security.

During our 28 years in business, Equilibrium has encountered various cases of sudden wealth syndrome, leading to the creation of our Rapid responsibility masterclass, launching later this month.

I will be hosting the masterclass and I have designed it with the objective of empowering attendees to take positive action and giving them confidence to make some of the financial decisions, by equipping them with the right knowledge and tools.

What can you expect from the masterclass?

The session will be held in an informal, relaxed environment, with no more than 20 guests, to encourage audience participation where experiences and thoughts can be shared. This is particularly useful when discussing the responsibility that money brings. I would also urge anyone to attend who may not have previously taken the lead when it comes to finances as one day you may need to at, what may be, a very stressful time.

"Having money also brings great responsibility, especially when acquired suddenly or unexpectedly"

Meet Haydn

In my role as a chartered financial planner, I have the privilege of helping clients and their families make the most out of their money by creating financial plans that enable them to live the life they want and look after those they love.

This might involve demonstrating to a client that they possess ample retirement funds, allowing them to enjoy more quality time with their family or feel secure when making substantial gifts to family members.

People often have no idea where to invest their money and more importantly, how investments work. We understand this can be overwhelming, and I aim to alleviate this by showing you how you can navigate your way through the world of financial planning and investing.

I will guide you through the key investment principles in an easy-to-understand and engaging format, exploring the four main areas you can invest in. You will also gain insights into the power of compound returns, the dangerous erosion of capital that inflation can cause, illustrating the need for long-term investments, and the effects taxation can have on your returns. You will discover the importance of having a sound investment framework and consider the purpose behind your investments to ensure the risk you take is aligned to your goals.

We'll conclude the session by delving into how Equilibrium creates long-term financial plans that instil confidence and clarity around your money. We will also discuss common pitfalls to avoid when managing money for the first time and discuss real-life scenarios where we have assisted clients in taking on the financial role following the loss of a loved one.

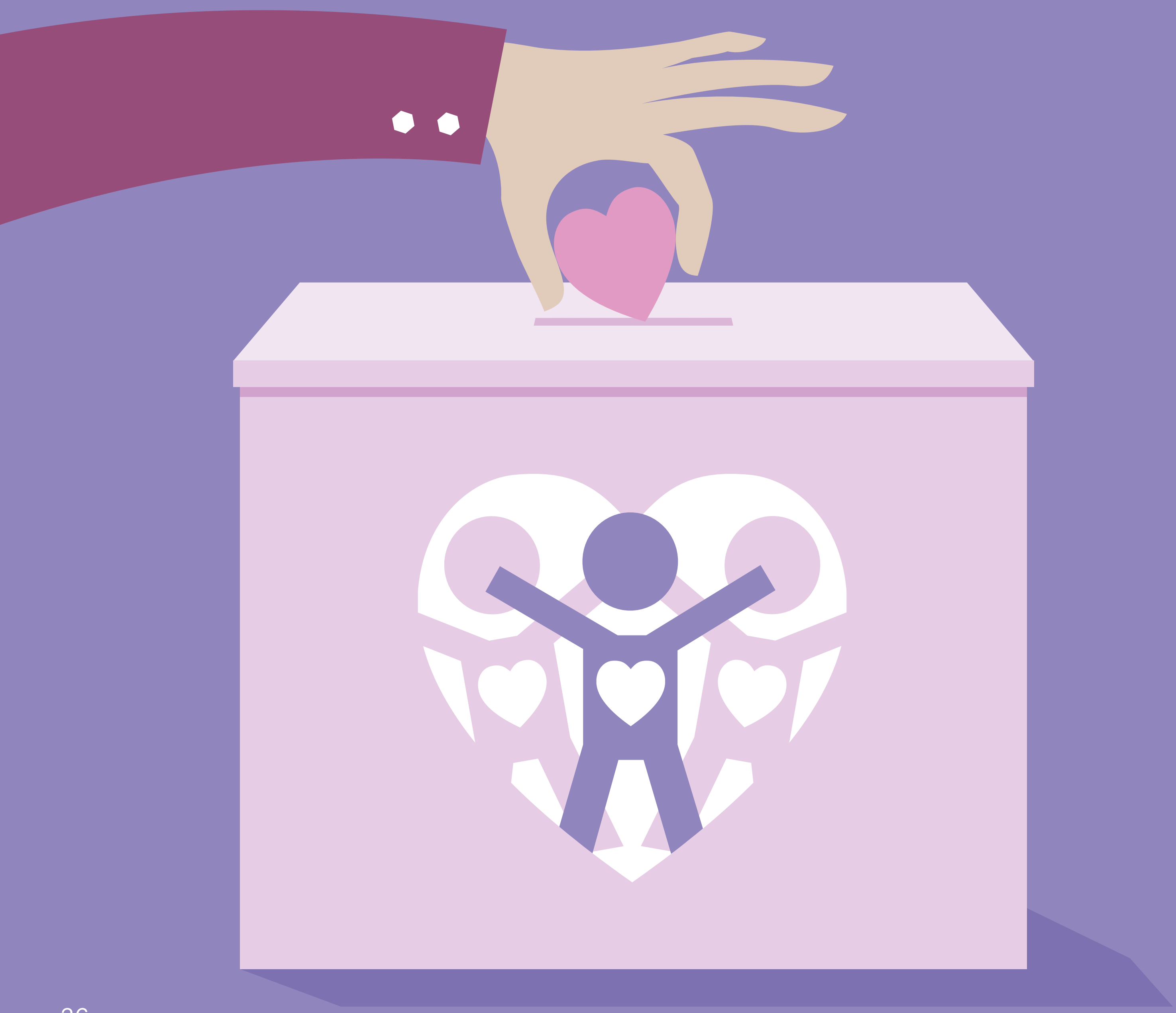
Book today

Rapid responsibility masterclasses at Equilibrium head office – Ascot House.

For more information and to reserve your place, simply visit **equilibrium.co.uk/events** or scan the QR code. Feel free to contact us on **0161 383 3335** or at **askus@equilibrium.co.uk** if you have any queries.

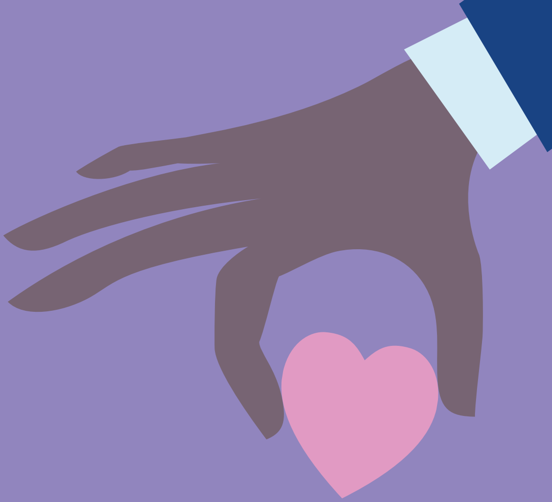
Give while you live

It's no wonder that the UK is among the ten most charitable nations in the world given its philanthropic traditions but what's more surprising is that a charitable gift is one that really can keep on giving.



We make a living by what we get, but we make a life by what we give”

Winston Churchill



According to a recent report produced by the Charities Aid Foundation, £13.9bn was donated to charity by the British public in 2023 – a record amount that saw an increase of 9% on the previous year. However, whilst the average amount per donor has gone up, the number of people donating regularly has decreased and Neil Heslop, the chief executive of CAF, is calling for the government to commit to a national strategy for philanthropy and charitable giving.

Despite 40% of individuals believing that it is important to discuss charitable giving, only 26% say that the subject has been raised by their adviser[1]. Many of our clients are well aware that we, as a business and team, already believe in giving something back to the community and encourage others to do so too.

As well as our Equilibrium Foundation (14 years old this year!), we have recently launched a Donor Advised Fund (DAF) which is one of the UK’s fastest growing philanthropic giving vehicles. DAFs allow individuals to make and invest charitable contributions, then recommend organisations to make grants to over time – less costly, more flexible and without any of the administrative and reporting requirements of setting up your own charity.

However, aside from the joy you get from helping make someone else’s life better by giving to a good cause, there are several financial benefits that provide additional incentives!

A number of tax reliefs are available to encourage taxpayers to donate to charity, be that during their lifetime or via a will. Lifetime donations can often be reactionary (such as in response to a major disaster) but also as part of a longer-term philanthropic effort to leave a lasting legacy. Either way, there are benefits to be had...

Income Tax – if you’re a higher or additional rate taxpayer, you can claim back the difference between your tax rate and the basic rate tax on the amount you donate, including Gift Aid. The gross donation also extends your tax band so can be very useful in reducing the tax you pay if your income sits in or near a tax trap threshold by restoring some, or all, of the Personal Allowance. The effect of increasing the basic and higher rate bands means that more of the donor’s income is charged at 20%, with a corresponding smaller amount being taxed at 40% or 45%.

Capital Gains Tax (CGT) – you can gift shares, property or other assets to a charitable cause. The gift is exempt from CGT and provides an ideal way to utilise unrealised gains on your investments. One of our clients recently transferred units in a general investment account to our Foundation – the value was £25,000 which had a gain of £18,500 and would have resulted in a tax charge of £2,500 had the funds been encashed personally. The gift also attracted income tax relief, saving a further £10,000 - win win!

Inheritance Tax (IHT) part one - any gifts made to charity are immediately exempt from IHT. For estates under £2m, these gifts can also help restore the Residential Nil Rate Band (currently £175,000). Help make a positive difference to a good cause or have your beneficiaries pay a bit more to the treasury - which would you rather happen?

Inheritance Tax part two – all charitable gifts in wills are exempt from IHT too. If you leave 10% or more of your taxable worth to a charity, a reduced rate of inheritance tax will apply – the estate will be taxed at 36% instead of 40%. In some cases, increasing the amount left to charity can actually result in your other beneficiaries receiving more.

Gift Aid – of course, it’s not just the individual that benefits from tax incentives. Charities can claim Gift Aid on the monetary donations they receive, providing the donor pays tax (income or capital gains) at least equal to the value of the Gift Aid claimed. This means that for every £1 donation, the charity receives £1.25.

This blog is intended as an informative piece and should not be construed as advice.

For further information on how charitable giving can positively impact your finances and wellbeing, call us on ***0161 383 3335*** *or reach out to your usual Equilibrium contact.*

1) Survey conducted by Savant on behalf of Charities Aid Foundation (CAF)

Book review:

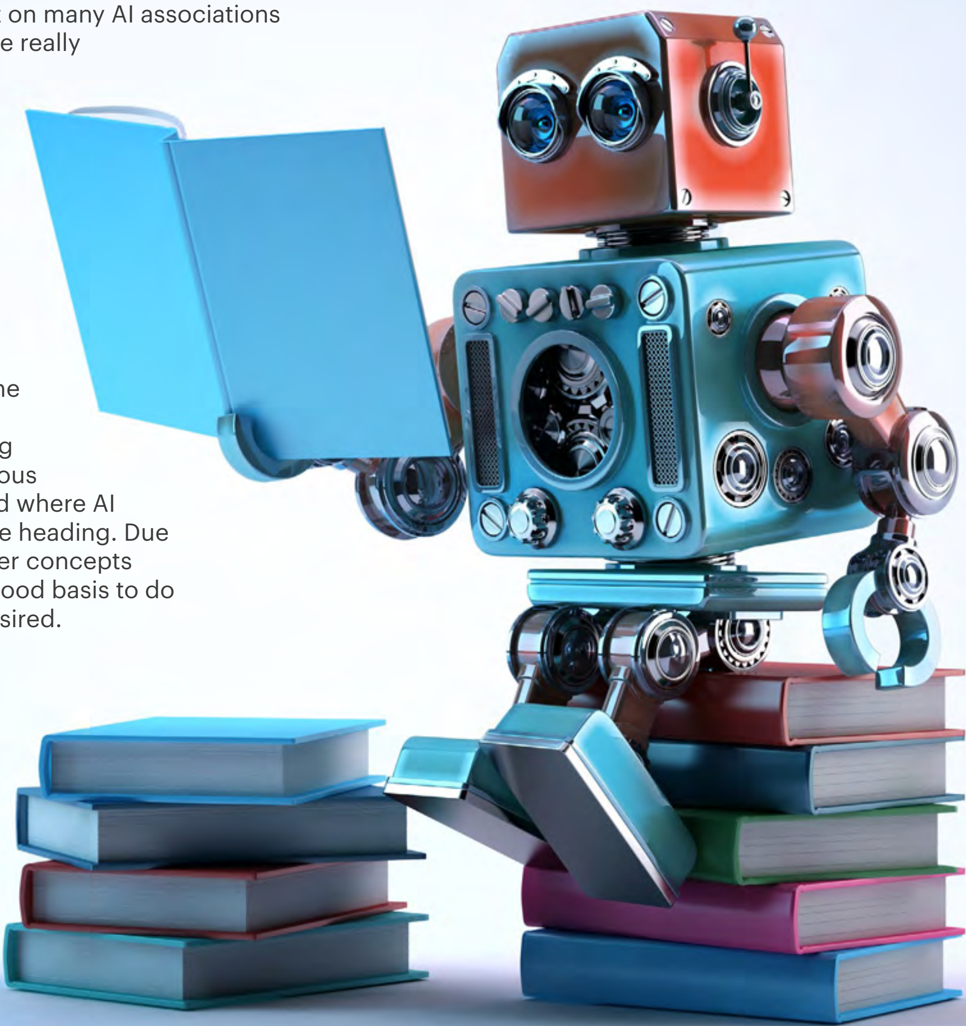
Artificial intelligence

Technology Manager, Amanda Jackson, recommends this short read for anyone wishing to learn more about artificial intelligence.

This little book on Artificial Intelligence (AI) was written in 2018 and things have changed exponentially since then, but for anyone wanting to understand a little bit more about the origins of AI and gain a simple overview, it's a great short read.

The book was written by Michael Wooldridge, who is Professor of Computer Science in the Department of Computer Science at the University of Oxford, and a Senior Research Fellow at Hertford College. He has served as President on many AI associations and written several other books so he really knows his stuff!

Since the release of ChatGPT in late 2023 and the rise of copilots, AI is now one of the most talked about and thought about subjects in the world, and understanding what it is and what it means for us can be quite confusing. In the book Michael takes us on the historical journey of AI, from its origins with Alan Turing and his 'Turing Test' of the 1950s, through the 'Golden Age', via expert systems and robotics finishing on autonomous vehicles and conscious machines. He helps us to understand where AI has come from and where it could be heading. Due to when it was written it doesn't cover concepts like ChatGPT, but it does provide a good basis to do further reading into the subject if desired.



The format is compact and as per Ladybird books of old, one page is taken up by colourful illustrations, so there's little room to go into detail on all the concepts he's trying to get across, but if you take it for what it is – an accessible introduction to the subject - it does the job nicely.

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