EQUINOX

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Culture, values and an elegant exit

EQUINOX | AUTUMN 2020

Welcome

Well, it's certainly been an interesting and challenging six months for us all. I am very proud of how well we managed the transition from being in one office to having almost 90 people working from home. Our culture, purpose and values have ensured that we remain a strong team despite the distance.

We stepped up our client communications so that we could stay connected and share our views, thoughts and actions. All of our videos and live online events can be viewed on our new website, so please do take a look. I would like to thank all our clients for adapting so well to virtual meetings and embracing our client portal.

As the dark nights and poor weather set in, we will need to work even harder to stay connected to both our team and clients. Our new office is now open and hopefully it won't be too long before we can host client functions there.

The main purpose of Equinox is to share our investment performance and our thoughts around it. The whole investment team have done a tremendous job of being as proactive as possible and their efforts are reflected in the results achieved.

I hope you enjoy the range of articles in this edition and, as always, if you have any feedback then please do get in touch with me directly.

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FOUNDER

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BY COLIN LAWSON

Culture, values and an elegant exit

What lessons can we take from the last 25 years in business?

On 10 August, Equilibrium celebrated 25 years in business.

Looking back, it's been a fantastic journey of constant evolution. The company, which started from a second-hand desk in my back bedroom, has grown from zero turnover to in excess of £10m, a team that's approaching 100 and a brand new 23,000 sq ft office.

Whilst these numerical achievements are fantastic, those numbers taken in isolation don't mean a great deal to me. You can have a big profitable business, but if your only focuses are the numbers and the money and they become your purpose, you can very quickly build a bad business.

There are countless stories of "bad businesses" in the press: businesses that treat their staff badly; that prioritise profit over client service; that effectively put their own interests above all else.

Over the last two-and-a-half decades, I have strived to build a business that puts its people first. If you do that, they will have the energy, expertise and enthusiasm to deliver a great service for your clients – and, if your team do that, then from a long-term perspective, the value for shareholders will increase.

As a business grows, this simple philosophy needs to grow with it and it needs to develop into a strong culture that is based on a shared purpose backed up by mutually agreed values.

If you ask me what I am most proud of over the last 25 years, it's the culture that we have built and how every member of our team buys into our values and purpose. You could be the most productive, highly qualified member of staff but if you don't live by our values then your career at Equilibrium will be very short lived.

Our purpose is a simple one: making people's lives better. This applies to our staff, our clients, our community and anyone that we interact with. I believe that we can't go far wrong if we are constantly asking ourselves the questions...

- "How can we make our clients' lives better?"
- "How can we make life better for our team?"

And backing this up by ensuring every decision we take is guided by our four values:

- Integrity
- Growth
- Simplicity
- Excellence

The crucial issue for me is ensuring that the values and purpose actually become stronger as the business continues to grow over the decades ahead.

As Founder and the majority shareholder, I take this challenge as a personal responsibility and that is where the "BHAG" and the "elegant exit" plan comes into play.

Allow me to explain...

"if your only focuses are the numbers and the money and they become your purpose, you can very quickly build a bad business"

BHAG 2028

In 2018 we set out our BHAGs – "big hairy audacious goals":

- Making 4,000 clients' lives better
- Managing £4bn of assets
- Raising £4m for the Equilibrium Foundation
- Reaching a turnover of £40m

We want to achieve these goals purely through organic growth, concentrating primarily on our local area of the SK, WA and CH postcodes.

The key question though is why? What would it mean if we get there? What would happen next?

The goals came about as we realised that, at some point, we would need to consider selling some or all of the business to release the value that has been built up through, literally, a lifetime's work.

It became clear that if we sold the business today with £1bn of assets, it was likely that the new shareholder would simply assimilate us into their business, which would result in:

- The majority of the team potentially losing their jobs or working for an employer they don't respect
- Clients ending up with a new, much bigger and very different firm to the one they selected
- The values and purpose of Equilibrium ceasing to exist
- But, on the bright side, shareholders would get a big cheque…

Is that really an ending to a lifetime of work that I could look back on with pride and joy? 25 years of putting the needs of the team and clients first, just to throw them both under the bus at the end?

I believe that a business sale done badly can be likened to a bereavement; you lose what you love and get a big cheque in exchange.

So, we came up with a plan; if we could reach our BHAGs, we would be too big to assimilate. Any new shareholder (in part or in full) would likely retain every element of the company, and our track record of growth would be so strong that they would likely continue or maybe even expand the brand into new areas such as the Midlands and Yorkshire.

Our thinking then developed into considering what the ideal shareholder would look like and how much of the company ownership we might like to retain.

Wealth management businesses such as ourselves are currently worth in the region of 3-3.5% of assets under management. Thinking about that caused a lightbulb moment.

Let's say that we decided to retain 30% of the business long term to demonstrate to any new shareholder our commitment going forwards. That would mean that the new shareholder(s) would be investing circa 2.5% of assets under management.

" a business sale done badly can be likened to a bereavement; you lose what you love and get a big cheque in exchange."

What if, rather than one big shareholder, we actually offered a private placing to our existing clients. An investment of 2.5% of their portfolios into a company they know well would be perfectly appropriate... and so, the idea of selling shares to our clients started to emerge.

We spoke with compliance consultants, lawyers and accountants and no major barriers could be foreseen.

What better way could there possibly be of making sure that our company, values and purpose continue than by having the business majority owned by our clients?

The concept for me is incredibly exciting, and so we are starting to put the outline plans and building blocks in place to make it become a reality.

There are bound to be obstacles to overcome along the way. Let's take a look at a couple we have encountered so far...

Secondary market

We would need to make sure that clients wishing to sell their shares had a method to do so. A few ways to facilitate this would be for the company to buy back shares or to offer new clients the option of buying in, effectively creating a waiting list of potential buyers.

Valuation and due diligence

How would the clients know that the business was in good order and that the valuation of the business is fair and reasonable?

One option we are considering here is to potentially offer, say, 10% to an institutional shareholder who would invest alongside the clients and who would naturally negotiate on price and undertake all the legal due diligence which could then be shared with clients as part of the offer.

So, for instance, the ownership structure would then be 60% clients; 30% myself and the other existing minority shareholders; and 10% institutional investor, which feels like a really good mix.

Nothing would give me more pride than to be sitting here 25 years from now writing an article looking back at the last 50 years in business, reminiscing about how many lives we have made better, how the business has been protected through client ownership and how well those clients have been rewarded for their investment.

As time goes by, I would like to work a little less and, no doubt, my role in the business will change. However, I never want to retire or sell my shares in their entirety. As long as I can still add value, I will be proud to keep working.

I truly believe that the next 25 years will be even more exciting than the last, and if there is one thing I can promise, it is that the 50th birthday party will really be something to behold.

" I have strived to build a business that puts its people first"

Project Phoenix

Not to be dramatic, but we've set fire to our investment process. What will rise from the ashes?

We've always aimed for returns well ahead of inflation over the long term.

Depending on the portfolio, we target a positive "real return" over rolling five-year periods, with an aim to generate between 4% to 5.5% pa above CPI (consumer prices index) over 10 years or more.

In July 2007, the Bank of England base rate was 5.75%. With inflation at 1.9%, the real return on a typical cash account was therefore 3.85%, not far below our target return.

Fast forward to July 2020 and rates are now 0.1%. Even with CPI at a very low 0.6% pa, the real return on cash is minus 0.5% pa. That is a very different starting point for building a portfolio!

We are often asked whether our target returns remain realistic given this backdrop. We therefore set out on a wide-ranging project to determine whether the portfolio objectives remain realistic and relevant to clients.

Project Phoenix was born. We felt this was apt given we were about to metaphorically set fire to our investment process and see what rose from the ashes!

Super-forecasting???

Forecasting investment returns is not easy but there are metrics in many asset classes that have historically been well correlated with long-term returns.

The lowest risk asset apart from cash is traditionally government bonds. When you buy a UK government bond or gilt you are lending them money for a fixed period, for a fixed level of interest. If you purchase a gilt and hold it until maturity you know exactly what your return will be in advance.

For the gilt market as a whole things are not that simple, because the price of gilts fluctuates according to demand, but the yield on a 10-year gilt is a pretty good indicator of what gilt returns are likely to be over the following decade.

Chart one shows the historic relationship between gilt yields and returns. Each dot represents a different 10-year period for UK gilts. The higher the dot is on the chart, the higher the annual return was over that decade. The further to the right, the higher the yield was at the start of that decade.

The chart shows a clear pattern - the higher the yield at the start of the decade, the higher the return you received with an 83% correlation (an R-squared of 0.83). The blue line shows the calculated line of best fit, whilst the red line shows where the return and the yield are equal.

Generally, your return has been the yield plus or minus around 1% pa. For the most part, returns have been greater than the yield. We have had a period of falling interest rates for the last few decades which generally drives up gilt prices.

If this pattern holds, with yields currently around 0.1% pa, we can expect gilt returns between roughly -0.9% and +1.1% pa over the next decade.

Using historic "spreads" or risk premiums, we can use this to derive forecasts for corporate bonds where we are lending money to companies rather than governments. Here we might expect returns of perhaps 2% pa for "investment grade" companies (those with a credit rating of BBB or above).

We can also carry out a similar exercise for commercial property, where the rental yield has been a decent forecaster of returns. This would imply a return of perhaps 3.5% pa over the next decade.

In our view, the traditionally lower risk asset classes of fixed interest and property are not likely to provide very high levels of returns over the next decade. To get close to our target returns, we either need very low levels of inflation, or we need to get some decent returns from our riskier assets, like equities.

Risky business

There are many ways of valuing equities, such as looking at the ratio between price and current earnings, forecast earnings, cash flows, or book value.

We combine all these into a single valuation score for each main region. We have used this process for a while, and it has appeared to be a reasonable forecaster of what is a highly unpredictable asset class! However, we noticed something strange in the data...

In essence, from the mid-2000s the returns we saw were lower. The valuation score still had a high correlation with returns, but at a noticeably lower annualised rate than previously.

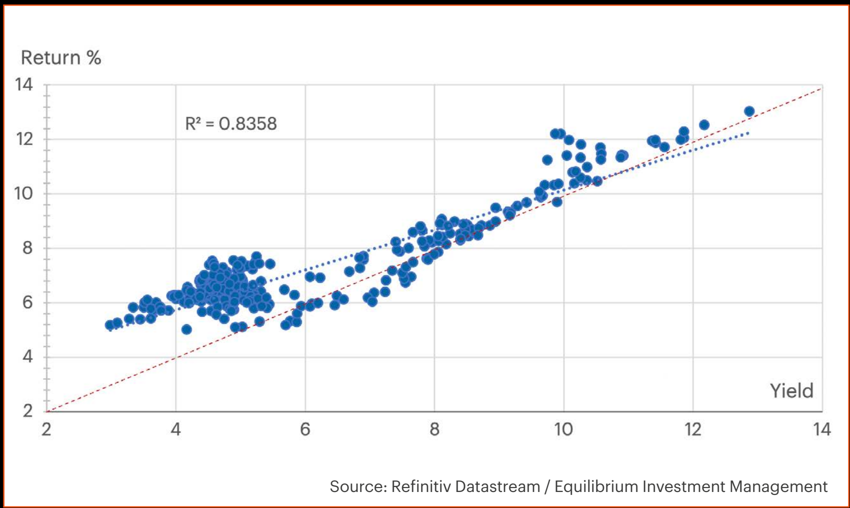
We theorised that it might have something to do with interest rates. In the early 2000s, the UK base rate averaged around 4.5% pa. Since the financial crisis, the average has been 0.5% pa. Could that explain the drop in equity returns?
We therefore adjusted our data not to look at the simple return on the stock market, but the return of the market relative to cash.

For the UK, the correlation of our scoring metric and returns increased from a decent 64% relative to nominal returns, to a very strong 78% for returns relative to cash.

Chart two shows this relationship. Again, each dot represents a different 10-year period and the higher the dot the higher the return relative to cash. The further to the left, the "cheaper" the market was at the start of that decade.

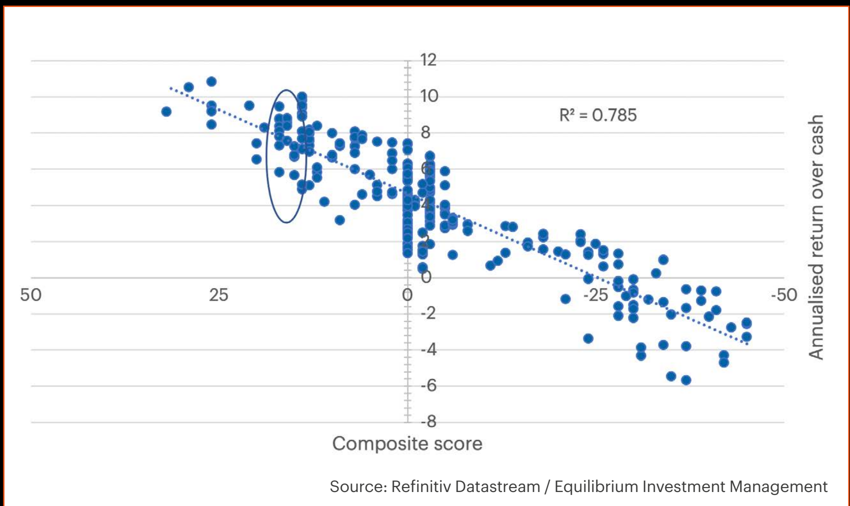
We have circled on the chart the current "score".

Chart one: 10-year gilt vs 10-year returns



Source: Refinitiv Datastream / Equilibrium Investment Management

Chart two: UK composite vs 10-year returns over cash



Source: Refinitiv Datastream / Equilibrium Investment Management

Chart three shows the same thing but in a different way. The green line shows how our score has changed over time (left-hand axis). The gold line shows the subsequent 10-year return relative to cash (on the right-hand axis).

The two lines follow each other closely. Note that the gold line stops in 2010 as that was when the last 10-year period began!

This implies returns on UK equities of perhaps 8% pa ahead of cash. But what will cash returns be? When rates were at 5% pa we might have been looking at a relatively healthy 13% pa!

We think rates will remain very low for the foreseeable future and we can't see them getting above 2% pa at any time in the next decade. The return on cash is likely to be perhaps 1% pa for the next 10 years, implying perhaps 9% pa on UK equities.

We have carried out the same exercise for other regions and seen similar results. This implies lower returns for European and US equities, but potentially some very good returns from emerging markets.

It goes without saying that no forecasting tool is perfect and of course we provide no assurances about whether these returns will be achieved.

Real-ly low?

I said right at the start that we are targeting real returns, and therefore we also need to try to forecast inflation.

Whilst there are plenty of market-based metrics around, they all have their flaws. For example, by comparing index linked gilts with normal gilts we can work out what level of inflation is expected. Unfortunately, this metric is always skewed by high demand from the likes of pension funds who have inflation-linked liabilities.

Adjusting for such flaws, we expect inflation to be lower than the Bank of England's target of 2% pa over the next decade. Our expectation is for CPI to be closer to 1.5% pa.

Risk and return

Coming back to the original question, "are our return targets still appropriate?", the answer is a qualified "yes".

The reason the yes is qualified is that to achieve them we are relying on the most volatile of the main asset classes.

Our asset allocation "table" usually has four main legs: equity, fixed interest, property and cash. If returns on the last three are going to be low, then we are essentially relying on one leg. This makes things inherently unstable.

Each portfolio has a minimum and maximum level of risk which we are allowed to take. To achieve the objectives, the average exposure may need to be more towards the higher end of the ranges.

Chart three: UK composite vs 10-year returns over cash

Source: Refinitiv Datastream / Equilibrium Investment Management

However, there are several ways we can try to eke out extra returns. Examples might be using defined returns instead of traditional equity, which often have double digit potential returns even if the markets only return single digits.

> **"However, there are several ways we can try to eke out extra returns"**

We can also use alternative assets like infrastructure which we think looks to be good value and which could be viewed as a partial replacement for property. The asset classes have a lot in common, being based on "real" physical assets, which provide an income and some inflation protection.

That said, if we're going to have to take somewhat more risk to get the same levels of real return we've seen in the past, this might make some clients uncomfortable.

We are therefore developing a new, more defensive portfolio, which will have a lower target return but also less volatility. Provisionally, the portfolio will aim to provide a positive return over rolling three year periods and outperform cash by 3% pa over the long term.

Watch this space for further announcements!

Opening doors

Jenny Hopkinson, Founder of the Bursary Foundation, explains how the organisation is helping disadvantaged children meet their full potential

Whilst working in inner-city Manchester, Jenny Hopkinson met a year three pupil named Sally.

"Bright, hardworking and articulate beyond her years, Sally was, at a glance, the kind of pupil I knew could go far," Jenny explains. "But, being from a disadvantaged background and living in a deprived area, Sally's chances of getting a high-quality education were limited by the poor secondary schools in the area and her family's lack of awareness of the options available."

Jenny took on the challenge of helping Sally and eventually secured a her a fully funded place at an independent girls' school where she is now thriving.

Jenny was inspired by this experience: "Since then, I have made it my mission to help more young people like Sally; this is the heartbeat that drives everything we do at The Bursary Foundation."

The Bursary Foundation connects high achieving pupils from low income backgrounds with the best educational opportunities.

"We work closely with primary schools in some of the poorest parts of Manchester to identify pupils with high potential," explains Jenny. "We support these pupils with tutoring and mentoring so that they and their families are well prepared and informed before sitting entrance exams for private schools and Trafford grammar schools."

2020 has of course brought unexpected challenges. The pandemic has disproportionately affected the poorest in society and, as a consequence, the organisation has lost some capable children from this year's program.

"A silver lining, though," Jenny explains, "is that we now have a deeper understanding of what it means to be disadvantaged. Our relationship with parents is stronger thanks to working with children in their home environment, albeit virtually. For some of them, weekly tutoring sessions were a lifeline during the lockdown.

"To me, this is just more evidence that our approach to identifying pupils is bang on. We are finding children who have raw, natural talent and an incredible capacity for learning.

"We owe it to them, and to our country, to address the tragic inequality of opportunity and do everything we can to nurture these outstanding young people. If social mobility becomes engrained in the culture of a school and bursaries are high on the agenda, we can provide more world class opportunities to some of our nation's brightest young people. Why should our best schools be a privilege reserved for the most affluent in society?"

The Bursary Foundation has worked with over 40 disadvantaged families to help gifted young people achieve their full potential.

"For me," Jenny says, "the magic happens when we meet children like Jakub from Harpurhey, whose family moved to Manchester from Estonia in 2016.

"Jakub's parents planned for him to go on to the local high school. They had, quite literally, never heard of a private school and had no idea that funding support in the form of a bursary might be available.

"We explained that, for an exceptionally capable boy like Jakub, Manchester Grammar School would provide a world class opportunity to be educated alongside 'the brightest young men in the North of England', and after a visit to the school, his family were fully on board.

"With a little exposure to the right materials, Jakub aced his entrance exams and was offered a full bursary at the school."

Find out more

If you would like to learn more about the Bursary Foundation or know anyone who could benefit from their work, you can get in touch with Jenny at: **jenny@thebursaryfoundation.com**.

Confidence and clarity in an uncertain world

How can we fulfil our basic human needs in a world of uncertainty?

We believe that, as financial planners, one of our core roles is to help our clients find confidence and clarity around their finances. Hopefully, that leads them to being able to make better financial decisions for the benefit of themselves, their families and even the world in general.

In my experience, the level of wealth a person has doesn't dictate the amount of "confidence and clarity" they have. I have witnessed people with significant wealth who lack both, and even those who are confident that they have enough money can often lack clarity on what to do with it.

One of the simplest questions we ask, which for many people is incredibly difficult to answer, is "what is the purpose of the money?" or, an extension of that, "how would you like to enjoy your money?"

Many people have never taken the time to truly think about this, yet I have found that unlocking the answer can transform the relationship that people have with their money and, in turn, how they utilise it.

We believe that money should be a positive thing that makes people's lives better – whoever those people might be. Yet, often, we see that money can instead cause stress and confusion.

The credit crunch certainly eroded people's confidence and COVID-19 has created huge uncertainty for us all, shattering any clarity we might have had!

In order to help our clients, we firstly need to understand how they are currently feeling, as it is often our thoughts that will dictate our actions, especially when those thoughts are fuelled by emotions. The field of behavioural economics is fascinating, and we will be exploring this topic through various communications over the next 12 months or so.

Perhaps one of the best ways to understand how we are feeling is to look at the six human needs as defined by the American motivational guru Tony Robbins. Regardless of whether or not you are a Robbins fan, he does have some excellent material.

According to Robbins, the six human needs are:

1. **Certainty:** assurance you can avoid pain and gain pleasure

2. **Uncertainty/Variety:** the need for the unknown, change, new stimuli

3. **Significance:** feeling unique, important, special or needed

4. **Connection/Love:** a strong feeling of closeness or union with someone or something

5. **Growth:** an expansion of capacity, capability or understanding

6. **Contribution:** a sense of service and focus on helping, giving to and supporting others

When we consider the impact of COVID-19, it's clear that it has significantly affected how many of these needs are being met.

I think of them as fuel tanks; if our uncertainty tank is low, we struggle to take on more. Some of us have larger tanks in some areas than others, for example, as a business owner, my uncertainty tank needs to be larger than others. However, at the peak of the COVID-19 crisis in March, my uncertainty tank had run dry and I desperately craved more certainty.

I think it's useful to keep a score of how we are feeling in each area on a regular basis, but for the purposes of this article, I'd like us to look at the bigger picture.

I am guessing that for almost all of us, the pandemic has ensured that our certainty score has plummeted. The level of change has been immense and for many people the sheer scale of the uncertainty has paralysed them, leaving them incapable of making new decisions. On the other hand, those who have been in full lockdown are craving variety and change, which is no doubt why so many DIY projects are being undertaken!

If you are a key worker or able to add value in these troubled times, your significance score would have increased. But, I would suspect, for the vast majority of people it has plummeted. My mum, for example, volunteers at a charity which no doubt boosts her significance, but this has stopped due to COVID-19.

She is also a fantastic mum and grandparent, but even these roles have been reduced. We have all lost connections with friends, colleagues, social or sports clubs and, let's face it, it's hard to feel significant when you are stuck in the house 24/7.

When it comes to connection and love, we have all struggled with the lack of hugs and lack of contact and while video calls have provided some much-needed connection, they can only do so much.

Looking at growth and contribution, these vary dramatically depending on individual circumstances and yet I would still guess that, for most, the scores are lower than they would have been.

It's clear to see that, for most people, the majority of their needs are not currently being met and therefore confidence and clarity have been severely reduced.

Whilst we may not be able to help meet all of those needs, we can certainly help to improve the scores in a number of areas, and even a small uplift in the scores can have a big impact on how people feel.

Our primary purpose as a company is to make people's lives better. Although we might not be able to wave a magic wand and make COVID-19 disappear or markets rise, we can do our best to make people feel better.

So, how can we help?

Step one: a lifetime cashflow

The first step is to explore all your financial needs both now and in the future, factor in anything and everything that might affect your financial life and, from that information, create a lifetime cashflow forecast to ascertain exactly where you are heading. We can then stress test that forecast with different assumptions around future returns until we have a model that you feel comfortable with.

Having a better understanding of your position and capabilities should reduce uncertainty and increase growth.

Step two: understanding the purpose

Hopefully, your plan will show that you won't run out of money and will therefore, by default, die with more money than you need. So, the next logical questions are:

- What else do you want to do?
- When do you want to do it?
- Who else do you want to help and how would you like to help them?

"These are some of the most transformative and enjoyable discussions I have ever had the privilege of attending"

We have seen clients spend more on themselves and support children and grandchildren in life changing ways. Hopefully this spending causes a rise in certainty by increasing pleasure and avoiding pain. Supporting others also creates feelings of significance, connection and contribution.

Step three: revisit the lifetime cashflow

We then need to stress test the new plan of spending and giving more to ensure it is robust, reinforcing your comfort and certainty.

Step four: enacting the plan

If you are gifting money, be that income or capital, how do you communicate that to people? How do you make sure that it fits in with their financial plans? How do you work as a family unit? (See article on page 20).

We usually issue questionnaires to family members so that we can fully understand how any gift can be used for the maximum impact. We also recommend hosting family meetings. These are some of the most transformative and enjoyable discussions that I have ever had the privilege of attending.

This stage can often improve the scores in all six areas.

Step five: clarity on your wills and wishes

If beneficiaries don't fully understand your financial position, how you got there and the rationale behind it all, it can often lead to confusion and sometimes even frustration:

- Why did you pay so much in inheritance tax?
- Why didn't you spend more on yourselves?
- Why didn't you help them earlier when they really needed it?

We have encouraged many clients to write what we have termed "letters of love" to accompany wills, trusts and pension nominations. The idea is to explain how the money came about, why you have dealt with it in the way that you have, what your hopes are for how the recipients will utilise the money and any other guidance that you wish to give them.

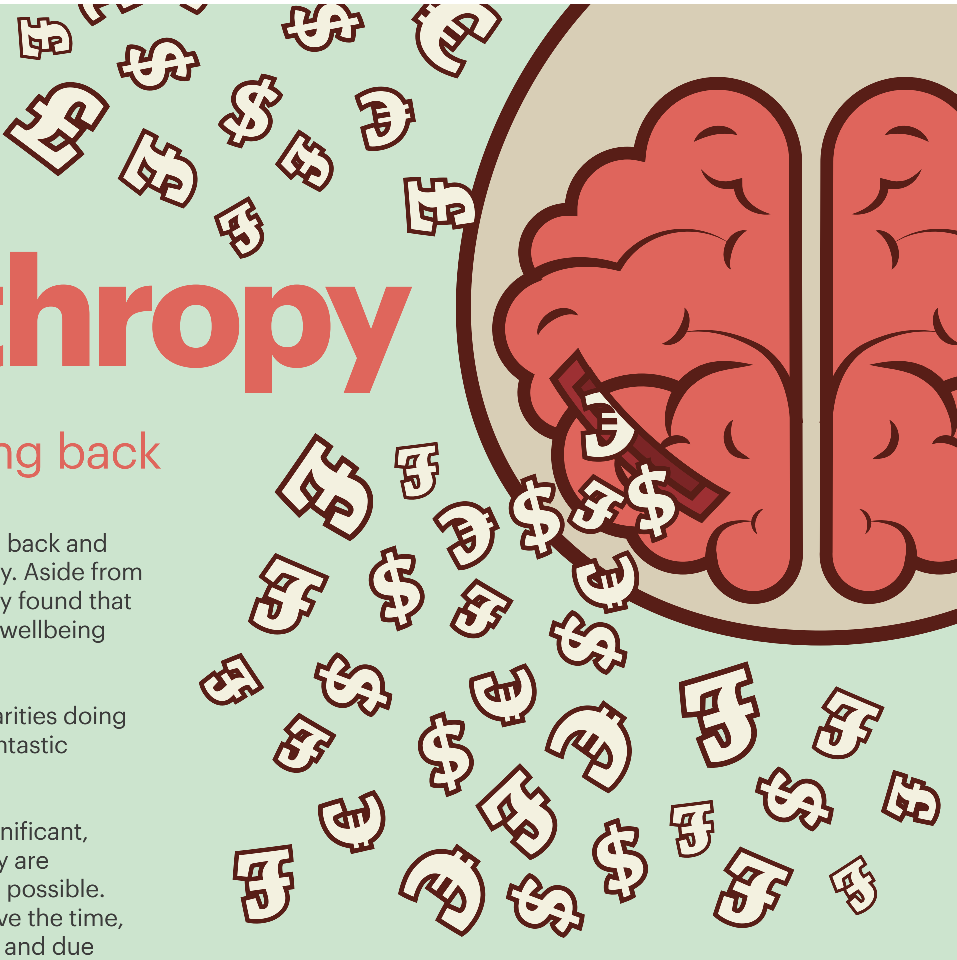
Every single one I have read has brought a tear to my eye. Whilst some don't want theirs to be shared until they are gone, the ones that have been issued during their lifetime have had an incredible impact for all involved. We have many examples that we can share to help get you started.

This, of course, can increase connection and love, as well as contribution and significance from the support you are providing.

Whilst it is certainly true that money can't buy you happiness, I truly believe that, with a bit of thought and soul searching, it can contribute to meeting all the human needs, leaving whole families happier, closer and more fulfilled as a result.

BY SAM RICHARDS

Think Philanthropy



Make the most of giving back

It's very common for people to want to give back and make a positive difference to the community. Aside from the warm fuzzy feeling, studies have actually found that contributing to charity can improve mental wellbeing and, in turn, physical wellbeing – win win!

For most causes, there are a plethora of charities doing amazing work or research, and these are fantastic options for small contributions.

However, when the contribution is more significant, naturally people want to make sure that they are gifting this money in the most effective way possible. Unfortunately, most people simply don't have the time, knowledge or resources to do this research and due diligence.

This is where Think Philanthropy comes in. Think Philanthropy was founded by Andrew Evans, who has extensive experience in the charity sector, having worked as a grant-maker, charity leader, trustee and fundraiser. Whilst working in these roles, he witnessed the enormous difference that effective giving can make for charities and the work that they do. Thus, Think Philanthropy was born with the aim of facilitating this process for people who want to use their money to make a difference, but who may not have the time or expertise to figure out the best way to do so.

Initially, Andrew gets to know a little more about the client and their aims, using a questionnaire to get them thinking about what they want to achieve with their philanthropy and identify their objectives.

They then try to narrow this down to two or three key fields of interest, and at this point, Andrew and his team begin to research these areas. They present the client with around six – 10 options.

Following this, there is a refinement process where the clients select the options that most appeal to them and Think Philanthropy will investigate these options more, eventually narrowing it down to what results in the client's final choice.

This allows people to use their wealth in areas that really resonate with them that, without the help of Andrew and his team, they would never have had the time to find. This can provide an incredible source of joy and contentment for people.

Andrew was introduced to Colin Lawson, Equilibrium Founder, earlier this year and Think Philanthropy has facilitated the Equilibrium Foundation in donating over £60,000 during the initial lockdown period to charities that can help those most in need.

Andrew has also been working alongside Equilibrium with some of our clients to identify their own philanthropic objectives (see page 17) and incorporate these into their financial plans. This service is, of course, available to all clients.

For many people, giving back is an important part of their life and can even form part of their identity. Think Philanthropy aims to pinpoint what people would like to achieve with their wealth and helps to make it happen.

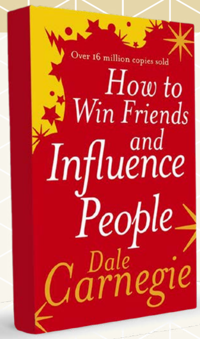
Find out more

If you are interested in learning more about how your wealth can make a positive difference to the causes close to your heart, get in touch at: **askus@equilibrium.co.uk** or **0808 168 0748**.

What we are reading this month...

Erika Barbosa
MI ANALYST

How to Win Friends and Influence People
by Dale Carnegie



"If you want to gather honey, don't kick over the beehive."

Sounds easy in theory, yet it's a bit more challenging to practice in everyday life.

According to Carnegie, the recipe to make friends and influence others is to make people feel special, as we all have an innate desire to feel important; show sincere appreciation that comes from the heart rather than from empty flattery.

This fascinating book, as relevant now as eight decades ago when it was first published in 1936, encourages us to find the other person's point of view and see things from their angle.

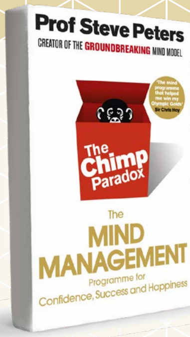
By explaining human nature through extensive, engaging examples, the author reminds us of simple, effective actions such as being genuinely interested in others, remembering people's names and smiling.

I really enjoyed reading this book and would invite you to do the same.

Who knows, you might even use Carnegie's techniques to make a new friend or two!

Sam Richards
MARKETING EXECUTIVE

The Chimp Paradox
by Professor Steve Peters



The Chimp Paradox offers an unashamedly simple model of human behaviour, suggesting there are three sections to our brain – the human, the chimp and the computer.

The "computer" is simply a place to store and retrieve information. The human is "you", the conscious, logical part of your brain. The chimp, on the other hand, is where things can go wrong.

The chimp ultimately wants to keep us safe and reacts instinctively, drawing conclusions based on emotions before receiving and processing all of the facts. Because of this, the chimp tends to react much quicker than the human which can often land us in trouble, reacting more defensively than we need to or overindulging in a tasty-looking cake before the human can say no!

Peters advocates learning to understand your chimp with the goal of taming him and even utilising his power for your own benefit. The book offers a wonderful insight into how the human mind works as well as providing useful solutions to negative behaviour.

So, next time you find yourself wondering, "why did I do that?", ask yourself – did you do it, or was it your chimp?

BY COLIN LAWSON

Finding a purpose for your wealth

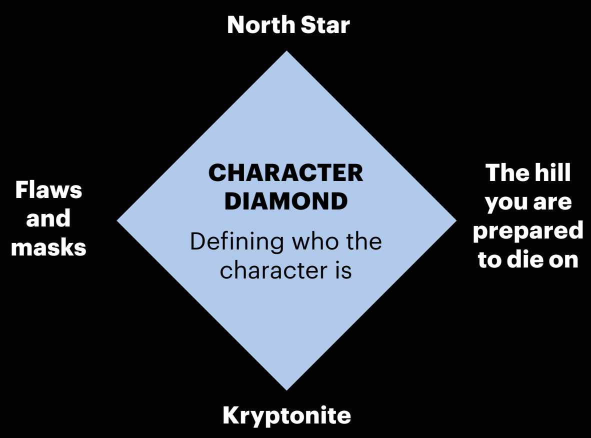
What do you do when you have too much money?

We had two clients, a married couple, in a very healthy financial position – in fact, the biggest problem they faced was that all the cashflow forecasts we created showed they would end up with too much money!

Both enjoyed high salaries with bonuses and share options and neither had any desire to retire. They lived a modest lifestyle and through this, their high incomes and inheritances received from their parents, they had accumulated a substantial portfolio.

The couple also had two children, the eldest of whom was 18, and they wanted to begin engaging with them about money. This was one area we agreed that we could explore.

Another area we found was important to them was 'giving'. We discovered this through creating a 'character diamond' for the couple, which is a technique used to highlight certain beliefs and attributes, as seen below.



- **North Star** – your superpower, the thing that makes you different and makes you, 'you'
- **Flaws and masks** – how you cover up your insecurities and vulnerabilities
- **The hill you are prepared to die on** – what you will always stand for, no matter what
- **Kryptonite** – the opposite to your North Star – what often gets in your way

With the knowledge and understanding that resulted from the exercise, we notionally divided their portfolio into three pots:

A core portfolio
This is for all their future needs. Cashflow forecasting confirmed they had more than enough.

Kids' portfolio
Money for their children's houses, pensions and a capital lump sum to get them started.

Charity portfolio
The amount they would like to gift to their own family foundation in the future, once created. In the meantime, growth was to be gifted annually. We would also put them in touch with Andrew Evans from Think Philanthropy to discover the areas the family were passionate about helping (see page 15 to learn more about Andrew's work).

The money, for now, is still all in their name, but we report under the notional titles. As the clients become comfortable and therefore confident with the strategy, they can physically gift the money over time. With a little thought around the clients' values, we achieved:

- more engagement from the couple by helping identify what was important to them
- better planning around how and when to help the kids
- greater family involvement with the money
- a large future charity donation which will also help with inheritance tax mitigation

This is just one of many examples where, by exploring the values you hold, you can create a financial plan that extends beyond your own life and makes a positive difference to the people and causes you hold dear.

Find out more

Find out how Equilibrium can make your life better. Get in touch today at: **askus@equilibrium.co.uk** or **0808 168 0748**.

The power of conversation

When families have open discussions about their finances, the results can be life changing

A common issue that families seem to encounter is that they don't discuss money, but this is often the key to unlocking the most value from your wealth.

One example that I am often reminded of involved two clients – a married couple in their 70s. The clients had always held the view that their children should 'make it on their own' and had only, at one point, provided funds to help with a flat purchase in London.

The problem with this outlook is, when you leave all your wealth to your children upon your death, you are actually just providing a lump sum on a random date with no opportunity to advise your child on how to spend these funds. Not to mention all the inheritance tax that would be due on a lump sum that could have been avoided had this money been gifted throughout their children's lives.

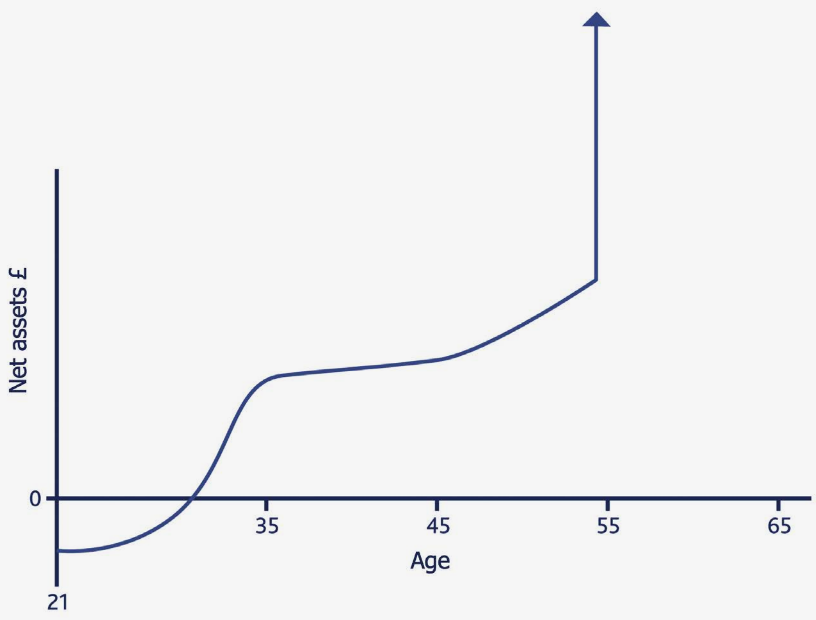
We call this "the wealth curve" as seen below.

As I have explained in a previous Equinox edition, this leads to one quite simple question: if you are uncomfortable gifting small amounts to your children whilst you're still here to provide guidance and support, why would you leave everything to them on your death, when you have no influence at all?

After engaging with the clients in question and explaining this to them, they began to understand the benefit of flattening the wealth curve and decided to involve their children with their financial planning. We sent out a questionnaire to the children in order to gauge their hopes and dreams to identify which areas the parents could potentially help in.

Both children were in their 30s and recently married, and both wanted bigger properties so that they could begin planning to start a family. I joked that they had the room to make a baby, but not the room to store one!

The wealth curve



As it turned out, our clients also desperately wanted grandchildren. So, we encouraged them to give full disclosure to the children on their income, expenditure, assets and inheritance tax position. Alongside this, we also encouraged them to explain how they had accumulated their wealth over the years – through one parent having a job with a good income and final salary pension and the other parent starting and selling a business.

We then held a family meeting, facilitated by Equilibrium, so that everyone could discuss the situation, the difficulties they each felt about gifting or receiving money and the emotions surrounding the topic. The result of this meeting was life enhancing for both the clients and their children.

The parents agreed to provide the funds for both children to move to bigger properties and hopefully start a family. Had they not provided this assistance and the children had had to save for the funds by themselves, it is possible that they could have been in their late 30s, early 40s or possibly even later before they had the opportunity to start a family of their own.

Hopefully, they will now have children at least five years earlier, meaning at least five precious extra years that our clients get to spend with their grandchildren.

Essentially, with just a little discussion, the clients were able to use their wealth to help their children start a family, hopefully enjoy more time with their grandchildren and also save hundreds of thousands in inheritance tax as a result.

It really is incredible what a little open conversation can achieve.

Find out more

Our inheritance tax and intergenerational planning service is available as a standalone module for people who aren't existing clients of Equilibrium.

Get in touch today for a no-fee, no-obligation chat with one of our friendly experts to find out how we can help you and your loves ones make the most of your wealth.

Working together

With interest rates heading lower than we ever thought possible, how can families work together to make the most of their wealth?

We thought that interest rates couldn't possibly go any lower. But along came COVID-19 to prove us wrong, and the Bank of England created another record, cutting the rate to almost zero at 0.1%.

With businesses and individuals alike sitting on record levels of cash, I believe that negative rates are a real possibility. I can't imagine that, when most financial institutions were designing their systems, they ever contemplated the possibility of entering minus figures into the interest rate box. Yet, the Bank of England has written to all institutions to tell them that negative interest rates are now under active review and that their systems need to be able to process that scenario.

Regardless of whether we see negative rates or not, it is my opinion that interest rates are not going up anytime soon and also that it's highly likely that we could still see rates at 1% or below 10 years from now. That would mean rates had been below 1% for two decades – something no one would have predicted. This might sound great for borrowers, but it does present challenges for savers. However, if families work together where possible, significant benefits can be achieved.

Let's look at a hypothetical situation of parents with one son, where everyone has all of their financial arrangements with Big Bank plc. The interest rates assumed are not untypical of those available today (although actual market rates can vary significantly from the ones we have used in the example); with the savings quoted being in simple annual terms.

Mum and Dad have the following:

- Instant access cash account – £30,000 (interest rate 0.60% pa)
- Long term deposit that they are thinking about tying up for five years – £50,000 (interest rate 1.40% pa fixed)

The son, on the other hand, has the following:

- Mortgage – £270,000 (interest at 4% pa - £10,800, 90% loan to value based on a property value of £300,000)
- Car loan – £10,000 (interest at 6% pa - £600)
- Credit card – £10,000 (interest at 20% pa - £2,000)

My observations on this are:

- The parents were about to deposit money for five years with Big Bank plc to receive interest of just 1.40% gross. That same money was then effectively being loaned by the bank to their son to whom they were charging between 4% and 20%, thus making a huge profit.

- What if the parents decided to cut out the middleman and lend £50,000 directly to their son, charging him 2% pa interest, giving them an extra £300 pa income compared to them having their money on deposit with the bank.

- The son could then consider reducing his debt. For instance, repaying his credit card would see his interest payments drop from £2,000 with Big Bank

"It is truly amazing how much more families can achieve when they work together"

plc to just £200 with his parents, saving him £1,800 pa. He could then structure additional capital payments so that the £10,000 was repaid within five years. He could also look to repay the car loan, saving a further £400 in interest, again structuring the repayments over five years.

- The remaining £30,000 could be used to reduce the mortgage and, interestingly, this is actually where the greatest difference can be made; as although the interest rate is the lowest, the debt is the biggest. The smaller loan amount would reduce his borrowing from 90% loan to value to 80% loan to value (again based on a property value of £300,000), allowing him to refinance at a reduced rate. In this example I've assumed just 1.5%. The interest on the mortgage would now be £240,000 at 1.5%, which works out at £3,600 pa.

- Interest on the £30,000 loan to the parents at 2% is £600. So, the total of his new mortgage with Big Bank Plc and the loan from mum and dad totals up to £4,200, saving a whopping £6,600 in year one compared to the previous mortgage that was costing £10,800. The interest payable to the bank will reduce in subsequent years as regular capital repayments reduce the value of the loan.

In summary, the total saved in the first year from the mortgage, credit card and car loan interest payments is £8,800, and Mum and Dad are still better off by £300.

Some of this annual saving could then be directed into savings vehicles for the son, such as an ISA or a pension, for example. In this scenario the son has no emergency fund to speak of, so building up a sufficient pot within a cash ISA, even at a low interest rate, would be beneficial. However, as rates are acknowledged to be low an investment strategy could be beneficial over the longer term; for example, a stocks and shares ISA or a pension. The key advantage to a pension is the tax relief, as irrespective of his taxpayer status, at least 20% is added to his personal contributions (up to the annual and lifetime allowances) and provides a nest egg for the future. However, the ISA allows for more flexibility if access is required in the shorter term.

It is truly amazing how much more families can achieve with their money when they work together. However, the example used here is simply to illustrate the financial benefits of looking at the circumstances of a family collectively and does not constitute advice. When considering such strategies it is important to check whether any penalties apply on early repayment of any debt and obtain professional help. It is equally important to understand the implications of making gifts from capital to the next generation. Equilibrium is not authorised to provide advice on debt counselling; but we can refer you to a professional partner should this be needed.

If this hypothetical scenario is a familiar one, then attendance at our next live online event covering inheritance tax and intergenerational planning could well be of benefit for you and your family.

Human doings

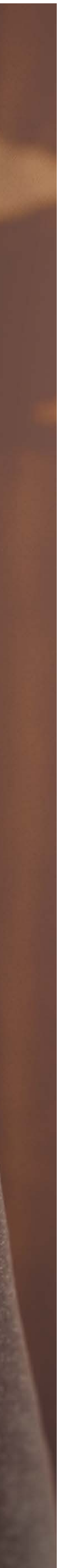
We're often called human beings, but we aren't actually very good at 'being'

When COVID-19 first started appearing on news channels, it seemed like a far-away issue that wasn't a big deal for those of us in the UK. Looking back, that's almost laughable now!

The virus has caused a huge amount of uncertainty for the vast majority, if not all, of the country. There have been concerns for our own safety as well as the health of our loved ones; many people lost their jobs and even more were furloughed; there has been market volatility like we have never seen before.

What's worse is that, usually when we feel a bit worried or even upset, we would book a holiday or arrange to meet up with a friend at the pub – but we couldn't even do that! It felt almost as though we were trapped in our homes with nothing but 24/7 news updates on how awful everything was.

In times like this, humans yearn for control, and our instinct is to try to find it in any way possible. This creates action bias, which can lead to irrational behaviours – such as stockpiling toilet roll!



It's important to keep this in mind in times of uncertainty. Irrational actions can often have negative consequences, especially when it comes to investing.

The new normal

There are many areas that have been and will continue to be affected by lockdown. I believe that lots of these are themes that were in play before the pandemic and have simply been magnified by it. Let's explore some of these and what they could mean for us.

Retreat of globalisation

A big one is the retreat of globalisation. The trade wars between China and the US were already far from over and this only seems to be getting worse. This will potentially lead to businesses buying and manufacturing more in the UK rather than outsourcing to other countries which should, of course, be positive for our economy.

Pay rises?

It's been estimated that NHS workers have taken roughly a 10% pay cut in real terms over the last decade. The pandemic has truly highlighted how vital these workers are to our society, so it seems almost inconceivable that they won't demand higher pay. France, for example, approved a pay rise of over €8bn for their health workers.

Would this then lead to other key workers and sectors demanding higher pay? It will be interesting to see how this develops but higher pay would presumably result in more spending and could also potentially help to close the housing gap, so again, this could be positive for the country.

Shift to online

The move to digital has been happening for years; however, the pandemic and lockdown have caused people (and even companies) who perhaps usually would have been reluctant to use technology to fully embrace it.

We have seen shares in Zoom soar as people turned to video calls and online quizzes for entertainment, as well as more people than ever using streaming services such as Netflix and NowTV. Naturally, we may not be as reliant on technology once the pandemic is over, but I certainly think it will be a lot more prominent than it was beforehand and it will be interesting to see the benefits of this.

> **Irrational actions can often have negative consequences"**

Consumers

We live in a consumer-driven economy, and if we spend less it will, of course, have an impact.

How the pandemic will affect spending behaviour going forwards is yet to be seen; however, there is a certain yin and yang element to this.

On the one hand, people will not have enjoyed the uncertainty and potential financial instability generated by COVID-19, which will potentially lead them to focus more on paying off debts and saving more. UK debt level has been unsustainable for many years so this would be a positive step forward.

On the other hand, after being cooped up for months, people may want to spend more to enjoy life whilst they can.

Working from home

We have seen the implementation of a working from home structure that will make it difficult for many employers to claim that work cannot be done from home going forwards. It can only be assumed that this will lead to an increase in people working from home.

The AA estimate that if just one in five people move to working from home, the difference on the roads would be equivalent to that of the school holidays. Getting to work faster and without the stress of traffic can only be a good thing!

People may also spend less as a result of this – they wouldn't need to purchase fuel or buy lunch, although this may be balanced out by spending on home office equipment. Only time will tell.

Zombies should be killed

Zombie companies are those which are only just surviving and are definitely not thriving. Approval for the lending schemes aimed at supporting businesses are based on the pre-COVID performance of firms, and so many of these zombie companies have not received the financial help required to get them through the period.

To me, this is no great loss. As these companies fail, their market share becomes available to better, more effectively run companies, resulting in more productive and efficient industries.

Doing business better

Hopefully, this will lead to many companies, as we call it, 'doing business better'.

Equilibrium have signed the 'how do companies act' open letter to political leaders, which advocates changing the Companies Act from stating that businesses must act in the best interests of their shareholders, to also including employees and customers in that statement.

For far too long, employers have been too focused on shareholder value, prioritising that above all else. We believe that if you prioritise your team and your clients, they will, in turn, generate long-term value for shareholders.

More and more, people are choosing to buy from and engage with companies that they feel represent their own values and are in line with their own beliefs. This will hopefully prompt companies who are not already exploring how they can make a positive impact on the world outside of their own profits, to do so.

BY COLIN LAWSON

Safe as houses?

Are buy-to-let properties really a good investment?

House prices are enjoying a post lockdown bounce, rising by 1.6% in August alone and 5.2% over a year according to the Halifax*.

With headlines such as these and with returns on cash at dismal levels, many individuals are naturally tempted to jump on the buy-to-let bandwagon. With everything you hear about people enjoying yields of 5% or more, plus the rising prices, surely a 10% pa return is possible? Personally, I'm not convinced!

Firstly, let's unpack that 5% yield, then we can move on to look at the outlook for prices.

A quick search on Rightmove for two-bed terraced houses in Macclesfield shows that I can buy a reasonable one for around £160,000 and that I can rent a similar one for £650pcm. So, with £7,800 a year in income then, voilà, that equates to a 4.90% yield on my £160,000 purchase price which, admittedly, appears attractive.

Now let's have reality check. I would realistically expect a change of tenant every year – sure, you might get lucky and find a tenant who stays much longer but for planning purposes, I would think a year seems sensible. I would then assume a one-month gap between tenants and an agent's fee of one month's rent for finding a new one.

Add to that an additional agency fee of 10% so that I don't get tenants calling me at all hours – oh, and I mustn't forget to insure the property and account for a budget for repairs and maintenance (no, you can't take it all out of the tenant's deposit!) as well as pay for annual safety checks.

"In reality, I don't think anyone has a clue right now"

So, in reality, the numbers look more like they do in table one, below.

So, not quite the 5% headline rate hoped for and, with a yield pretty much in line with the Bank of England's forecast for inflation, if I actually want to make any real money, I am 100% reliant on capital growth.

House price forecasts are incredibly varied at the moment with Barclays predicting 0.6% growth in 2020 (implying a third quarter fall) whilst at the other end of the scale you have Knight Frank predicting a 7.5% fall.

In reality, I don't think anyone has a clue right now. What we do know, is that unemployment is rising fast, that house prices relative to incomes are at all-time highs and the cost of borrowing is unlikely to drop much further.

Table one: net yield after fees and tax

Annual rent	£7,800
One-month void	£650
Agency fee	£715
New tenant finder fee	£650
Allowance for maintenance	£1,500
Building insurance	£200
Safety certificates	£160
Remaining rent	£3,925
Less 20% tax	£785
Net yield on £160,000 property	1.96%

So, in my opinion, I think prices are unlikely to rise much further and significant falls are possible.

When you factor in the additional cost of purchase including legal fees, stamp duty (you still pay the extra 3%) and the void period between purchase and first let, then it could take a number of years just to break even.

If you are fortunate enough to make a capital gain, then you need to take into account the higher capital gains tax rate of up to 28% and also that the tax needs to be paid within 30 days of selling the property.

I remember the days of 10% net yields, low stamp duty, inflation busting capital growth and interest that could be offset against higher rate tax.

In that environment anyone could make money on property but, given the current conditions, I am not so sure I would "jump on the bandwagon" any time soon.

*Halifax Price Index August 2019 – August 2020 (https://www.halifax.co.uk/assets/pdf/august-2020-house-price-index.pdf).

" I think prices are unlikely to rise much further and significant falls are possible"

Switched on

Technology investing for the 2020s

The numbers are mind-boggling....

- The top six US technology stocks have the same value as the German, French, Italian, Spanish, Canadian and UK stock markets combined.

- If Apple were a country, it would be classified as the 9th richest (assuming an equivalence between market capitalisation and GDP).

- Tesla's share price is up nearly 500% since the start of this year and is now the largest car company in the world, recently overtaking Toyota, despite Toyota selling over 27 times more cars than Tesla last year.

...and so, it continues.

Whilst this is a nerd's paradise, there are some serious implications for investors.

Technology encompasses almost all aspects of life, and so investing in this part of the economy can take very different forms – do you prioritise investment in the software makers, for instance, or the companies that use the software to build successful businesses?

As the big numbers suggest, there are now around half a dozen technology giants, which means that investments in this sector can be very concentrated in a few stocks. An investment in the technology-laden index using a NASDAQ 100 tracker fund would currently have almost 60% of its value in the 10 largest companies.

"Technology encompasses almost all aspects of life"

A number of clients have asked us to look at the whole area of technology and provide recommendations for a portfolio of investments in this theme. Our approach has been to diversify the portfolio so that it encompasses the makers and the users of technology, but also to offer a much broader spread of applications, from big data to robotics – which also reduces the concentration risks with the top 10 holdings comprising only around 13% of the total.

To achieve this mix, we have selected funds that take very different approaches to technology investing. The following articles are from two managers of funds in the portfolio who describe their particular approach and how they look to drive performance.

Smith & Williamson Artificial Intelligence Fund

We believe artificial intelligence (AI) is one of the most important investment themes of the coming years and is likely to have a profound impact across a range of sectors. However, it is important to understand that artificial intelligence provides a range of investment opportunities across a wide variety of industries. As a result, we are not focused on investment in the tech sectors.

A lot of tech and robotic funds invest in enabling technologies – such as component or "widget" makers if you want to call them that. These technologies are important but, in our opinion, just focusing on the enabling technology is missing the point. Indeed, at the end of June 2020, only 40% of our fund was invested in the tech sector.

To give just some idea of the breadth of artificial intelligence, it is worth pointing out that two of the sectors that are most likely to be affected by AI – the healthcare and consumer sectors – actually fall outside the remit of most tech funds. In the healthcare sector, we believe AI will have a huge role to play as governments seek to deliver better healthcare at lower cost.

In the US, there is a wealth of evidence that suggests that AI can help minimise or eliminate errors or misdiagnoses and, by dealing with routine cases more efficiently, it can free up capacity for doctors to deal with more complex problems. In the consumer sectors, AI will have a huge impact on the production and distribution of consumer goods.

The important thing with AI is that companies need to try to understand how it could affect their businesses. Corporate culture takes a long time to change but for businesses to be resilient they need to understand what the future could look like.

By definition, we are investing in progressive businesses that have chosen to engage with AI. We think that those businesses are giving themselves the best chance of success in the long term because they are open to new ideas and prepared to adapt.

Polar Capital Global Technology Fund

Technology is about innovation. We have a dynamic definition of what constitutes a technology company, which includes not only technology suppliers but also companies and business models that are enabled by technology. These companies use technology to create a competitive, or even unfair, advantage. We are drawn to those with technology intellectual property and business models that are difficult to replicate, resulting in high barriers to entry.

We have always taken a thematic approach to technology investing. However, it is clear that COVID-19 has accelerated the adoption of many of these themes, some by years.

Digital transformation is now the number one priority for management teams. It is about making an organisation resilient and agile in this new environment, enabling employees to work from anywhere, continuing to service customers, having robust financial controls and analytics to keep a business running in the middle of this uncertainty. This includes areas such as cybersecurity technologies, e-commerce platforms and digital payments.

Digital transformation is now the number one priority for management teams"

Connectivity is also seeing renewed importance, with the start of 5G, accelerated cloud adoption, streaming and the "internet of things".

Much progress has been made in artificial intelligence and machine learning with more companies now using these in their operations and products. We believe AI will ultimately permeate every industry globally.

Why is it different from the tech bubble 20 years ago?

Equilibrium's view is that the 1999 bubble was the hype phase of the real cycle that is happening now. The internet, the general-purpose technology that underpins all the changes we are seeing, is of a size and reach that is totally unprecedented. In the 1990's it was a narrowband, PC-based internet of a few hundred million nodes, whereas today's broadband network connects 4.4 billion people and 14.2 billion devices.

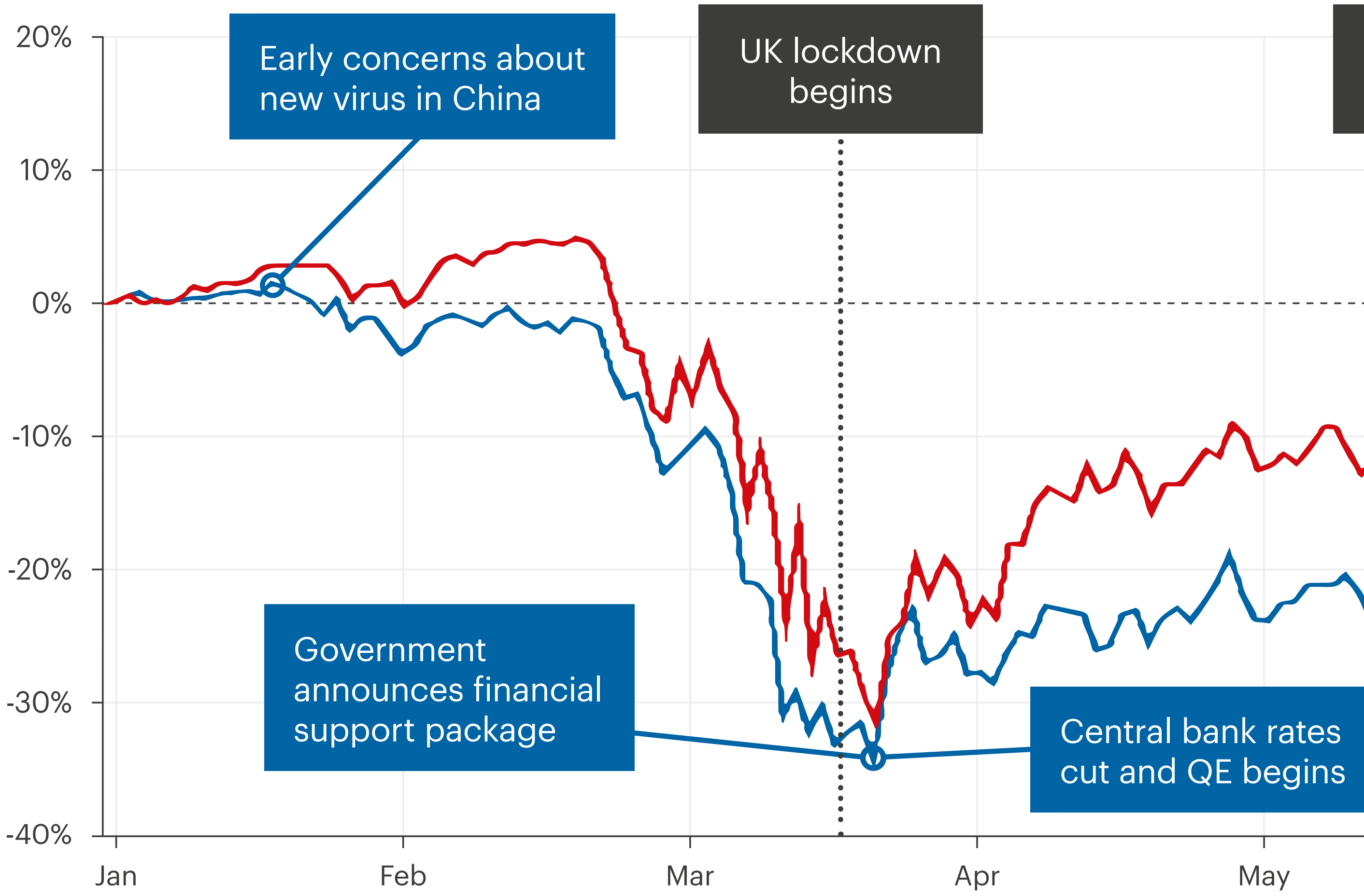
The tech bubble was fuelled by untested companies built on valuations alone, whilst today listed technology companies show strong growth in revenue and profits.

INVESTMENT REVIEW

Living in extraordinary times

Welcome to the investment review section of this edition of Equinox

Mike Deverell
PARTNER & INVESTMENT MANAGER



S&P 500 (6.57%) **FTSE 100** (-19.10%)

30 **Summary**
It's been an unprecedented six months. Here we explain our approach and our outlook on the future.

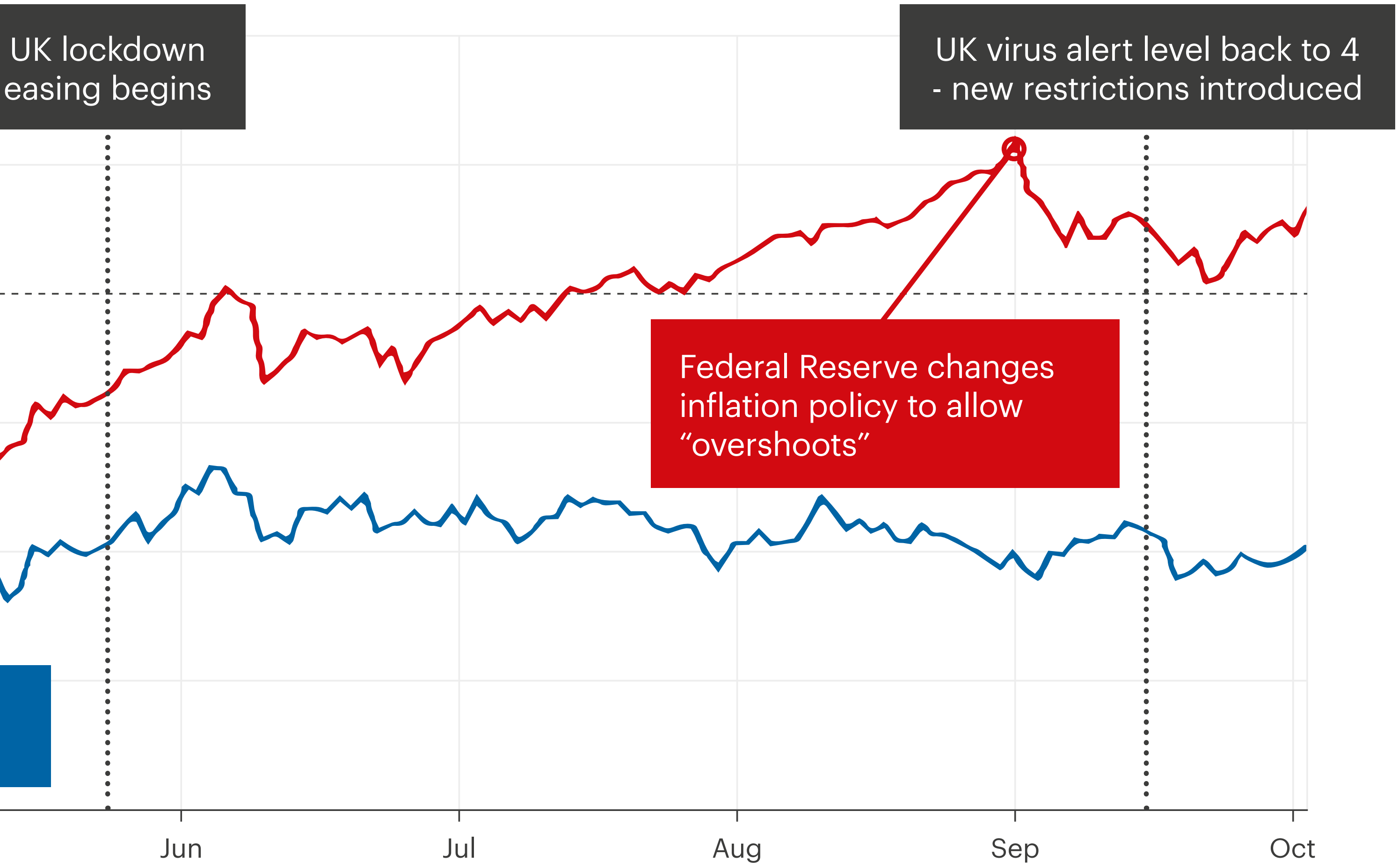
32 **Asset class outlook**
Here we evaluate each asset class and explain their role in our investment strategy.

We normally begin with a timeline of events from the past six months plotted against the stock market. For this edition we have extended our timeline back to the beginning of 2020 since many of the things which happened in the first quarter are still affecting markets today!

Rather than just plotting events against the FTSE 100 as usual, we've also included the S&P 500 (the main US stock market).

Whilst the FTSE remains around 19% below where it was at the start of the year, the US market has more than made up what it lost in February and March. This is an extraordinary difference and the pace of the recovery in the US has been phenomenal.

Over the coming pages, we'll look at what has driven these markets and why there is such a huge difference. We'll also look at how we've reacted to events and share our thoughts on where we might go from here.



Source: FE etc in local currency. Data from FE fundinfo2020. 31/12/2019 - 05/10/2020

36 **Performance & sector analysis**
After a turbulent few months in markets, here we look at how our selected funds have performed compared to their relative sectors.

39 **Portfolio performance**
Here you can find a thorough breakdown of how each portfolio has performed in both the long and short term.

In the first quarter of this year, the UK stock market fell peak-to-trough by over 35%. Over 25% of that fall came within a two-week period! The bear market we've experienced this year was also unprecedented, at least in terms of speed.

Given the ongoing global pandemic and the extent of these falls, it is somewhat surprising that our portfolios have actually made money over the past 12 months!

Table one shows the returns of the main IFSL Equilibrium Portfolio funds over six and 12 months relative to the average mixed investment fund which takes a similar level of risk. The FTSE 100 is also shown for context. The average fund has lost money and the FTSE is still more than 14% down over 12 months, and so under the circumstances we are very pleased with these returns.

The positive performance over 12 months is, in part, driven by a much stronger recovery for our portfolios than either the average mixed investment fund or the FTSE, as we can see in the six month returns. In the coming pages we'll explain how some of the actions we took helped constrain losses and capture more of the gains.

Table one also tells us something about how badly the FTSE has done over this period. The UK has been particularly hard hit by COVID-19, both from a human and an economic point of view. The UK market is full of the sort of companies that have been hard hit by the pandemic such as oil & gas, travel and leisure, and financial stocks like banks and housebuilders. That's before we even mention Brexit-related concerns.

Meanwhile, the US stock market has largely gone from strength to strength. The makeup of this market is very different from the UK.

In the last edition, we mused about whether certain companies could actually be "winners" out of this crisis. It certainly appears like some of the big technology companies fall into that category, notably the likes of Amazon and Microsoft, big beneficiaries of the shift to shopping and working from home.

However, other less obvious beneficiaries in the "tech" world have also done extremely well. In the next few pages, we'll look at this in more detail and explore why this may have been the case. We'll also look at the rally in other asset classes, notably fixed interest (corporate and government bonds) has done phenomenally well.

Finally, we'll also consider how market dynamics may have changed and how correlated certain assets have become. This poses some serious risks to the traditional equity and bond portfolios, and we'll explain how we try and deal with this.

Whilst we can't avoid mentioning COVID-19, we will refrain from discussing it in too much detail, since anything we write will be out of date in very quick order!

Technology & the whale

A whale is of course a large marine mammal. Given its size, a whale's movements can significantly affect the waters around it, meaning shoals of fish can find their own movements disturbed. In financial terms, a whale is a large trader that sits "under the surface" whose own movements send ripples out across the market.

Over the summer, there were rumours of a large "whale" making unusual and speculative bets on a number of tech stocks. These bets were largely made by the use of financial derivatives known as options.

There are two main types of options an investor can use. One, known as a "put", is an option (not an obligation) to sell a particular stock at a fixed price at some point in the future. Put options are useful for hedging a large position and are essentially a form of insurance.

The second type of option is known as a "call" option. This is an option (not an obligation) to buy at a fixed price at a fixed point in the future.

Let's say shares in company A are £100. An investor buys an "out of the money" call option to buy at £110 at some point in the future. Perhaps this costs them £1 in option premium.

If the share price rises to £120, the investor would exercise their option to buy at £110 and be able to immediately bank a £10 gain (which nets down to a £9 gain when we account for the £1 premium, which is paid regardless).

Buying an option allows an investor to put down a small outlay initially but benefit massively from a large price movement. In this example, our £1 outlay has been turned into £9, an 800% return!

However, if the share price had gone up only to £109, then the option expires worthless and the £1 premium is lost in its entirety (a 100% loss).

Moving the market

Usually these options have terms ranging from several weeks to several months. However, recently we've seen an unusual pattern where big option positions have been taken out with only a very short time to expiry, often a week or even less. Speculation grew that there was a "whale" out there, placing big bets which were moving the market.

If you take out an option, you are doing a deal with a counterparty who has written the contract. Usually, this is one of the big investment banks.

If the investor exercises their option to buy, the investment bank has to

Table one: Portfolio returns

Portfolio	6 months %	1 year %
IFSL Equilibrium Cautious Portfolio	13.97	1.25
IFSL Equilibrium Balanced Portfolio	15.98	1.24
IFSL Equilibrium Adventurous Portfolio	20.70	2.76
UT Mixed Investment 20%-60% Shares	12.67	-0.10
FTSE 100	11.59	-14.09

Source: Data from FE as of 5 October 2020. (For a full performance table including longer history please see page 39) sell them that stock. This means the bank needs to own the stock. As the price gets closer to the exercise level, the bank is forced to "hedge" their position by buying shares. However, that very act of buying can of course push the price up!

In sufficient size, this creates feedback loops. It might work something like this:

- A large investor buys an out of the money option to buy company A at some point in the future.
- The investor then buys shares in that stock, in a trade large enough to push the price up.
- The investment bank is forced to buy shares to hedge their position, again pushing up the price.
- The investor is able to exercise their option and make a profit.

This might appear close to market manipulation, but it is perfectly legal. As with most feedback loops, they can work in reverse should the share prices fall rather than rise. Banks would no longer need their hedges and so would sell stock instead.

All of this speculation has been helping drive the returns in tech stocks, and also contributed (in our view) to a minor but sharp sell-off in these stocks in September.

Robinhood?

So, who or what was the whale? Well, there are two main candidates.

The first is Softbank, the giant Japanese conglomerate. They confirmed earlier this summer that they had bought large holdings in certain big tech stocks. They have also definitely been involved in options trading in large numbers, reportedly with a notional value of around $30 billion!

The second whale may not be a single investor at all, but an army of individual retail investors or "day traders". Together, the FT estimated that these individuals took out options positions with a value of over £40 billion in August alone – even more than Softbank. This massive increase in retail options trading is a new phenomenon. It mainly began with the launch of the Robinhood trading platform, where retail investors can trade small amounts at little or no cost.

A whole online community has grown up around these Robinhood traders, sharing trading tips on forums and in videos. There is even a new YouTube star, Davey "Daytrader" Podmore, who used to bet on sports but since the pandemic has turned his attention to the market. He even tweeted:

"I'm sure Warren Buffett is a great guy, but when it comes to stocks, he's washed up. I'm the captain now."

Warren Buffett he may not be, but the Robinhood traders may well be moving the market now in the way that retail investors rarely have before.

Tech titans

There's a good reason the Robinhooders have largely focused on tech stocks. The pandemic has accelerated the existing trends for work and shopping to move online, benefiting many of the big tech stocks. We have increased our tech exposure in the portfolios over the past six months, which has had a positive effect on returns.

Tech's superb run means the US stock market has far outperformed the rest of the world so far this year. The "big five" alone (Microsoft, Apple, Amazon, Alphabet (Google) and Facebook) now account for around 24% of the S&P 500 on their own. Exclude just these five stocks and track only the remaining 495, and the US market returns are no better than anywhere else.

For most of these stocks, it is easy to see why they have done well with the acceleration of online shopping and working from home. However, there are other stocks that get lumped into the "tech" basket which have done even better, but without any obvious driver. One such stock is Tesla.

From 1 January to the end of August the stock went up almost 600%. In the most recent quarter they delivered around 90,000 cars, down from 95,200 in the same quarter of last year.

Car sales have of course been hit by the pandemic and so this is by no means a bad result, but it demonstrates that there has not been a massive increase in sales to justify the massive increase in the share price. Tesla is a market leader in battery technology and electric vehicles, amongst other things. It seems well placed to be a long-term beneficiary of current trends and very possibly the current share price will look cheap in ten years' time!

However, it seems likely that one reason for its amazing run of performance is its popularity amongst retail day traders.

There have also been some very unusual options trading in Tesla, with extremely short-term options changing hands in large quantities, often outside of normal trading hours.

We are all fans of technology on the investment team and see this as a long-term trend which we want to benefit from. However, in the short term, we are concerned that this market is stretched. Looking at popular valuation metrics of both the technology and the consumer discretionary sectors (where the likes of Amazon and Netflix sit), we see a market which looks very expensive relative to history.

One of our favoured valuation metrics is the price/book ratio, which compares the market value of a company with the "book value" – the total assets minus liabilities as shown in its accounts.

Chart one shows the price/book value of the consumer discretionary sector and how it correlates with returns over a typical five-year period. Each dot represents a different five-year period for the sector. The higher the dot, the higher the return over that period. The further to the right, the higher the price/book ratio was at the start of that period. There is a strong correlation where the more expensive the market was, the lower the return.

The vertical black line illustrates where the current value of that sector sits compared to history. There has never been a five-year period where the sector has had anything like such a high valuation! The current valuation of stocks in this sector is nearly 3.5 times book value. The only five-year period we can find which comes close was when the sector was at around three times book value, which saw a return of essentially 0% over five years.

Predicting a pandemic

Markets are rarely predictable, but they have rarely been more unpredictable!

Like many people, we track the data around COVID-19 and consume all news about treatments and outbreaks avidly. Tracking this stuff closely means we can react quickly if required, but we would be kidding ourselves if we thought it meant we could say where things are going!

As I write, we are seeing what appears to be a second wave of the virus in the UK. At present this also seems to be less deadly (thankfully) than the first wave. There are many theories why this might be the case, which we won't go into here! We simply have no idea whether this wave will accelerate or die away. Whether we end up back in another lockdown, or back to relative normality. We don't know when or if an effective vaccine will arrive and how quickly it can be rolled out.

Should things get worse and there be another significant hit to the UK and global economy, we would likely see stock markets pull back sharply. Should there be a vaccine or a major improvement in treatment, it is possible that markets could rally very sharply indeed.

This means we have a difficult balancing act in positioning our portfolios. Too much equity and we will be susceptible to a double dip. Too little, and we could miss out on future gains.

At present, we are tilted marginally more towards a recovery, with slightly more in equity than usual. We balance this out by having more than usual in cash and lower risk bonds investments. We have also tilted our portfolio slightly more towards "quality" stocks, which means those companies whose earnings would be more resilient in a downturn. This includes some tech stocks but also some consumer staples and healthcare, for example. However, should there be a vaccine for example, it is not those stocks that would likely do the best. The ones which would rally the most might be those who have been hit the hardest, such as travel and leisure stocks and more "cyclical" firms whose fortunes are linked more to the economic outlook.

In that scenario, it is even possible that the tech companies don't just underperform but actually see their share prices fall!

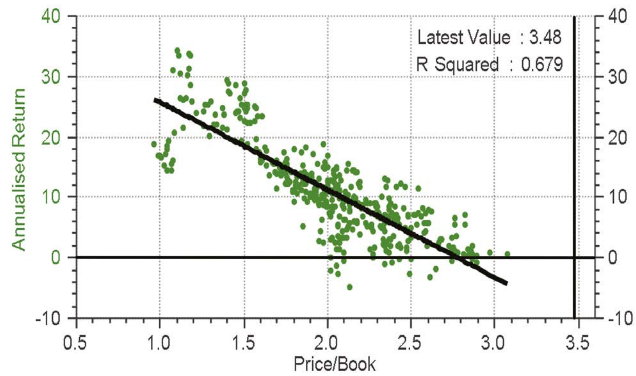
Virtuous circles and vicious ones

The key to constructing a portfolio which provides relatively stable returns is to choose a mix of assets that all do something differently. We want assets which are lowly correlated to each other, meaning if one does poorly another might continue to do well, for example.

However, correlations between assets are rarely static. They change over time as different factors affect their returns.

One thing we have learned from previous crises is that assets which appear to do their own thing in normal times, can suddenly all move in the same direction. This is what really hurt portfolios in March this year when there was little hiding place from the downturn.

Chart one: World - consumer discretionary sector



Source: Refinitiv Eikon / Equilibrium Investment Management to end September 2020

Chart two shows the returns of global stocks, gold, sterling gilts and corporate bonds over the past 12 months. These assets often do completely different things to one another. However, in March, we can see all of them falling at the same time as they became much more correlated (highlighted with the black dashed-line).

You may also be able to see that gold (pink) and stocks (red) have become very correlated again over the past couple of months (see the blue circle). Gold is also increasingly correlated to the so-called "real yield" on government bonds like gilts.

We've never liked using gold in portfolios as we feel it is a speculative investment which is prone to wild swings in price. However, we do track its price as historically it has been a good sentiment indicator – when gold prices go up it's usually because people are worried, and it usually sells off when they are more comfortable. This relationship appears to have broken down.

It is our view that virtually any asset class you can think of is now driven to a great extent by central banks. By cutting interest rates to (effectively) zero or below, and by carrying out massive amounts of quantitative easing (QE), central banks have helped markets and economies recover.

However, by its very nature (some would say by design) QE is pushing up asset prices, no matter where they sit on the risk spectrum. The banks electronically "print" money and use this to primarily buy government bonds, pushing up their price whilst pushing down the yield. Investors then re-cycle this money into something that provides a higher return, like corporate bonds, equities and (yes) gold.

This positive correlation is great when markets continue to rise. Hopefully, with the amount of stimulus pumped into our financial system they all continue to go up.

However, as we discussed earlier, when trends turn, such virtuous circles can rapidly turn into vicious ones.

As such, we feel that to diversify our portfolio and balance out the risks of holding assets like equities and corporate bonds (where we still see value), we also need to hold more cash than usual.

Fixed interest

Whilst we were perhaps surprised how correlated government bonds and equities became back in March, we were not surprised to see corporate bonds fall.

Corporate bonds are essentially loans to companies. In an economic downturn, companies are more likely to default on these loans, and so a recession tends to hit both corporate bonds and equities. In the usual order of things, equities are the first movers. They are quick to react and we saw stock markets begin to fall in mid-February, once it became clear that we were experiencing a global pandemic.

However, corporate bonds are more secure than equities. They are traded "over the counter" rather than on a listed exchange which makes them less liquid and hard to trade. These factors mean they tend to react more slowly, and they did not start to really fall until the beginning of March.

Knowing this relationship and seeing the falls in equities, we saw this as a trigger to sell much of our exposure to corporate bonds, especially those with lower credit ratings, in late February and early March.

These funds subsequently fell sharply, and we decided to buy some of them back at these lower prices. Table two shows the dates we sold and when we bought back (if applicable). The return since the repurchase is also shown where applicable. We have also added additional fixed interest funds since this date, increasing our exposure in the Balanced Fund from 11.4% on 20 March 2020 to 28.4% on 5 October 2020.

Buy low/sell high

With fixed interest we demonstrated we were able to sell at relative highs and buy at relative lows. We try to do this across all asset classes. In equities, we have always tried to buy at relative lows by carrying out what we call volatility trading.

Stock markets are always volatile. In most years they fall at least 10% at some point during the course of the year, even when the returns for the year as a whole are positive. To take advantage of this, we regularly set what we call "trigger points" in advance. Should markets drop to our trigger level, we automatically switch a small amount out of lower risk assets and into equities, usually by buying an index tracker.

Having bought, we then set an appropriate sell trigger and switch back again if markets recover. We also set a further buy trigger for a lower market level in case the correction turns into something else.

Chart two: Returns on global stocks, gold, sterling gilts and corporate bonds

- A - S&P GSCI Gold SPot (23.68%)
- B - MSCI World (11.58%)
- C - IBOXX UK Sterling Corporate All Maturities (3.91%)
- D - FTSE Actuaries UK Conventional Gilts All Stocks (1.79%)

Source: Data from FE in local currency 04/10/2019 - 05/10/2020

Since the beginning of 2018 we have typically bought when the FTSE 100 dropped to 7,100 and then sold again at around 7,500. We did this five times during 2018 and 2019, plus a further trade when we bought at around 6,750 and sold at c.7,000. Six times the market fell to one of our triggers, and six times we were able to buy and then sell at a profit.

The problem with doing this is that sometimes a correction turns into something more serious. When markets began to fall in early 2020, we did not know at that time that we were facing a global pandemic. We bought in at 7,100 as we had done many times before. As markets dropped further we then bought in again at around 6,500. When markets got down to around 5,000 this was looking like a serious mistake. Buying on the way down had made matters worse.

However, whilst the FTSE 100 is yet to recover to the levels we bought at, by being active we have managed to make a significant profit on one of these volatility trades.

In this pandemic the asset class we invest in which was hit the hardest was defined returns. This is our term for a particular type of structured product, also known as an "autocall".

For example, on 25 February we bought a product from BNP Paribas when the FTSE 100 was at 7,017 and the S&P 500 was at 3,128. This product will end, paying us a fixed return of 14.95%, should those two markets be at or above those levels on 25 February 2021. If the markets are still below those levels (as seems likely for the FTSE 100 at least) then the product would roll on to February 2022. If it kicks out at the second anniversary, we would get two lots of 14.95% (29.9%). This process can continue for up to six years.

If the markets are still down after six years we just get our money back, unless one or more of the markets is 40% below the start level. In that case we would lose capital in line with the market fall.

These products are usually seen as lower risk than a FTSE tracker (for example) since they have an element of capital protection and only require markets to be flat over the term to achieve a strong return.

However, earlier this year these products fell by more than the markets on which they were based. As financial stresses became apparent in March and liquidity dried up (which is why bonds were falling as well as equities), these products were hit by a perfect storm. For example, this BNP Paribas product was worth just 69p in the pound had we sold on 19 March.

Whilst this was painful, we also saw this as an opportunity. We felt these low prices did not fairly reflect the intrinsic value of the products and so we decided it was time to buy. Even if markets never recovered, we reasoned that the product's capital protection ought to kick in. Using the BNP Paribas product as an example, should this be the case it would still likely be worth at least the original £1 per share (a 44% gain).

We therefore decided to switch the FTSE tracker we had bought at 6,500, into a fund of defined returns (the Atlantic House Defined Returns fund). We sold the FTSE tracker at an approximate 15% loss, switching into defined returns over a few days.

We sold this additional Atlantic House investment on 28 May (we still hold some in portfolios), banking a gain of around 27% on average. This means the volatility trade made around 9% despite the FTSE still being well below the 6,500 point at which we'd bought.

Also during March, we set up another defined return product with Goldman Sachs when the FTSE was 6,000 and the S&P 500 was 2,808. This works in the same way to the BNP Paribas product mentioned above, except that it will pay a 20% annual return on kickout.

As of 5 October, the FTSE remains below the 6,000 level but the S&P 500 has gone up substantially. If we wanted, we could sell today for a secondary market price of £1.11, or an 11% gain. However, we think it well worth holding on as we only need a small gain in the market to get a big return. In some ways this is especially so if it doesn't kick out after the first year – 40% after two years sounds pretty attractive, for example!

Active allocation

Chart three shows the asset allocation of our balanced portfolio and how it has changed over the past 12 months. It is what we call a "sand chart". For example, the dark pink "layer" shows how much equity the portfolio holds and how this has changed over time. When the pink area is larger this means we hold more equity, for example. You can see here how we increased equities in the spring as markets fell and have reduced gradually as they recovered.

You can also see how the green areas of fixed interest and short dated fixed interest reduced markedly at the same time, whilst the blue area of cash increased. Whilst we have reinvested much of this cash, we still hold more than usual today.

As we saw in table one on page 30, all this activity helped our portfolios to recover very quickly after the lows of March. Over the six months to 5 October, our portfolios returned between 13.9% and 20.7%. Meanwhile the UT Mixed Investment 20%-60% Shares sector returned 12.67% and the FTSE 100 returned 11.59% over the same period.

Project Phoenix

In the article on page 8, we explain our recent project to look at what long term investment returns are likely to be going forward. It is worth pointing out that when setting out our expectations we are looking at what the asset class as a whole might return, based on some sort of index. However, we don't just use index tracking funds.

Defined returns are a great example of where we think we can add value over and above an index. We will also often use actively managed funds. In addition, we don't keep our asset allocation the same but switch between asset classes as their outlook changes.

Looking at projected index returns in the future is therefore only part of the picture. So, we have also carried out detailed analysis on how much value our active management has added since we began managing assets on a discretionary basis.

Table three shows the returns of our portfolios (taking into account all changes made along the way) across the major equity regions we invest in, compared to the main index for that region.

This data looks at rolling average five-year returns rather than total return over the entire time period. We prefer this approach as it better demonstrates whether or not any outperformance has been consistent, and not skewed by any short-term periods of good returns. We can also look at the best and worst time periods.

Table two: Fund returns

Fund sold	Major sale date	Date bought (if applicable)	Price difference between sale and buy back %	Return since (re) purchase to 5 October %
Royal London Short Duration High Yield	28 Feb	27 Mar	-8.41	8.29
Semper MBS Total Return	09 Mar	n/a	n/a	n/a
L&G Sterling Short Dated Bond	28 Feb	n/a	n/a	n/a
TwentyFour Absolute Credit	28 Feb	n/a	n/a	n/a
Royal London Sterling Extra Yield	09 Mar	02 Apr	-10.86	7.78
TwentyFour Dynamic Bond	13 Mar	08 Apr	-5.86	11.82

Source: Data from FE

The only region where we have not seen outperformance by a significant margin is in the US. We have largely held index tracking funds in the US as we have found it hard to find active managers that outperform consistently. The negative excess return is largely accounted for by the fees on the index tracking fund.

Note that we are not claiming that this outperformance is down to great skill. Passive fund advocates could rightly point out that this may be explained by style bias, for example by our choosing small caps over large caps, growth over value etc.

We would not dispute this but for the purposes of this analysis the source of the outperformance is not relevant. By using rolling five-year returns we show that this has occurred consistently, and we believe this can be repeated in the future.

We also have made asset allocation and equity allocation changes along the way which of course can also add or detract value.

In order to assess the total effect of all active management, whether driven by allocation changes or fund selection, we use the following method.

We compare the total returns of our actual portfolio against a portfolio made up of the various indices. The weightings of those indices are represented by our strategic asset allocation (rebalanced annually). The strategic allocation is what we would invest in if we had a "buy and hold" approach and felt all asset classes were roughly fair value. Since 2008, the balanced portfolio has returned 7.87% pa over the average five-year period, net of the underlying fund management fees but not including Equilibrium's fees which would be charged regardless of the approach.

Over the same period, the "synthetic" index-based portfolio would have returned 6.31% pa over the average five years. The average five-year excess return is 1.56% pa. The highest excess return over any five-year period was 2.76% pa. The smallest was 0.23% pa.

If we can repeat this in future, it could make a significant difference to long term returns.

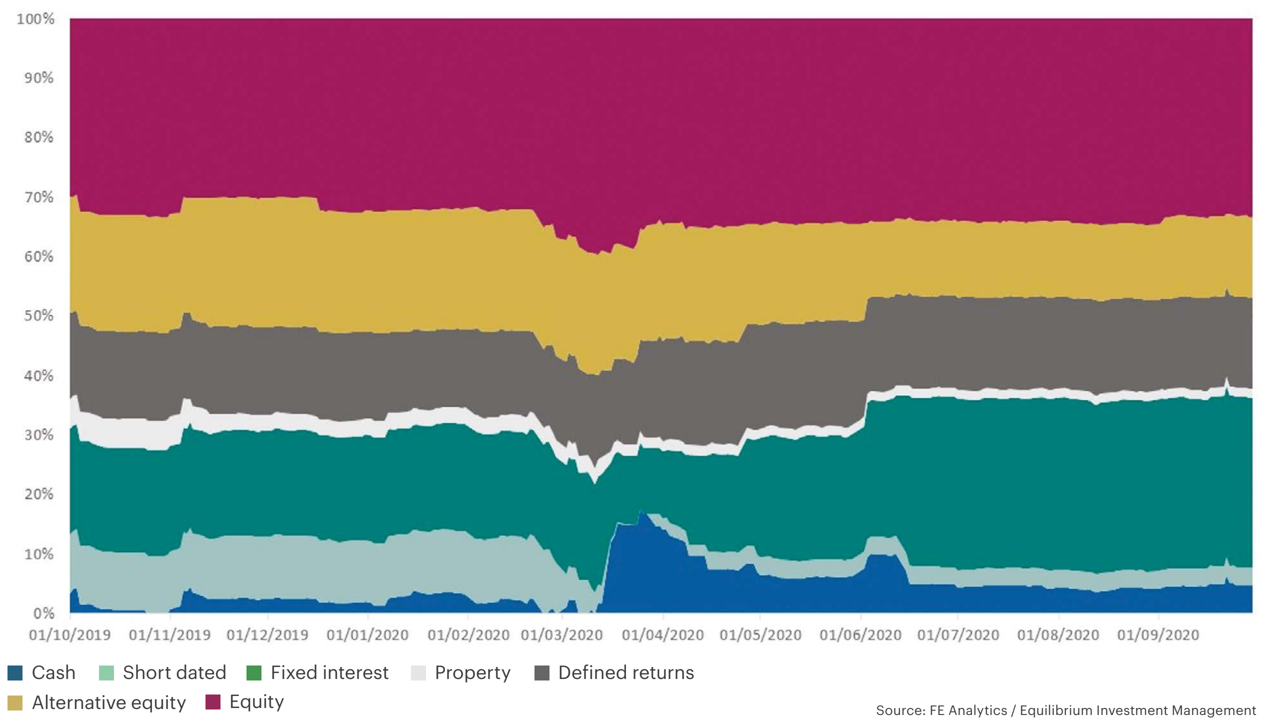
Table three: Equity performance

Equity region	Equilibrium portfolio - average 5 years pa %	Benchmark - average 5 years pa %	Average excess return pa %	Largest excess pa %	Smallest excess pa %
UK *	10.00	7.94	2.06	4.34	-0.29
Europe	13.00	7.16	5.84	9.64	3.29
US	15.69	15.94	-0.25	1.24	-0.84
Japan	13.02	10.63	2.39	3.65	0.78
Emerging markets	6.70	5.51	1.19	3.36	-2.18

*assumes 50/50 holding in UK Conservative Equity and UK Dynamic. Benchmarks used: FTSE All Share, MSCI Europe ex UK, S&P 500, Topix, MSCI Emerging Markets. Rolling 5-year periods beginning 31 December 2007 and ending 31 December 2019. Source: FE Analytics / Equilibrium Investment Management

Source: Data from FE

Chart three: Equilibrium Balanced Portfolio asset allocation since launch



Source: FE Analytics / Equilibrium Investment Management

Sector performance & analysis

UK equity

As mentioned earlier, the UK stock market has been hit harder than many by the pandemic.

However, we largely hold actively managed funds in the UK and our UK portfolios have outperformed both the FTSE All-Share and the average fund within their sectors.

Partly this is because we have a deliberate bias away from the FTSE 100 and are tilted towards smaller companies. We tend to see higher growth from small firms than large ones over time. It is also because we had expected the UK to have a positive year, with hopefully new clarity around Brexit!

We were wrong about that, but ultimately right about the fact that small caps would outperform. It didn't feel like it during February and March when they fell further than large caps, which we'd normally expect in a downturn. However, they have recovered much quicker.

Table four shows all our UK funds and our two main UK equity portfolios compared to the average fund. Green numbers show outperformance compared to the average fund.

Our UK conservative equity portfolio was designed to be a less volatile way of investing in UK equities, and we'd normally expect it to fall less than the market in a downturn.

Whilst the Miton UK Multi Cap Income fund did this job extremely well, our more traditional equity income funds like Royal London, struggled. We have since sold one of them (Rathbone Income) and are likely to reduce exposure to these types of funds further.

Given the dividend cuts and high exposure of the UK market to challenged sectors like oil and gas and banks, we actually believe smaller growth companies are in some ways less risky UK listed investments going forward.

Overseas equity

We divide overseas equity into established markets (North America, Western Europe, Japan) and emerging markets (everything else). However, there is a grey line between established and emerging which will only become more blurred as wealth increases in Asia, for example.

We went into this period somewhat underweight North America, holding less than usual. Given how well the US has done, this positioning turned out to be wrong. However, our global established portfolio has done very well regardless. This is partly because we added to American exposure during the period, putting in the Baillie Gifford American fund which has done extremely well since purchase.

Meanwhile, the funds we selected in Europe (and to a lesser extent in Japan) have been outstanding, returning far in excess of the average fund in their region, but also in many cases in excess of the US index.

In emerging markets, our global speculative portfolio outperformed over every time period. In particular, our China fund fell by a lot less than most regions during the downturn and has produced superior long-term returns.

Table four: UK equity fund performance

	3 months %	6 months %	1 year %	3 year %	5 year %
LF Miton UK Multi Cap Income B Inst Inc	1.19	20.88	3.01	0.06	20.10
Royal London UK Equity Income M Acc	-1.51	12.76	-14.85	-12.03	11.35
Portfolio : Equilibrium UK Conservative Equity 01/10/2018	0.28	16.32	-7.85	-7.52	11.78
Sector : UT UK Equity Income	-1.29	13.65	-13.13	-14.38	2.96
LF Miton UK Value Opportunities B Inst Inc	8.95	30.39	-4.35	-5.93	16.36
Lindsell Train LF Lindsell Train UK Equity	2.75	20.24	-2.81	20.86	62.37
MI Chelverton UK Equity Growth	9.99	37.29	Not in portfolios		
Polar Capital UK Value Opportunities	0.30	20.69	Not in portfolios		
Portfolio : Equilibrium UK Dynamic Portfolio 01/10/2018	5.50	27.13	-3.19	2.72	37.10
Sector : UT UK All Companies	0.10	19.00	-8.75	-7.85	14.66
Index : FTSE All Share	-1.64	14.21	-12.72	-9.61	16.04

Source: FE Analytics to 5 October 2020. Numbers are in green where they are ahead of the benchmark shown

"Clearly, we are not out of the woods yet as far as the pandemic goes"

Our Indian fund has had a tough time with India hard hit by the pandemic, but it has done very well in the recovery. We continue to think that emerging markets, and Asia in particular, remain an attractive long-term place to invest.

AIM

The EQ AIM Portfolio invests in stocks listed on the Alternative Investment Market (AIM) which we believe qualify for business relief (BR). The primary purpose of the portfolio is for inheritance tax (IHT) planning.

When we wrote last year that the stock market had been a "roller coaster", little did we realise that that was just a minor dress rehearsal for 2020. As a collection of small companies, the FTSE AIM market saw very sharp volatility when the markets plunged and then staged a significant rally from the bottom, around 20 March. This six-month reporting period therefore encompasses most of the recovery period since that low-point.

The "recovery rally" resulted in total returns for the FTSE AIM Index for the last six months of 48.24%, compared with 14.21% for the main market FTSE All-Share Index. This very strong performance was driven by many companies in the mining (especially gold and silver), finance and technology sectors and recovery in dozens of companies that investors thought may not survive the downturn in March.

As we have highlighted, most of these companies do not qualify for BR or meet the criteria (in terms of quality, liquidity, etc) for inclusion in the portfolio. As such, the returns on the portfolio over the period were 18.99%. The usual half-yearly rebalance of the portfolio was curtailed this year, limited to only two stocks and the introduction of a new company, Strix Group. The costs in terms of spread (difference between buying and selling stocks) had widened significantly as a result of the market volatility and we took the decision that the costs outweighed the benefits of a rebalancing at the time.

Clearly, we are not out of the woods yet as far as the pandemic goes. We continue to focus on balance sheets for our 'stress tests' to check that each company could at least survive if a second wave worsens the economic outlook and be in a prime position to recover as the picture improves.

Alternative equity

Alternative equity includes various strategies that do not fit into the main asset classes. For example, it contains funds which can "go short" – profiting from shares going down in price – as well as "going long" and benefit from stocks going up. These are often called absolute return strategies, but we don't like this term as they can actually be very risky.

We also include other asset classes such as infrastructure, which are usually listed companies but where the underlying investment is a physical asset with a solid income stream which goes up with inflation.

We'd normally expect this to be less volatile than traditional

Table five: Global equity fund performance

	3 months %	6 months %	1 year %	3 years %	5 years %
Baillie Gifford American B Acc**	16.24	Not in portfolios			
Vanguard US Equity Index Inc GBP	4.05	31.58	9.58	37.45	110.52
Sector : UT North America	3.61	29.53	11.07	36.71	105.12
BlackRock European Dynamic FD Inc**	7.97	44.17	25.40	31.98	99.76
LF Miton European Opportunities	11.89	45.76	35.94	Not in portfolios	
Sector : UT Europe Excluding UK	2.69	28.61	7.09	6.42	52.81
Baillie Gifford Japanese B Inc	8.90	36.67	9.83	24.31	106.24
Lindsell Train Japanese Equity B Sterling Quoted GBP	0.64	11.93	6.80	Not in portfolios	
Sector : UT Japan	4.45	24.37	3.58	12.82	66.39
Portfolio:Equilibrium Global Established Portfolio	6.34	33.87	16.90	31.71	101.44
Portfolio : Global Established Benchmark	3.32	29.05	9.44	23.94	82.62
Federated Hermes Global Emerging Markets SMID Equity	0.37	34.90	Not in portfolios		
GS India Equity Portfolio I GBP	12.64	43.39	2.46	3.52	Not in portfolios
Invesco China Equity (UK)	-0.43	28.87	27.49	39.14	127.03
Schroder Asian Alpha Plus Z Inc	7.80	34.90	22.75	26.88	116.82
Baillie Gifford Emerging Markets Leading Companies**	6.00	38.86	Not in portfolios		
Portfolio:Equilibrium Global Speculative Portfolio 01/10/2018	4.97	35.20	17.48	22.83	103.27
Sector : UT Global Emerging Markets	2.40	26.70	3.62	5.86	72.00

*40% UT North America, 40% UT Europe ex UK, 20% UT Japan

Source: FE Analytics to 5 October 2020. Numbers are in green where they are ahead of the benchmark shown equities and drop less in a downturn. Chart four shows our portfolio (red) compared to the FTSE All-Share (blue) over the past 12 months, and we can see that this did turn out to be the case. The portfolio subsequently recovered much of its lost ground whilst the index did not.

That said, some of the funds fell further than we had expected and were slower to recover. However, the recovery has continued through the summer even as stock markets have dipped back. Infrastructure in particular remains an asset class which we think has a very solid long-term trend.

Chart four: Alternative Equity vs FTSE All-Share

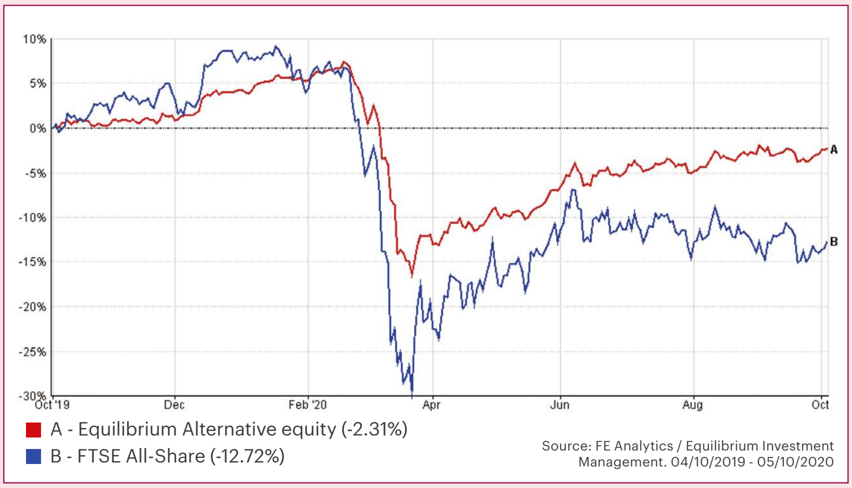


Chart five: Fixed interest vs benchmarks

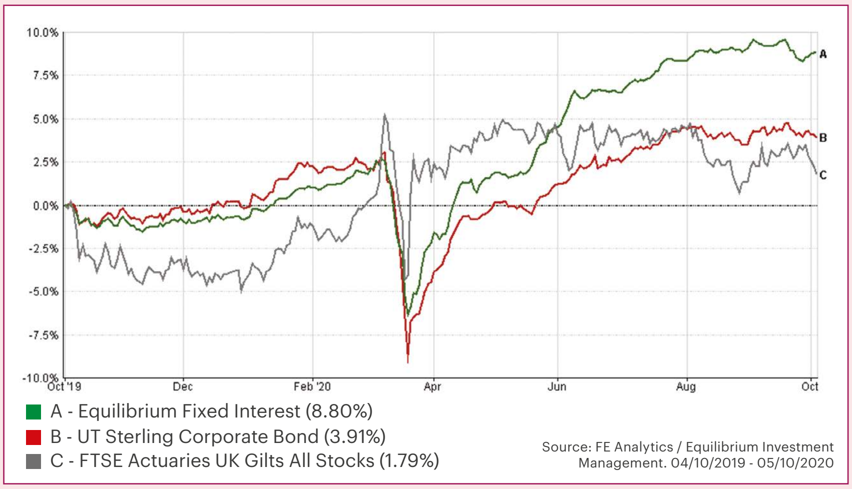
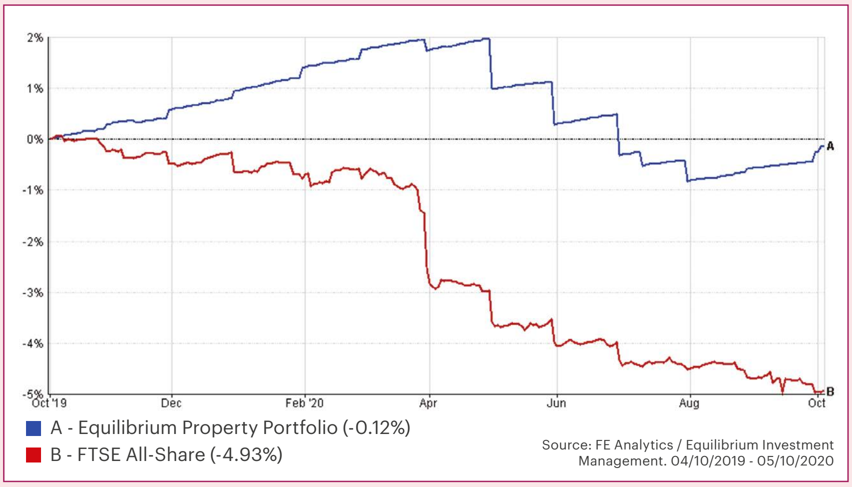


Chart six: Property vs FTSE All-Share



Fixed interest

As mentioned on page 33, our fixed interest portfolio has done well, in part because of the way we sold to cash and then bought back in.

Chart five shows our portfolio in green over 12 months compared to the average corporate bond fund in red, and UK gilts in grey. By selling and buying when we did, as well as switching between corporate and government bonds to an extent, we have ended up with a very pleasing return of 8.8%, more than double the average corporate bond fund and four times the gilt return over this period.

Property

Many property funds have been struggling for the last year or two as the increase in online shopping hits shopping centres and the high street.

This has then been accelerated by the pandemic with similar trends hitting offices, as more people work from home.

We had only very little in property going into this crisis and in March we sold most of our exposure, retaining around 1% to 1.5% depending on the fund.

The only fund we still hold invests largely in defensive assets like supermarkets on very long leases, and so it has held up much better than most property funds. Chart six shows our property portfolio in blue vs our benchmark in red. Under the circumstances, a return of essentially zero over a year is a reasonable result, given the almost 5% drop in the average fund.

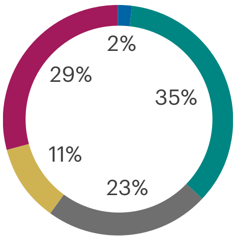
The asset class will remain structurally challenged by these economic shifts for some time in our view. In addition, most property funds, including the one we hold, are currently suspended, meaning investors can't take their money out. This is because valuers are having difficulty knowing exactly what the assets are worth.

The sector has come under FCA scrutiny and we think the regulator may require changes to the fund structures, with either less frequent dealing and/or notice periods. We are therefore unlikely to hold more than low single digit exposure to the asset class in future.

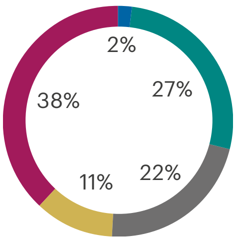
Model portfolio returns

Below is the performance of our Cautious Portfolio, Balanced Portfolio and Adventurous Portfolio.

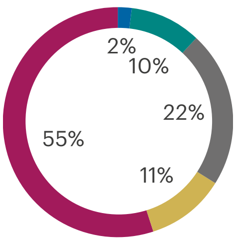
Strategic asset allocation



Cautious Portfolio	**6 months %**	**1 year %**	**3 years %**	**5 years %**	**Since launch* %**
Cautious Portfolio	13.35	0.28	3.87	19.99	81.60
Mixed Asset 20-60% Shares Sector	12.67	-0.10	4.74	24.15	59.53



Balanced Portfolio	**6 months %**	**1 year %**	**3 years %**	**5 years %**	**Since launch* %**
Balanced Portfolio	15.33	0.27	4.23	23.41	87.57
Mixed Asset 20-60% Shares Sector	12.67	-0.10	4.74	24.15	59.53



Adventurous Portfolio	**6 months %**	**1 year %**	**3 years %**	**5 years %**	**Since launch* %**
Adventurous Portfolio	20.01	1.77	6.49	34.00	99.52
Mixed Asset 20-60% Shares Sector	12.67	-0.10	4.74	24.15	59.53

Equity   Cash   Fixed interest   Property   Alternative Equity

We also show returns compared to the Asset Risk Consultants indices made up of other discretionary managers' portfolio returns. These are shown in the table below and are given to 1 October 2020 as ARC indices are published on a monthly basis:

Model Portfolio	**6 months %**	**1 year %**	**3 years %**	**5 years %**	**Since launch* %**
Cautious Portfolio	12.59	-1.23	4.33	21.60	81.27
ARC Sterling Cautious PCI	6.86	0.76	5.52	16.27	47.19
Balanced Portfolio	14.29	-1.32	4.83	25.37	87.24
ARC Sterling Balanced PCI	10.29	-0.33	6.42	24.20	59.16
Adventurous Portfolio	18.42	-0.39	7.25	36.54	99.18
ARC Sterling Balanced PCI	10.29	-0.33	6.42	24.20	59.16

* Launch date 1 January 2008. All data to 5 October 2020.
Figures are highlighted in green where they are in excess of the relevant sector.

Sector portfolio returns

Equity Portfolios	6 months %	1 year %	3 years %	5 years %	Since launch* %
UK Conservative Equity	16.32	-7.85	-7.52	11.78	73.36
UT UK Equity Income Sector	13.65	-13.13	-14.38	2.96	52.16
UK Dynamic	27.13	-3.19	2.72	37.10	127.59
UT UK Equity All Companies Sector	19.00	-8.75	-7.85	14.66	64.58
Equilibrium AIM	20.36	1.52	-4.93	57.57	282.65
FTSE AIM All-Share ***	48.24	13.79	-0.97	41.81	7.85
Global Established	33.87	16.90	31.71	101.44	219.90
Global Established Benchmark **	29.05	9.44	23.94	82.62	182.17
Global Speculative	12.42	6.28	70.12	84.28	86.58
UT Global Emerging Mkts Sector	9.88	1.68	52.42	51.86	63.61
Balanced Equity Mix	29.04	6.97	13.50	59.69	131.88
Balanced Equity Benchmark ****	23.57	-0.18	5.61	43.25	103.01
Adventurous Equity Mix	32.05	10.31	18.35	71.90	142.60
Adventurous Equity Benchmark ****	24.86	1.45	7.88	50.40	106.20
Alternative Equity	12.43	-2.31	-1.95	9.82	73.97
UT Mixed Asset 20-60% Shares	12.67	-0.10	4.74	24.15	59.53
Fixed Interest Portfolio	10.98	8.81	20.30	36.09	107.03
UT Sterling Corp Bond Sector	7.79	3.91	13.37	27.89	82.28
Property Portfolio	-1.87	-0.12	5.48	18.70	74.61
Composite Property Benchmark *****	-2.07	-4.93	0.59	3.57	55.16

* Launch date 1 January 2008 except Property Portfolio 1 July 2009.
** Global Established Benchmark is 40% UT North America, 40% UT Europe Ex UK, 20% Japan.
*** Performance data prior to 17 March 2015 (launch date) is calculated using the backtested model portfolio.
**** Cautious, Balanced and Adventurous Equity benchmarks are an appropriate composite of the benchmark for each component of that equity mix.
***** Composite Property Benchmark is an equal weighting of all eligible funds in the UT Property Sector. Property portfolio switched to cash 15 June 2012 to 11 April 2013 as we did not hold property funds in this period.

Figures are highlighted in green where they are in excess of the relevant benchmark.

Market returns

Equity Markets	6 months %	1 year %	3 years %	5 years %
FTSE 100 Index (UK)	11.59	-14.09	-10.70	15.22
FTSE 250 Index (UK Mid Cap)	25.96	-7.87	-5.46	17.28
FTSE All Share Index (UK)	14.21	-12.72	-9.61	16.04
MSCI Europe Ex UK Index	25.53	3.09	6.19	53.10
S&P 500 Index (USA)	30.20	10.86	40.89	115.33
Topix (Japan)	20.87	1.83	11.55	63.99
MSCI Emerging Markets Index	25.76	6.11	7.64	74.79
Fixed Interest				
IBOXX Sterling Corporate Bond Index	8.85	4.10	15.57	34.27
UT Sterling Corporate Bond Sector	7.79	3.91	13.37	27.89
UT Sterling High Yield Sector	15.97	1.82	7.20	25.43
FTSE British Government Allstocks (Gilt) Index	-0.36	1.79	17.30	27.17
UT Gilt Sector	0.36	2.57	17.92	28.15
Property				
Composite Property Benchmark*	-2.07	-4.93	0.59	3.57
Other Measures				
Bank of England Base Rate	0.05	0.38	1.66	2.39
UK Consumer Prices Index	0.00	0.09	4.32	8.38

* Property benchmark is a composite of all eligible funds in the UT Property sector.

Risk warnings and notes

Past performance is never a guide to future performance. Investments will fall as well as rise.

Any performance targets shown are what we believe are realistic long-term returns. They are never guaranteed.

None of the information in this document constitutes a recommendation. Please contact your adviser before taking any action.

Unless stated otherwise:

- All performance statistics are from Financial Express Analytics on a bid-bid basis with income reinvested.
- All performance data is to 5 October 2020.
- Model portfolio performance is stated after a 0.75% financial planning fee, 0.25% investment management fee and platform cost of 0.2% per annum.
- Your own performance may vary from the model due to dividend pay dates, transaction dates, contributions and withdrawals.
- Actual performance may also differ slightly due to constraints over how we can reflect fees and discounts from fund managers. These are assumed not to change over the whole investment period. In reality, discount levels change as we change the funds in which we invest.
- Individual sector portfolios are shown with no charges taken off or fund manager discounts applied.

For details of your own portfolio performance, please refer to your half-yearly statement from the wrap platform in which you are invested. We will also provide personalised performance information at your regular reviews.

Ideal funds

Portfolio	Fund name	Initial charge %	Annual management charge %	Ongoing charges figure %
Short Dated Fixed Interest	Royal London Short Duration High Yield	0.00	0.50	0.63
Fixed Interest	Allianz Strategic Bond	0.00	0.60	0.79
	Nomura Global Dynamic Bond	0.00	0.60	0.75
	Jupiter Strategic Bond	0.00	0.50	0.73
	Royal London Extra Yield Bond	0.00	0.75	0.83
	TwentyFour Dynamic Bond	0.00	0.75	0.80
	Muzinich Asia Credit Opportunities	0.00	0.65	0.86
	GAM Credit Opportunities	0.00	1.00	1.14
	Waverton Sterling Bond	0.00	0.40	0.54
Property	Time Commercial Long Income	0.00	0.98	1.29
Alternative Equity	Lazard Global Listed Infrastructure	0.00	0.85	1.03
	Carmignac Long Short European Equity	0.00	0.85	1.22
	Foresight UK Infrastructure Income	0.00	0.65	0.65
	Foresight Global Real Infrastructure	0.00	0.85	0.85
	Blackrock European Absolute Alpha	0.00	0.75	0.92
Defined Returns	Direct defined returns	0.15	-	-
	Atlantic House Defined Returns	0.00	0.55	0.78
UK Conservative Equity	Royal London UK Equity Income	0.00	0.62	0.68
	Miton UK Multi Cap Income	0.00	0.75	0.82
UK Dynamic Equity	Lindsell Train UK Equity	0.00	0.65	0.75
	Miton UK Value Opportunities	0.00	0.75	0.83
	Polar Capital UK Value Opportunities	0.00	0.75	0.86
	Chelverton UK Growth	0.00	0.75	0.87
	Liontrust Special Situations	0.00	0.75	0.84
Global Established Equity	Baillie Gifford Japanese Co.	0.00	0.60	0.63
	BlackRock European Dynamic	0.00	0.75	0.92
	Lindsell Train Japanese Equity	0.00	0.65	0.85
	Miton European Opportunities	0.00	0.50	0.66
	Vanguard US Equity Index	0.00	0.10	0.10
	Baillie Gifford American	0.00	0.50	0.52
	Morgan Stanley Global Brands	0.00	0.75	0.90
Global Speculative Equity	Invesco China	0.00	0.94	0.94
	Schroder Asian Alpha	0.00	0.75	0.96
	Goldman Sachs India	0.00	0.85	0.99
	Hermes GEM SMID	0.00	0.45	0.77
	Baillie Gifford EM Leading Companies	0.00	0.72	0.77

These are the funds in our standard portfolios at 5 October 2020. These will change periodically and have not all been held throughout the period covered by this document.

Have you felt reassured?

"As is the case for everyone, 2020 has been a very difficult year for me and my family, but I am very grateful that the one thing I haven't had to worry about was my financial situation - partly because I am very lucky to have a good pension but also because the team at Equilibrium have kept me informed and steered me through these turbulent times. It was good to receive regular updates and know everyone was still working on our behalf - thank you."

Dr. Rylands

"This week marks the 10th anniversary of my first visit to Equilibrium! I just wanted to thank you for everything you have done for us since then. Quite apart from the financial side, the amount of time and stress you have saved me personally over the years is immense. Anyway, heartfelt thanks once again."

Anon

"Personal and always accessible service from Andrew and Richard is very reassuring in these times. Management of our finances is specific to our situations and therefore inspires our confidence. Thank you so much."

Mrs. Caldwell

If you would like to find out how our financial planners can provide you with peace of mind, get in touch today.

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