Future Directions Newsletter 6

– May 2020

Welcome to our May newsletter.

As before, we have put together a few articles that we hope you may find useful.

We hope that have been managing well in 2020 with all its challenges.

From all at Future Directions

Article: Taking the long term view – and looking back

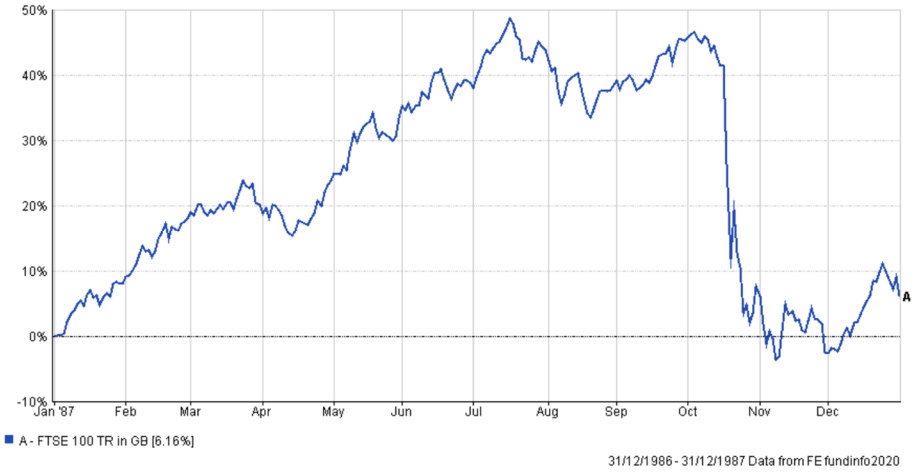
At the end of February and through March Investors the developing situation with Covid-19 throughout the world had an impact on world markets

On various days, several world market indices suffered their worst drops since 1987, the infamous Black Monday of October of that year.

When we are in the middle of the storm, it is often hard to widen the scope of our perspective, especially as the news will invariably be focussing on the dramatic and the negative. As an investor, the focus should not be on a few weeks, a few months, not even a few years. But rather, the focus should be on the long term.

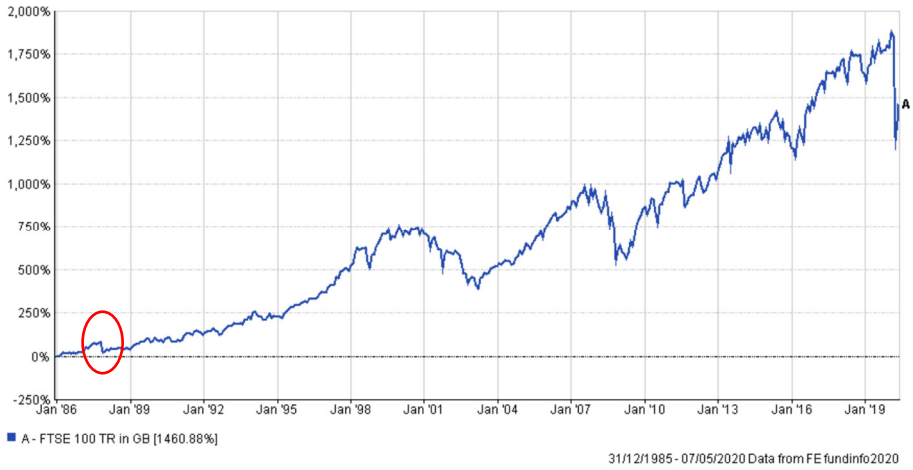
There is a great quote by Alan Abelson, a former editor of Barron's magazine, regarding listening to market news frequently, he said, *"Do you know what investing for the long run, but listening to market news every day is like? It's like a man walking up a big hill with a yo-yo and keeping his eyes fixed on the yo-yo instead of the hill."*

Let's have a look at the example of 1987 and the FTSE 100 index …



… you can see why the headlines at the time were focussing on the size of the fall – it was big when it happened.

However if we zoom out and look at 1987 from a long term perspective – it is hardly a blip:



During recent, the word 'unprecedented' has justifiably been used over and over again to describe the current global situation, and we are certainly not nearing the end of this crisis; no one knows how long it will last.

Large global market falls are always triggered by something 'unprecedented' it is the very uncertainty of an unprecedented situation that causes the short term market upsets. The historic falls such as in 1987, 2001, or 2008, or 1929 for that matter, were all triggered by different events and today's situation is, once again, caused by something not previously experienced – which can lead to us watching the news constantly to hope to get some handle on the situation, in a world that has had no recent experience.

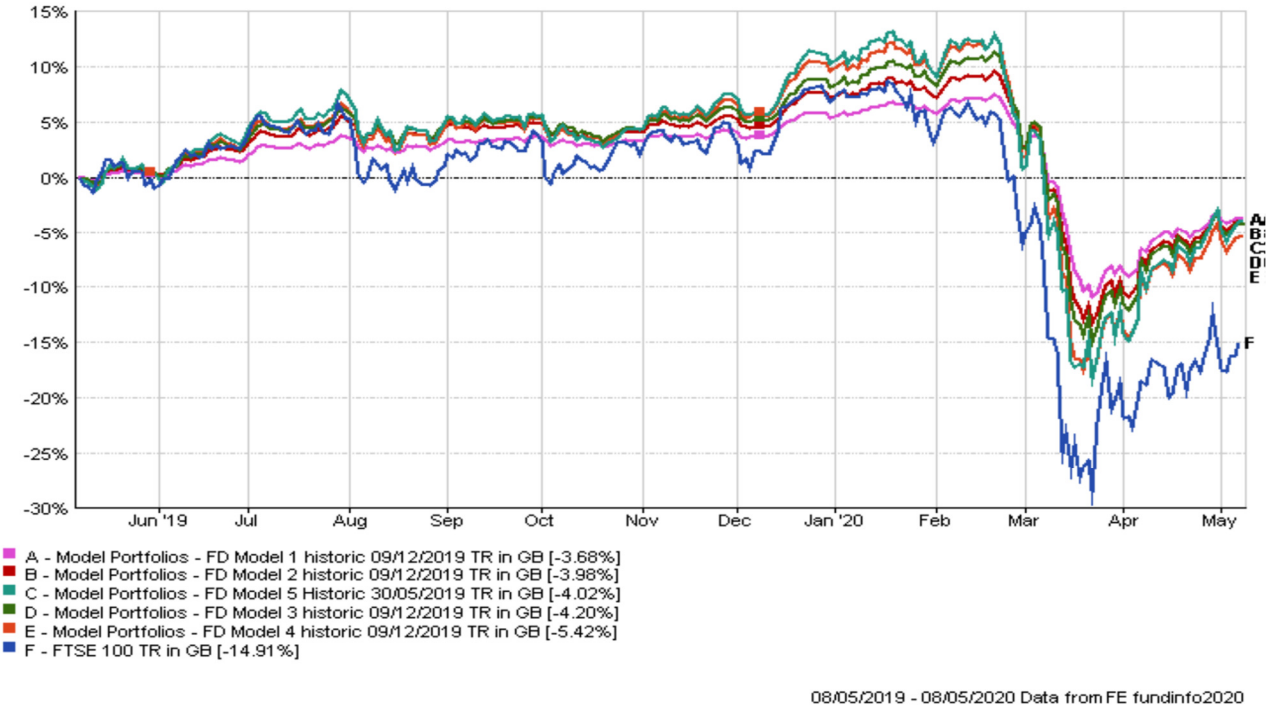
This is where it is a good idea to remember Alan Abelson's wise counsel; that is, don't look down at the yo-yo, but focus your investment eyes on the top of the hill.

We have already seen some level of market recovery, since the largest falls in late February through to March. We are clearly still in the middle of the world dealing with the pandemic and the short term is very much an unknown, (mind you, the short term is always an unknown – it's just that we don't tend to worry about it when things look fine).

Another factor of the news is that is often forgotten is that much is made of the main indices, such as the FTSE 100, as they are well known and easy to follow. However, most people do not have their investments sitting in a direct FTSE 100 tracker – as this is a fairly risky strategy.

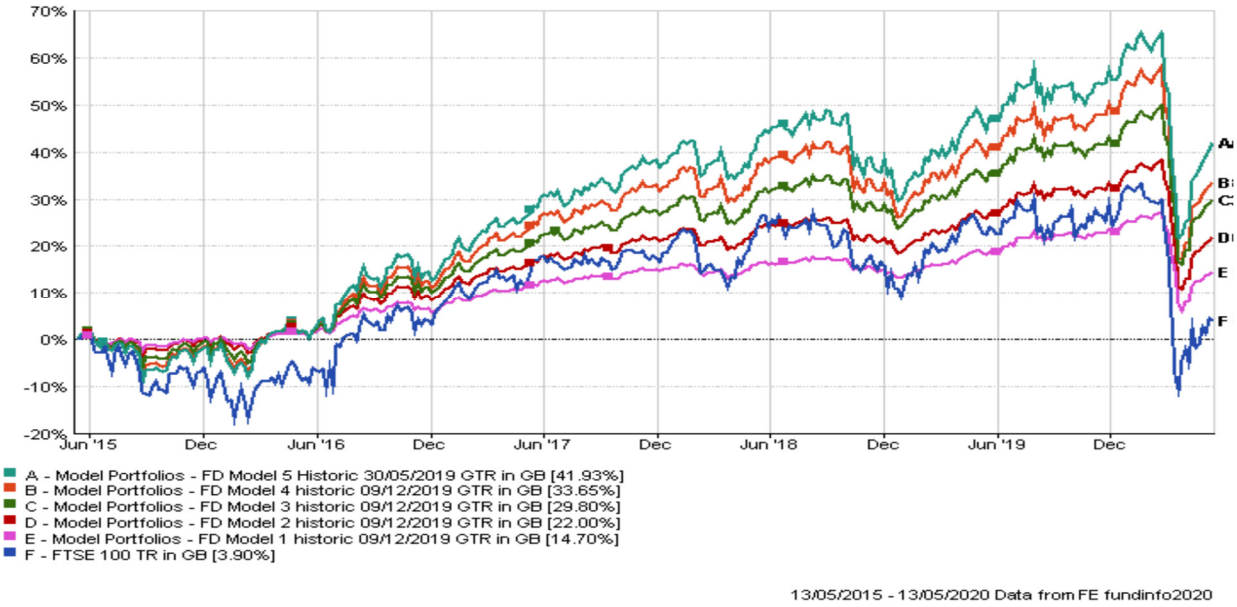
By investing in a wide portfolio of funds across a range of asset classes, (equities, property, corporate bonds etc), across a wide geographical area risk in a mix that is appropriate to your general risk profile and personal objectives, you can minimise a lot of your risk.

The graph on the next page shows the 1 year picture of 5 risk rated portfolios (1 being very low risk and 5 being very high). As you can see, the highest risk portfolio has had the highest short term falls while the lowest risk portfolio has had the least short term volatility, although it has still been affected by short term falls. The main point to highlight is that all the risk rated portfolios have held out better in this short term market volatility than the FTSE 100.



Please note - past performance is no guarantee of future performance. These are examples only and are not a direct reflection of your own investments.

I have also included below a 5 year graph, to give a more medium term picture of the same portfolios vs the FTSE 100:



So remember, headlines focussing on market indices won't reflect the real picture of a well balanced portfolio.

As well as this, an important thing to remember is the reason people invest in the first place. People take investment 'risk' as the expectation for return over the medium to long term is much higher than in short term cash savings. Cash savings struggle to keep pace with inflation and therefore generally lose real value over time. Recent interest rate drops from the Bank of England will have reduced even further the returns from cash savings, making this even more of an issue. What, therefore, are the alternatives ?

History tells us that once an ‘unprecedented’ situation becomes more known and less newsworthy, investors look again at where their money is held and cash starts to look increasingly less appealing. This then brings a movement back into ‘risk’ assets, such as equities, which then starts the process of a market recovery.

This is not always a quick or straightforward process. There can be false starts and there are obvious reasons to think we may see further short term market falls if measures governments are taking across the world to stem the epidemics aren’t as effective in the short term as hoped – so going back to the yo-yo metaphor, fixing our eyes on the short term won’t help a good night’s sleep.

Lastly, remember that having short term cash to fall back on, in such times, is always an important part of any investment strategy – precisely so you can leave invested money to ride out volatile times. Invested money is designed to expect short term volatility. Cash is designed to give short term liquidity. Using both in your overall planning allows you to know you have your short term needs met while your long term money can be left to ride the storm.

Storms always pass – the weather, seasons and, indeed, life is a cycle …. and so are markets.

Article: Gifting your tax

Inheritance tax (IHT) allowances have failed to keep pace with house prices and many more people now have to consider the IHT burden they leave to their beneficiaries. In the current tax year of 2020/21, your individual IHT allowance stands at £325,000 (£650,000 for married couples and civil partners), with an additional “main residence nil-rate band” of £175,000 per eligible person. This means that parents or grandparents can leave a property worth up to £1,000,000 to their direct descendants before IHT kicks in. Despite all the urban myths, the one thing you definitely cannot do is simply to sign your house over to your descendants whilst continuing to live in it and expect this to save you any IHT. This is called a 'gift with reservation' and is ultimately inefficient for tax-planning purposes as the house will continue to form part of your estate. The only way to get around this is to pay the beneficiaries a market rent; however, this is unlikely to be a popular option for those who have paid off their mortgage in order to enjoy a comfortable retirement. Your beneficiaries will also have to pay income tax on the rental income; moreover, it leaves you vulnerable to the possibility that the house might have to be sold from under you if your beneficiaries find themselves in financial trouble. So what options do you have? You could sell, move out and rent, or buy somewhere smaller and gift the balance of your gain to your beneficiaries. This is called a potentially-exempt transfer (PET) and becomes IHT-free as long as you survive seven years. If you have a big enough house, you could arrange joint ownership and live together in the house. That proportion of the house then becomes a PET and again, is IHT-free as long as you survive for seven years. For larger estates, there are more complex schemes to consider; however, these schemes need to be constructed with the help of a financial adviser to ensure not only that they meet the regulations, but also that an equitable deal is reached. There are no easy ways to avoid IHT if a lot of your equity is tied up in your main house. However, you can at least make the most of all the other allowances available to ensure that you manage the tax liabilities, whilst also keeping a roof over your head.

The Financial Conduct Authority does not regulate Tax and Estate Planning.

Article: Cash ISAs : don’t lose out to inflation

Low interest rates might be great news for borrowers but they can have a devastating effect on the long-term wealth of savers. Furthermore, when inflation runs in excess of interest rates, the buying power of your money will be eroded, even though the value of your capital might appear safe. Therefore, you need to keep a close eye on the amount of interest you are making on your hard-earned cash. Nowhere is this more apparent than with cash Individual Savings Accounts (ISAs). Although interest rates on cash savings are generally low, there are numerous long-term fixed-rate cash ISAs that offer relatively attractive interest rates, so it’s worth shopping around to find the best deal. It is good practice to retain some cash in an easy-access deposit account to ensure you can cover unforeseen emergencies and short-term necessities, but there is no reason to tie up all your cash holdings in this type of account. Many ISA investors aim to leave their ISAs untouched for as long as possible in order to make the most of the benefits, and interest rates can be significantly higher for those who are willing to sacrifice some flexibility.

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