
The Wire 1 April 2017

# The Future of Advice

### By Marcus Carlton

A letter has flooded in, as they say.

Mrs Trellis from North Wales writes:

"I have been much intrigued to read reports in the financial press about something called 'Robo advice' - which really does seem to be all the rage in the United States.

"As HFM Columbus always seem to me to be at the cutting edge of financial planning, I am wondering when I can expect to be serviced by one of your Robo advisers?"

Well on the money as ever Mrs Trellis and yes you can relax secure in the knowledge that the HFM Columbus IT team of young Millennials have not been lying around the basement sniffing copydex (or whatever it is that they are on these days).

No, they are currently deep in the Beta stage of testing with the first of three new Boston Dynamics Titanium Atlas model Anthropomorphic Robo advisers. (You try saying that after a heavy client lunch and two bottles of Gevrey Chambertin).

We are planning for these to come fully online sometime during Q3 2017 just as soon as we can iron out the usual teething problems associated with any new technology.

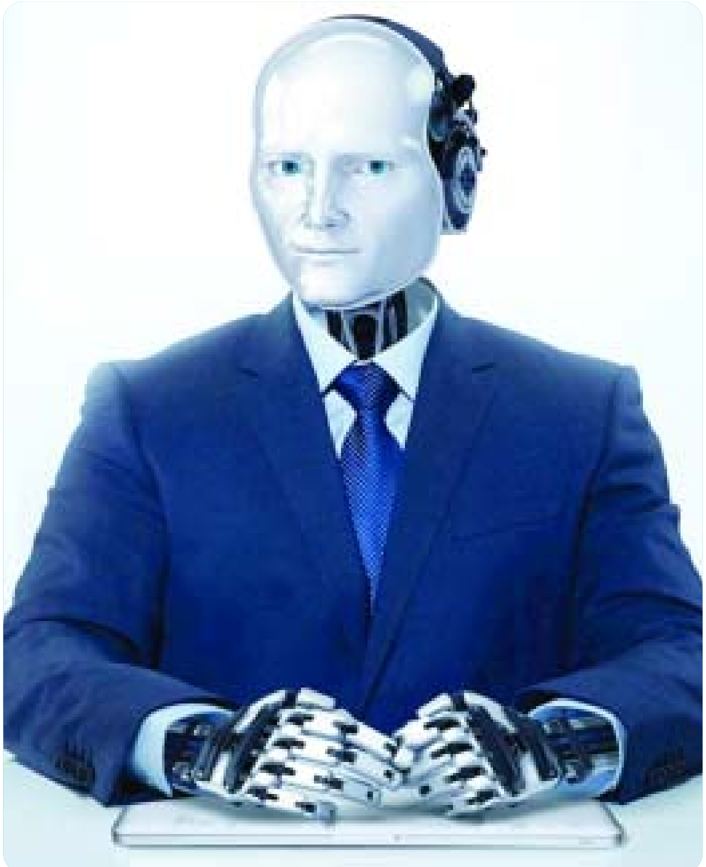
Once we are online with the new service our valued clients can expect to be able to interact with their Robo adviser 24/7, 365 days a year.

In exchange for simple data entry on a 16 page input sheet, the Robo adviser will deliver a 1500 page report so comprehensive that earlier versions are already being incorporated into the Brexit pathway document and can, we are told, cover every possible permutation of an investor's planning needs over the next 75 years.

Reports will be generated within 32 seconds and are configured to be not only i-Watch compatible but also with most other hand-held, desktop and popular gaming devices.

Furthermore the associated planning and implementation software can be linked directly to your primary banking arrangements. In this way clients will be allocated the correct amount of spending money deemed suitable by the Robo adviser while the balance is immediately deployed in the most suitable and tax efficient allocation in keeping with the Robo adviser's prime directives.

In this way clients can relax secure in the knowledge that no longer will they be tempted by frivolous spending, un-accounted for meals out, or flowers for their loved ones outside of pre-determined events.



The service will be all-encompassing, delivering half hourly prompts direct to your chosen device, keeping you constantly updated on progress and news from the markets. You need never miss an urgent Budget announcement or pension rule change ever again.

Naturally there will be a few die-hard technophobe clients out there – but don't worry, we won't be ignoring you.

Our plans do allow for a focused team of professional advisers to continue delivering the old analogue style of advice and service. They will be there for you to guide you and your loved ones through the complex choices and options. We do recognise that some of you prefer to spend your time with family or concentrating on your business rather than being plugged directly into the world of finance.

Meanwhile our AI technicians report an early teething bug with the Robo adviser's Bluetooth. Apparently it is directing the office Nespresso machine to deliver shots of WD40 rather than espresso.

# Thoughts from Hotel California - and not an Eagle in Sight

## By David Andrews

IT so happens that I am penning this from the balcony of a small hotel in a place called Hermosa Beach, which is located on the Southern California coast, a dozen or so miles north of Santa Monica.

California is an unashamedly unconventional place. Attitudes are predominantly liberal and you see a pretty eclectic mix of people here. Most lifestyles are represented and largely speaking they all seem to rub along. None of the locals, for example, batted an eyelid yesterday at the bearded transvestite who was casually walking along the beach.

Which provides an interesting backdrop for a brief look at how the evolution away from the nuclear family which is happening in the UK - albeit perhaps a little more slowly than in LA - is impacted by and having an impact on pensions, which were of course designed in more conservative times.

I could spend the next few paragraphs discussing the pros and cons of gender inequality in pension provision and argue about glass ceilings or whether, for example, a woman choosing to take a career break or work part time to bring up children justifies her having a smaller retirement income than a man who doesn't.

Fortunately that topic is well debated elsewhere and so I will not have to pick my way through the minefield that is 21st century gender politics. Suffice to say, for the purpose of this short piece, that inequality does exist, not only between between men and women in general, but also between specific individuals in most relationships, which means that for many families, whatever their structure, benefits paid from pensions after the original member has died are very important.

For those whose pension entitlements have accrued within personal pensions, the world of death benefits is pretty straightforward. The residual fund is available, subject to the Trustee's discretion and in some cases, some tax deduction, to whoever the member nominates. However, for those in defined benefit, occupational schemes, the position is a lot less clear. Legislation provides some basic rules but much is down to how individual schemes have been drafted. So if you are a member of one of these schemes who is keen to ensure his or her loved ones are provided for or if you are someone whose partner is a member and you are expecting to be provided for, here is some food for thought which might lead you to ask some searching questions of your pension trustees. Pick a category and read on:

### Married Couples

For married couples, the vast majority of schemes provide a proportion of the entitlement of the deceased member to his or her spouse for the rest of their lifetime. According to a recent House of Commons Library briefing paper, in 2015, 93% of schemes provided this by right, 6% at the Trustees' discretion and 1% provided no spouse's pension.

However, some schemes (precisely how many is not disclosed in the briefing paper) will pay such benefits only where the couple concerned were married whilst the individual was an "active" member of the scheme and not to a spouse who became married to the member after he or she left the associated employment. Those of you with deferred benefits in a previous employer's scheme and have entered into marriage since should check this point carefully.

## Cohabitees

In February 2017, The Supreme Court judged that cohabitees should be afforded the same rights as married couples and so ostensibly, the same observations I've made in relation to married couples should apply here.

That said, whereas it is simple to determine whether or not someone is married, it is more difficult to determine the point at which a relatively casual relationship qualifies as cohabiting. There may be more legal cases which need to be brought before the Courts to test the definition.

## Same Sex Partners

Those who are in a civil partnership are afforded similar rights to married couples, though it is important to know that these rights only apply to pensionable service accruing since 5th December 2005, which is the date upon which the Civil Partnership Act 2004 came into force. Beneficiaries could therefore find that their entitlement is restricted to a much smaller pension in practice than is implied by the current scheme rules.

Of course, this situation may be improved by the Supreme Court judgment mentioned above, relating to cohabiting couples but this may require further clarification in the Courts.

## Single With Children

When it comes to those families where there is a lone parent, the majority of schemes (91%) will provide a pension to a dependent child in the event of his or her parent's death. However, only 72% of schemes offer this by right with a further 19% offering it at the Trustees' discretion, so not as many as will provide spouse's pensions.

However, where the children are no longer dependent, only 2% offer a residual pension by right, with a further 83% offering it at the Trustees' discretion and 15% not offering it at all.

So, what can we conclude from all of this? Well, while the UK pensions world may not look or feel as ambivalent to different lifestyles and family structures as the beaches of Southern California, it certainly seems to be, albeit relatively slowly, moving into the 21st Century. However, much still depends upon scheme rules and/or trustees' discretion. Where there is any doubt as to how a scheme might treat your individual situation, it's worth asking the Trustees to clarify their position. If that reveals a shortfall in your retirement provision, fear not. We have solutions which can address the issue.

# A change is gonna come

## (with apologies to Bob Dylan...)

### By Gary Festa

IT is becoming harder and harder to make a crust from the once can't fail buy-to-let investment strategy.

In past issues of The Wire we have highlighted various changes to the stamp duty rules on second homes and buy-to-let investments. There is now a 3pc tax on the purchase price of homes worth up to £125,000, 5pc tax (instead of the previous 2pc) on homes that cost between £125,001 and £250,000, and a staggering 8pc (which used to be 5pc) on homes worth between £250,001 and £925,000. Owners at this end of the market, and particularly in the £2 million and up home bracket – of which there is no shortage in the more prosperous areas of London, the Home Counties and south east and west – are feeling the pinch when trying to sell.

The combination of the unknowns which lie ahead in the wake of the Brexit vote, and the fact that the market has become broadly over-valued in recent years due in large part to overseas buyers inflating prices, is further muddying the waters.

And, for any clients still thinking about trying to secure more income from a buy-to-let portfolio, there is more pain to come. It's three years off yet, but from 2020, landlords who have taken out loans to help purchase their investment properties will no longer be able to deduct the cost of their mortgage interest from their rental income when they calculate the tax due. So tax will be paid on turnover rather than profit, meaning that tax could be due on non-existent income.

That could mean that for higher-rate taxpayers – basically most HFM Columbus clients - mortgage costs above 75pc of rental income will make their buy-to-let portfolio loss-making. And that is a worry, when you factor in mortgage interest relief will be restricted to 20pc, so higher and additional-rate taxpayers will be particularly affected.

So our advice here at HFM Columbus is to think long and hard about getting into buy-to-let at this particular juncture. It was without doubt once a copper-bottomed alternative investment route. But like Brazilian football, the rules are changing very quickly indeed and the future for buy-to-let, for those who did not get in on the act at the outset, is now not so rosy.

# Death and taxes…. and more taxes

## By David Andrews

Between you and me, I have a feeling that I might have been onto something in the last edition of "The Wire". Sadly, there appears to be no evidence that this is because my scribblings have become more engaging or that my attempts at injecting a little humour into some dry topics have improved. Rather, it seems that the thought of having a large chunk of the family's estate eroded by 40% after a lifetime of hard work is about as appealing as root canal surgery. It's not hard to see why. I'm betting that you didn't ask the HM Local Inspector of Taxes to join that photograph of the children you have on the mantelpiece. Yet, if your estate is to be distributed to two or more children when you're gone, he ends up as the biggest beneficiary of all.

The people who've been in touch about this don't have a problem with paying tax per se. They understand the principle of being taxed for earning a decent income, for making financial gains, for unhealthy habits and even for warming up the planet. But then to be taxed all over again for just for being dead strikes them as being a little harsh.

Unpalatable though it undoubtedly is to many people, there is much that can be done to reduce the impact of inheritance tax. Because it primarily applies on death, wealth which is genuinely given away during one's lifetime is, subject to some limitations, outside its scope. This is very good news for those with substantial amounts of liquid capital available to be given away during their lifetimes. With some careful planning undertaken early, it becomes, at least to some extent, voluntary.

However, what about those whose wealth is largely tied up in the family home or other illiquid assets which cannot easily be genuinely given away to offspring? Where substantial gifts of capital aren't practical, you're probably wondering what can be done to limit HMRC dipping its shovel into the family's stores. If so, don't despair. Here are some ideas:

### 1) Don't make the problem worse than it already is

Unnecessarily bringing wealth into the inheritance tax net sounds a pretty obvious thing to avoid and that's because it is. However, many people do just that when they nominate their spouses to receive large lump sum death benefits from pension schemes.

Of course, it's somewhere between desirable and absolutely necessary in most cases for one's widow(er) to have access to the pension fund, but that's no excuse for bringing exempt capital into HMRC's net. By nominating a family trust as the beneficiary instead (from where the surviving spouse can draw whatever income he or she needs) it never enters the family's estate and so remains exempt from inheritance tax.

Furthermore, if the surviving spouse draws the income he or she requires in the form of loans, repayable on his or her subsequent demise, the taxable part of the family's estate ends up in debt to the tax efficient trust, making things even more efficient for the children when they inherit both.

### 2) Small gifts from surplus income can make a big difference

Many people are unaware that gifts which form part of an individual's normal expenditure pattern and do not impact on his or her standard of living are generally exempt.

Grandparents reducing the value of their taxable estate by paying school fees for their grandchildren is a good example of this working in practice. I can assure you that school fees are eye-wateringly expensive these days and so an effective reduction of almost a third of their cost can have a big effect on the family's wealth.


Equally interesting are pension contributions for children or grandchildren. Even babies can have personal pensions set up for them with modest contributions of £2,880 each year. They create real long term value for the child, which cannot be squandered away by little Jonny when he reaches 18. Really interesting though, is the fact that not only should the contributions be an effective shelter against inheritance tax, they will also attract a basic rate Income Tax credit, even though the child is unlikely to be a taxpayer. This means that the real cost to the family's estate of a gross pension contribution of £100 is in fact £48, so it's a super-efficient way of passing wealth down the generations over time.

### 3) The underrated role of life assurance

Life assurance is often used in estate planning and is usually seen as a way of facilitating the payment of the inheritance tax bill rather than mitigating the tax itself. However, in practice, paying the tax can cost substantially less if the right type of policy is used.

Modern whole life assurance policies can be written on the basis that they only pay out on death and have no early surrender or "cash in" value. When calculating the premiums for these policies, actuaries make an assumption for the positive impact on the insurance pool of the fact that some people will terminate their policies early. The effect of this is greater than you might think. The following table illustrates this, using current premium rates for a healthy 50 year old woman, whose estate has a potential inheritance tax liability of £1,000,000:

| Effective Cost of Inheritance Tax | | |
|---|---|---|
| Age at death | …if not insured | …if insurance policy established at age 50 |
| 70 | £1,000,000 | £243,961 |
| 85 | £1,000,000 | £418,219 |
| 100 | £1,000,000 | £592,477 |

So, even if this lady lives to be 100 and so premiums are paid for fifty years, the cost of funding the tax bill is reduced by over £400,000.

It goes without saying that my usual health warning applies here, namely that this quick walk through what is a small selection of bright ideas may not be appropriate for everyone's circumstances. For the same reason that we need clever doctors rather than just pharmacies to make us feel better when we're under the weather, effective estate planning needs professional advice too. A chat with your HFM Columbus adviser is just the ticket.

# Bury My Heart at Wounded Knee

## By Marcus Carlton

It is August 1862. Chief Little Crow, leader of the Dakota Sioux tribe, had arrived at an impasse.

The US Government had failed to uphold its part of a treaty whereby Little Crow's tribe had retreated to a reservation, giving up their lands in exchange for what passed as an annuity back in 1862.

Compounding the stress on his community was the continual cheating by traders which led to the tribe starving, unrest and increasing tensions.

Little Crow tried to negotiate but was unable to stop 500 of his braves raiding a Dakota food warehouse.

Fortunately wiser heads prevailed and the agent in charge of the food depot was able to contain his men from a mass shooting and called instead for a council.

Little Crow argued that his men were owed the money to buy the food but the representative of the traders, Andrew Myrick, in a Marie Antoinette moment, suggested that if they were hungry then they could eat grass.

Bad move. Within days the Sioux were on the warpath up and down Minnesota and in one raid Myrick was killed, scalped and had his mouth stuffed with grass as revenge for his comments.

However it was in a later attack on a tiny settlement called Garden City where 8 year old Henry Wellcome witnessed this clash of cultures. Helping his uncle to treat citizens injured in the raid, the young Henry first acquired his interest in medicine.

Wellcome went on to study Pharmacy and develop an interest in marketing – then in its infancy - eventually becoming so successful that in 1910 he was invited to settle in the UK where his joint venture, Wellcome Burroughs, revolutionised the pharmaceutical business in Europe.

Henry never forgot his earlier experiences though, such that at his death in 1936 the majority of his fortune comprising his shareholdings in Wellcome Pharmaceuticals was delivered into a charitable trust.

Today that trust, with its HQ in London, is the largest of its kind after the Bill and Melinda Gates Foundation, with assets in excess of £20Bn

In establishing the trust Henry was not alone among his peers, and has been joined by names such as Lever Bros, Sainsburys, Rowntrees et al.

Trusts can be a means to engage younger family members and future generations or to preserve posterity and create a truly lasting legacy and resonate for decades to come. For the family considering their philanthropic aims and family mission they can be an important part of their legacy planning.

Trusts typically fall into four different categories: trusts for the relief of poverty, the promotion of education and religion tend to be the most prominent, while there is no shortage of trusts such as arts and animal welfare etc.

In the UK, substantial tax benefits arise allowing gains and income to accrue tax free within the trust. In addition, assets top heavy with gains can be transferred to such trusts without gains tax falling to the donor and allowing full value from the asset to accrue in the trust.

Gifts can also be offset against income tax potentially creating a double tax break.

However it is important to note that trusts are rigorously monitored by the Charities Commission to ensure that their aims remain strictly charitable and are not abused for self-interest.

For the family considering a charitable trust as part of their legacy planning it is important that they establish and maintain the trust correctly.

For this reason the services of legal specialists practiced in this avenue of law should be considered, and HFM Columbus can co-ordinate and assist with the establishment and ongoing management of your trust accordingly.

Today Henry Wellcome's legacy lives on, with millions of lives positively benefited by the research and medical breakthroughs curated by the trust.

In an interesting and related side note, two other Sioux leaders of the uprising were caught and later hanged for their part. Their bodies were eventually disinterred and one sold to a Doctor William Worrall Mayo who used the skeleton to educate his sons in osteology.

Just before the year 2000 the Mayo Clinic (now a major non-profit organisation spending over $660M a year on research) returned the skeleton to its tribe for reburial.

Sadly for Chief Little Crow, while the impact of his actions were lasting his personal legacy proved somewhat shorter lived. The chief was shot and killed while innocently collecting raspberries with his teenage son by settler Nathan Lamson - who received a $500 bounty.

# Style Wars

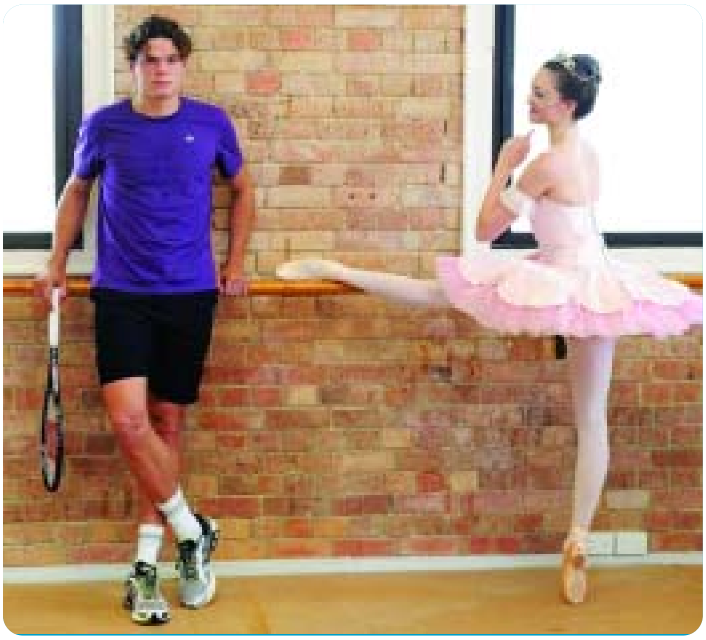
## By James Tuson

Many a fevered word has been written of late about the two key equity-style drivers 'growth' and 'value', but what does this actually mean? Where today's terminology is couched differently to suit newspaper hacks with their 'reflation-trade', 'Trump bump' or 'risk on'; stripped back to the bare wood, what re-emerges is the age-old clash between two schools of equity market investing that go back as far as markets themselves.

Value investing is buying companies that have fallen out of favour with the market and are considered cheap relative to their fundamental value, measured in terms of earnings, dividends, sales or net assets. These are the diamonds in the rough picks for stock investors which allow a purchase of a company's shares for less than its inherent worth. Whether through falling on tough times, at an industry or sector level, or through being 'economically cyclical' with a business model closely tied to the strength (or weakness) of the global economy. In recent times, the suspects here are the big energy and commodity companies (global growth, China slowdown) which make up a hefty part of the FTSE100 index along with the big banks and insurers (the hangover of the pre-2008 credit boom).

Growth investors buy companies whose earnings are expected to grow at an above average rate relative to the market. These stocks typically share a number of very desirable attributes – strong balance sheet, a consistent stream of predictable earnings over many years, competitive and defendable advantages within their industry, resilience to industry changes, strong free cash flows and a growing dividend stream.

Such stocks are often found in the consumer staples and healthcare sectors along with some technology behemoths and include the likes of Unilever, Diageo, Microsoft, Johnson and Johnson, Philip Morris and Coca-Cola. In the post-2008 world of deflation, low growth and low interest rates the growth stocks have hugely outperformed their value counterparts, earning the nicknames 'bond proxies' and 'expensive defensives' along the way. The tide though began to turn last year, partly on valuation (unloved value shares were becoming priced for bankruptcy, over owned growth stocks priced for perfection) and partly because markets sensed the beginning of a more positive global economic outlook.



Growth may have massively outperformed value over the last seven years but this may be an anomaly due to the very unusual macro circumstances and over the very long term value has been the predominant style. Deflationary forces remain strong so it's too heroic to call for a big style switch at this point.  We have increased the value tilt of portfolios over the last 18 months or so to be a more 'style neutral' and so we feel a bit ahead of the game. Buying value funds at the start of 2016 was more for an exercise in acknowledging the existence of mean-reversion in markets, rather than predicting major market shift. Everyone loved growth, everyone hated value, ergo we saw an opportunity.

I should raise a note of caution as inevitably the distinctions aren't as black and white as I have thus far implied and shades of grey exist between the text-book and the real world, as one investor's value stock may be considered a growth stock by another.

In our portfolio management here at HFM Columbus we always look to have a mixture of styles in our fund choices. Many funds will be GARP (growth at a reasonable price, so effectively style agnostic and looking for a blend of both growth and value characteristics). This is a difficult trick to pull off successfully but one that River and Mercantile UK Dynamic has managed over the last 5 years. Other funds are much more 'full on' in their style bias with the leading managers being Nick Train, Neil Woodford, Terry Smith in the growth camp and value being championed by Ben Whitmore at Jupiter and Kirrage and Murphy from Schroders.

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