half yearly investment magazine

Forgive Them For They Know Not What They Do

Wills

Why you need one in your life

Alternatives to Banks

equilibrium

October 2012

PLUS: Private Equity | In Profile: Dave Ferguson | Wine Feature | Justin Urquhart Stewart

Welcome

The economic climate during the last 6 months has certainly kept the Equilibrium team busy! Choosing which asset to invest in, which geographical area and when to invest has never been more challenging.

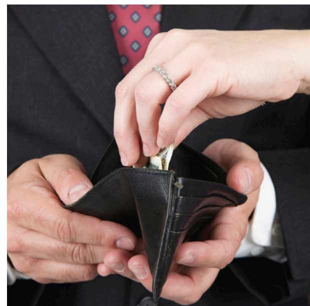
Despite the continued uncertainty we are optimistic about the future. Our balanced strategy (page 38) is up over 13% in the last year and we expect returns above our usual average annual assumptions to continue.

We are pleased with the performance that we have achieved and on pages 31-35, we explain the steps we have taken to maximise returns in these difficult markets.

However, if you are bored of hearing about investments, then turn straight to page 25 and pick your Christmas tipple! Mine's a red, with the Argentine Tiasta Reserve Cabernet Sauvignon hitting the spot!

We hope you enjoy this latest issue and if there is any topic you would like to see in the future editions, or any question you would like answering, then email me directly at colin@eqasset.co.uk.

Colin Lawson
Managing Partner



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Forgive Them For They Know Not What They Do

By Colin Lawson

It is my fundamental belief that the solutions implemented by central banks to solve economic problems often create the next crisis.

The more serious an illness is, the stronger the medicine used to remedy the situation but, potentially, the more significant the side effects are as a result. In much the same way, the bigger the economic crisis, the greater the solution used to fix the problem and then the larger the next crisis may be.

Let us test this theory by looking back in history before we consider what is happening today and what the future may hold.

On 31 December 1999, the FTSE 100 peaked at 7,000 shortly before the technology bubble burst. This was quickly followed by the 9/11 attacks and the Iraq war. In order to stave off a recession and avoid deflation, the Board of Governors of the Federal Reserve in Washington slashed interest rates from 7% to 2% in just over 12 months and then cut them again to a historic low of 1%.

When you apply such drastic measures in such a relatively short space of time, you are likely to encounter some unforeseen consequences. With interest rates so low, a mortgage boom was created and house prices soared as a result. Consumers went on a borrowing binge and a spending spree, the economy was indeed supported and, so, initially the medicine worked.

In fact, so great was the appetite for borrowing that banks simply did not have enough money to lend to meet requirements. The only way they could attempt to keep up with demand was to sell on loans they had already made to release cash and give them more capital. Collateralized debt was therefore born which, as a side effect, meant that these financial institutions could now mix in some toxic debt without anyone noticing.

Faced with this situation, the Fed had no choice but to raise rates and they did so rapidly, with rates increasing from 1% to 5% in 2 years. When you have borrowed more than you can afford in the first place and then someone increases your borrowing costs 5 fold, the consequences are inevitable.

People defaulted on their mortgages, house prices crashed and the credit crunch began. The subsequent collapse of the banking system brought us closer to the end of the traditional western economic system than I believe most people will ever realise.

As a result, the Fed was faced with the biggest economic illness that the world had seen in living memory. So they did what they always did and slashed rates to 0.5% and have continued to keep them unchanged for the longest period in history.

However, this was never going to be enough and Quantitative Easing (QE) was born. In the UK and the US, this has amounted so far to more than $3 trillion and the total stimulus is much greater on a worldwide scale.

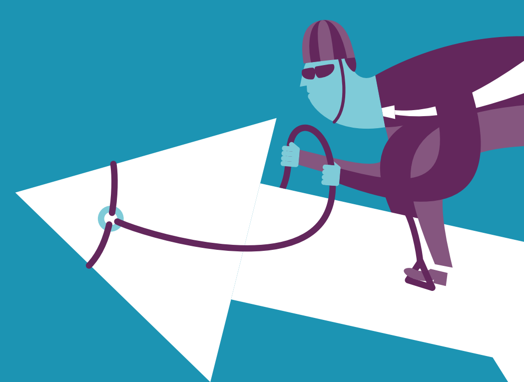
In September, QE3 was launched in the States. This time round, the rules have changed and there is now absolutely no limit either to the amount or time frame - just a firm statement that they will press on with a whopping $40bn per month "until it works". Wow!

This is, I believe, the greatest economic experiment ever undertaken. With this much medicine being administered, no one knows for sure what the consequences will be but rest assured there will be some and they will be significant.

QE has worked and, effectively, has 'done what it said on the tin'. Stock markets are up, Government borrowing costs are down and the world economy has been saved from the abyss.

However, at what price? What will be the side effects of such radical treatment? Despite not having a crystal ball, I believe I know what the next crisis will be! I believe that in a few short years from now, inflation will return and may even reach what for some people could be catastohropic levels.

It is widely accepted that printing money fuels inflation; however, it takes a few years for the full effect to work its way into the economy.



> "The subsequent collapse of the banking system brought us closer to the end of the traditional western economic system than I believe most people will ever realise.

Over the last 2 years, inflation has totalled 10% whereas wages (which usually rise faster) have only increased by 4%. That is effectively the equivalent of a pay cut of 6% for every single worker in the UK.

I believe that this has been tolerated up until now as this income squeeze has been offset by lower borrowing costs and, with the economy on a knife edge, people have been glad to have a job.

However, let me take you on a journey into the future and let's imagine that we can see forward to October 2014. At that point in time, we are likely to have enjoyed eight consecutive quarters of economic growth. Company profits and cash balances could be at record highs and the FTSE 100 may well have passed through the 7,000 barrier for the first time. Unemployment is likely to be significantly lower although, even now in 2012, we are seeing the numbers of those out of work starting to fall.

With the news flow switching from negative to positive and headlines being dominated by the above good reports, then workers may well begin to demand wage rises. Every business that I have spoken to recently, whether they be small or large, tell me that even with today's level of unemployment there is a shortage of skilled labour. Therefore, these wage demands may well be met in the future as firms attempt to secure and retain the best employees.

Historically, when wages have not kept pace with inflation and workers finally demand pay rises, then they make claims not just for the cost of living increase in the current year but also for the shortfall over the previous few years. On that basis, commanding 10% wage increases would be perfectly understandable and reasonable.

When you get a large pay rise, you go out shopping and buy all of the things you have been depriving yourself of. With the rising demand for goods and the rising wages to cope with, businesses start to put prices up and so the inflationary spiral begins.

On top of this, we have the 'emerging market effect'. During the last 20 years, we have imported "deflation" by importing cheap goods and services from the emerging world. With wages and costs rising significantly in these areas, this process is likely to reverse itself and, in addition, their demand for raw materials will add to costs worldwide.

Looking beyond October 2014, I think that inflation could easily reach 7% pa and may rise significantly higher. Once the inflation genie is out of the bottle, it is incredibly hard to put it back.

However, inflation itself could be the cure for many of the ills of the Western world. Inflation is good for government and household debt as it is deflated. Wage rises create a feel-good factor and the extra spending fuels the economy. With house prices remaining flat whilst wages are rising strongly, housing then becomes affordable and the market starts moving again.

On the other hand, inflation can decimate those individuals on fixed pension incomes and even so called inflation-linked pensions are often capped at 3% or 5% per annum. With high inflation, the value of cash on deposit is eroded quickly and gilts can crash in spectacular fashion.

Inflation is the next crisis we will all face in my opinion and being prepared is essential. As a result, we are already considering the impact this could have on portfolios and researching strategies that we could use to take advantage of the situation.

Private Equity

A Good Time To Invest?

By Knights Solicitors LLP

Private equity firms have been around in one form or another since around the 1960s. Such firms have become some of the first conglomerates, hunting down complacent companies and then transforming them with a ruthless devotion to cost cutting and cash generation

Historically, private equity firms have looked for bargains in businesses that were undervalued on the stock market or by their owners. The private equity firm would acquire enough shares in a company so they could take control of it. The funding for such investments was usually made up from some investment money from the private equity firm followed by the banks to fund the shortfall. The firm would only want to hold onto the company for a short period of time, usually 3 to 7 years during which time highly controversial decisions about the company's business plan and personnel would be taken.

Over the intervening years the private equity industry has developed an insatiable hunger for bigger and more audacious deals which led to a swathe of corporate mergers and acquisitions in 2005 and, as such, private equity companies are gradually becoming a dominant force in the UK economy.

One tool used by private equity firms and strategic buyers to generate an automatic positive return is the concept of multiple arbitrage. In essence, the concept is to increase the value of a company between buying and selling prior to making any cost cuts. The idea hinges on the fact that the investment will be sold at some point in the future as opposed to being retained for a longer period of time.

Top Tips For Success

Following the global economic downturn, it has been recognised by many that there is a need to adapt current practices in order to survive in increasingly threatened markets . Where before, the ability to understand and manage a balance sheet was sufficient, the private equity industry now looks beyond and seeks new and varied skills so that success is in sight from the moment the deal is sourced.

In order for an effective development and an increase in value of any fund, it is essential for the fund managers to work actively with the company's board. Whilst day to day operations are usually left with the company's senior management, it is imperative that a more hands on approach is taken during times of crisis to ensure the business is supported and does not fail during times of upheaval.

Leading private equity firms are now recruiting top talent to ensure they can build repeat models for success. Whilst the market has seen fundamental change since its inception, many firms retain the 'cottage industry' practices from the early days. This practice involves deal makers taking complete responsibility for all decisions from the commencement of the investment to exit.

Hunting For Opportunities

Having endured the recession and decreased rates of investment since the financial crisis began, recent studies have revealed that many industry experts believe that now is a good time to invest and that the rate of investment activity will increase over the next twelve months.

There are many emerging sectors within the private equity industry and the 'business services' sector seems to be the area in which industry experts feel attracted to invest over the next twelve months. Alongside business services, research and technology seems to be emerging whereas retail sectors seem to have a declining level of interest.

In light of the decreased value of business over the recession, it would seem to be the case that private equity firms do not need to rely on debt to support the investment as valuations of businesses remain at an all time low. A lack of confidence and fear and panic in sellers may be the reason for the rise in uninvested funds over the last five years. That said, it must only be a matter of time before private equity firms have an appetite to invest more heavily as vendors come forward, with opportunities to sell, presenting business gems for investors.

The Retail Distribution Review

By Debbie Jukes

Back in 2006, the Financial Services Authority announced one of the most comprehensive overhauls of financial distribution ever undertaken and, in the summer of 2007, published a discussion paper setting out their views. The regulator's views were clear – there had to be change as the present business model was bust!

The review of the industry was to identify and address the root causes of problems that continue to emerge in the retail investment market. The FSA felt that the market for retail investments was not working as well as it could to serve the interests of consumers or firms.

The regulator's views were clear – there had to be change as the present business model was bust!

This was because of

- A lack of clarity for consumers about the services provided
- The potential for bias in terms of how advisory firms are paid
- The minimum base requirement qualification for advisers did not deliver the necessary level of knowledge needed

The result is that by the end of 2012

- A new standard for independent advice will be introduced
- Commission will be banned for investment products
- Firms can only be paid for the service they provide
- Advisers will need to be qualified to a new, higher level
- Firms will need significantly more capital available to run their businesses and meet the new regulatory requirements

These proposals aim to ensure that

- Consumers are offered a transparent and fair charging system for the advice they receive;
- Consumers are clear about the service they receive;
- Consumers receive advice from highly respected professionals;
- Advisory firms are more stable than before and better able to meet their liabilities.

The new rules will apply to all advice given for retail investment products, regardless of the type of firm for whom any individual adviser works – so advisers within banks, asset managers, life insurers, sole traders, IFAs etc will be subject to the same regulatory environment. The RDR is a key part of the FSA's 'Consumer Protection Strategy' and an example of intervention by the regulator which aims to address problems across an entire market.

In spite of the fact the discussions regarding the RDR have been going for several years now and the changes need to have been implemented by the year end, our research indicates that only 8.5% of firms were ready for the proposed new changes as at the end of the second quarter of 2012 (according to a survey by MyTouchstone).

We believe that

- The industry will continue to decline rapidly and a large proportion of IFA firms will go out of business leaving clients with no advisers
- Those firms going out of business could leave a significant liability for remaining firms as compensation falls on the industry as a whole
- Clients could be locked into products which may be high-charging, poorly performing or both
- The large proportion of the industry that is not yet ready will need to change their charging structure, rapidly causing internal and external stress

Importantly, for any products recommended after the end of 2012, advisers will only be able to charge an ongoing amount in return for an ongoing service. However, the rules will not be applied retrospectively so if you follow a recommendation for a product that pays trail/renewal commission before then, you need to make sure that you get an ongoing service for the ongoing commission!

We have been concerned that some advisers, who will not be able to carry on after RDR because they don't have the right qualifications, could use the current rules to their advantage for one last payday. As if to reinforce this view, the FSA has recently said that there has been an increase in the proportion of investment bonds sold and a quirk in the rules means that they will continue to pay commission after the RDR is implemented. As a result, the regulator is also concerned that some advisers will exploit loopholes in the RDR to continue to earn commission.

At the beginning of September in fact, the FSA announced their findings into the way sales staff are incentivized to sell clients products and services. Their research showed that firms need to start putting customers first as most of the incentive schemes they looked at were likely to drive staff to mis-sell in order to meet targets and receive a bonus.

The Retail Distribution Review is being implemented by the FSA with a view to "establishing a resilient, effective and attractive retail investment market that consumers can have confidence in and trust".

Despite the abolition of commission to achieve this objective, the replacement fee structures can still create bias and be unfair even if it they are transparent and have been agreed between the adviser and client in advance.

The FSA has issued a publication to inform consumers about the forthcoming changes in legislation which you can find at www.fsa.gov.uk/consumerinformation.

Incidentally, clients should also be aware that the FSA is actually being replaced by two new regulatory organisations in the New Year. This will see the supervision of the banking sector, insurance firms and the major investment firms transferred to a subsidiary of the Bank of England, the Prudential Regulation Authority. The remainder of the FSA, and the element under which we will be governed, will be renamed the Financial Conduct Authority.

"

The new rules will apply to all advice given for retail investment products, regardless of the type of firm for whom any individual adviser works...

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Wills

why you need one in your life.

By Justine Clowes
Partner – Private Client Group, SAS Daniels

Making a Will is one of the most important things you will do in your lifetime, but for a lot of people it is one of those things that they never quite get round to doing. For a lot of us, thinking about our own death is not something that we want to spend a lot of time doing and so making a Will and planning for the event is something that we put off. But what are the consequences of not having a Will?

For some people, the easiest way to make a Will is to do it themselves, but this can often lead to greater problems than if the person hadn't bothered to make a Will at all. Similarly, often people make Wills and then never revisit them. The planning that they did 20 years ago is often incompatible with their circumstances when they die.

Below are some examples of cases that I have been involved with that illustrate what can go wrong, at any time of life.

Once you have made a Will, it is important that you review it regularly to make sure that it is still relevant to your circumstances...

In your 20s

Craig was 25, single and living with his mother. He had graduated from University a few years previously and was back at home while he saved a deposit for a house. Craig's parents had divorced when he was 3 years old and he hadn't seen his father since then. Craig's mum had held down two jobs while he was at school, and his maternal grandmother had been very involved in his upbringing. They were a very close family and were delighted when Craig graduated, as both Craig and his mum had saved to fund his education.

When Craig's grandmother died she split her estate between Craig and his mother. Craig inherited £50,000 and was intending to use the money to put towards the purchase of his first house. Tragically, Craig was killed in an accident shortly after he inherited his grandmothers' money. He hadn't made a Will. The intestacy provisions had to be applied to his estate and meant that his estate was split equally between his parents. The father that he had not seen for 22 years inherited over £25,000.

In your 30s

James and his girlfriend Hannah had been together for 10 years. They had been living together in James' house for the last 5 years and got engaged 2 years after they moved in together.

James was diagnosed with a terminal illness and he died very shortly afterwards. As they weren't married and as James hadn't made a Will, everything he owned, including the house where James and Hannah had lived together for the past 5 years, went to James' parents under the intestacy provisions. Although an agreement was reached between Hannah and James' parents so that Hannah was provided with some money to reflect the financial contribution that she had made to the property during those 5 years, Hannah lost her home and her partner.

In your 40s

Paul and Kate had been married for 20 years but had decided that they would divorce. The situation was acrimonious as Paul had discovered that Kate had been having an affair for the last 5 years with a colleague at work. Previously they had made Wills where they left everything to each other. On the death of the survivor everything passed to their respective siblings (Kate's two sisters and Paul's two brothers). They had always kept their finances separate and so once the divorce was finalised, they didn't take any action to legalise the financial position. Kate moved out of the house to live with her new partner and Paul stayed there.

Once the divorce was made absolute, although they were advised to amend their Wills, neither of them did so. Paul died of a heart attack while on a skiing holiday with some friends, having previously been in the peak of health.

Because the house was owned in their joint names, Kate inherited all of it by the right of survivorship. It was not included as an asset in Paul's Will. Although following their divorce, Paul's Will took effect on the basis that Kate had predeceased him, his cash assets were still divided four ways between his brothers and Kate's sisters. Once you have made a Will, it is important that you review it regularly to make sure that it is still relevant to your circumstances, particularly when your circumstances change. In this situation, Paul's family had no doubt that he wouldn't have wanted Kate or her siblings to benefit from his estate, but that was exactly what happened.

In your 50s

Ann and Roy had been married to each other for 8 years. They didn't have any children together although they both had 3 adult children from their previous marriages. They made homemade Wills leaving everything to each other, with provision that after the death of the survivor, the estate would be split 6 ways between their respective children.

Roy died after a short illness in hospital and Ann inherited everything under the terms of his Will. Unfortunately, following Roy's funeral there was a disagreement between Ann and Roy's 3 children. The relationship turned very sour and Ann cut all contact with Roy's children. She then changed her own Will leaving everything to her 3 children. On Ann's death, Roy's children will inherit nothing and there is very little, realistically, that they will be able to do about that.

Had Ann and Roy taken advice before making their Wills, they would have been advised to consider the use of Trusts within the Wills to prevent this scenario from taking place.

In your 60s

Joan and Brian had both retired, following successful careers. They had Wills leaving everything to each other which they made around 20 years ago when their son was younger. Their estate was now worth around £650,000 which included their house worth £500,000 and their investments worth £150,000. They both had pension funds which would pay lump sum death benefits to their estates and which would take their estate above the nil rate band for inheritance tax purposes. They hadn't taken these benefits into account when considering their inheritance tax position and had decided that their existing Wills would meet their requirements.

Shortly after they retired, Joan suffered a stroke and died. Her pension paid out a lump sum death benefit to her estate. Although everything passed to Brian under the terms of the Will, Brian's estate will potentially have an inheritance tax liability on his death. This could have been avoided if Joan and Brian had done some straightforward estate planning during their lifetimes. The simple solution in this situation would have been for them set up a Trust so that the lump sum death benefits could have been paid into the Trust on death rather than into their respective estates, which would have allowed them to mitigate the tax.

Unfortunately, the implications of not having a Will, or of having the wrong Will, are usually only fully realised once you have died, and it is too late to do much about it. But for those left behind, the financial and emotional cost of dealing with the fall out can be a large burden to carry.

The relationship turned very sour and Ann cut all contact with Roy's children. She then changed her own Will leaving everything to her 3 children.

Alternatives to Banks

By Mike Deverell

Our banking system is founded on trust. Capitalism only works if we can trust our banks, and that confidence is most definitely on the wane!

From LIBOR fixing to money laundering failures, any trust remaining after the financial crisis is disappearing at a rate of knots.

The "Move Your Money" campaign, which asks people to pledge that they will move away from high street banks to allegedly more ethical alternatives, is gaining traction. Mutual building societies and supposedly ethical alternatives such as the Co-operative Bank are reporting rising demand.

In this article we will look at how important banks are to the economy, and some alternatives to the big high street names. Where could you put your money that might a) get you a higher return or b) be used more responsibly?

The Banking System

Firstly, a history lesson.

Our financial system is founded on "fractional reserve banking". This allows banks to lend out a multiple of the money they take in as deposits. They can create money from nothing. To put it another way, most of the money in circulation doesn't really exist!

Let's say Megabank plc takes in £10,000 in deposits. All banks are required to keep a certain level of capital in reserve so that it can repay depositors who want their money back. Let's assume Megabank is required to keep 10% of its capital in reserve.

This means they can lend out £9,000 to borrowers, keeping back £1,000 in reserve. There is now £19,000 of money apparently in existence; the £10,000 of deposits plus the £9,000 that has been lent out.

The £9,000 which has been lent out will then most likely be used to buy goods and services. The service provider will then deposit the money in the bank again. On this £9,000, a further £8,100 (90%) can be lent out. This can continue indefinitely.

By this method, capital deposited in banks has a "multiplier effect".

Unfortunately, as most of the money therefore doesn't really exist, our financial system only really works if depositors retain confidence in the banks and do not withdraw their money in large quantities.

Central Banks

From the above example, you can see how the money supply has a big effect on both economic growth and inflation.

Since the financial crisis, the "multiplier effect" is not functioning properly as banks try to repair their reserves after the credit crunch. This is holding back economic growth.

They can create money from nothing. To put it another way, most of the money in circulation doesn't really exist!

Central banks exist to ensure the banking system functions properly. To prevent short term liquidity issues, banks can borrow money from the central bank to repay depositors who ask for their money back.

Central banks have historically controlled inflation via the interest rate they charge, which effectively stops the banks from creating too much money.

At present central bankers are trying to do the opposite via low interest rates and quantitative easing. Since the credit crunch, rather than creating money, banks have been effectively destroying it. The current policies are designed to get the money supply expanding again.

Banks are not lending in the way they have in the past, partly because they're repairing their balance sheets and increasing their capital ratios.

The high street banks now make much more of their money from their trading and investment banking divisions than they do from 'proper' banking. Arguably, this is less socially or economically "useful" than the traditional taking in of deposits and lending to small businesses and individuals. Unfortunately, traditional banking business also has a much lower margin and perhaps is no longer top priority for our biggest banks.

Confidence

So if you've lost confidence in your bank, don't trust them or don't like the way they operate, where else can you put your money?

Arguably, those institutions most like the banks of old are the mutuals; generally building societies and credit unions.

Building societies such as the Coventry, Manchester and Nationwide often appear on best buy tables for savings accounts. Unlike banks, they have no shareholders but each depositor or borrower becomes a member of the society. Since they do not need to pay profits out as dividends, in theory they can offer better rates than the banks.

They also use deposits to fund lending rather than as stake money for casino banking.

Similar to building societies but on an even more localised level, are credit unions. These work in a similar way, but with more of a community focus.

Credit unions are democratically run institutions where each member gets a single vote, regardless of how much they have invested. They are not-for-profit organisations, generally only open to people who live or work in the area served by the union. For example, only Stockport workers or residents can join the Stockport Credit Union.

These unions aim to provide affordable loans to members. Sometimes that can mean providing loans to people who really need it, who might otherwise have to borrow at vast rates from payday lenders or loan sharks (is there really a difference?).

Deposits do not receive interest as such but each year members receive a dividend payment. How much this is will depend not just on returns on lending, but also on what members vote for. They may vote to reinvest profits back in the union, pay out to shareholders, or both.

Credit unions are also covered by the Financial Services Compensation Scheme (FSCS). This means that the first £85,000 deposited will be 100% guaranteed by the Government. This makes saving with a credit union relatively low risk.

Higher risk, higher return

A riskier way of using your cash but with potentially higher returns, is to utilise peer to peer lending firms.

Websites such as Zopa and Fundingcircle allow you to lend your money to

companies or individuals, again bypassing the banks.

The interest you receive can be much higher than if you left your money in the bank. However, your risk is increased as not all individuals or companies will be able to repay their loans.

Zopa says the typical return after charges and actual defaults over the past 12 months is around 5.5%. Fundingcircle advertise a gross yield of 8.8% before fees and bad debts.

Remember that interest is subject to income tax, and that you will need to be able to tie up your money for a reasonable length of time so these alternatives are not suitable homes for an "emergency fund". Peer to peer lending may, however, be a suitable alternative to any long term cash savings.

Unlike a cash deposit, peer to peer lending is not covered by the FSCS.

Socially Responsible?

As well as being perhaps more socially responsible than banks, what these alternatives also give you is control.

With peer to peer lending you can decide how much risk you want to take and who

Remember that interest is subject to income tax, and that you will need to be able to tie up your money for a reasonable length of time ...

you want to lend your money to. With mutuals, you get a say in how they are run.

For those that no longer trust their banks, it is reassuring to know that there are viable alternatives.

Please note that this article is not intended to constitute a recommendation and is purely for information only.

In Profile:

Dave Ferguson

Nucleus

By Mike Deverell

What made you decide to start Nucleus?

Recognition that the industry structure was primarily aligned against the customer and that much of the complexity existed to conceal commission payments. I just thought we could create a better model and consequently better client outcomes.

What makes Nucleus different from a traditional insurance company or other product provider?

Hopefully almost everything! I guess the principle points would be around increased transparency of charges and better use of technology to improve visibility and operating efficiency.

Nucleus are part owned by South African insurer Sanlam. How involved are they in the running of the business and what is your relationship with them like?

Sanlam is represented on the Nucleus board and have contributed massively to our governance infrastructure. I'd say Nucleus enjoys a very positive relationship with Sanlam and my sense is that they feel they have made a wise investment in our business. I personally think they have shown great enlightenment in working in genuine partnership with advisers on such an ambitious project.

What impact will the Retail Distribution Review (RDR) have on Nucleus?

I hope a very positive one. We have always been set up for the post-RDR world and have sought to work with adviser firms that are in a similar position. This is the biggest regulatory and commercial disruption this market has ever known and time will tell how it all plays out but for now it's feeling pretty good.

What impact will the RDR have on the industry?

It will force an unprecedented level of accountability and authenticity on a sector not widely recognised for great behaviour. We'd expect this to result in massive fall out and realignment of the various sectors which make up the whole market. In particular we'd expect to see significant consolidation in the asset management sector and a medium-term positive impact on client outcomes.

> My ambition is to build the most admired wealth management platform in the UK

Where do you see Nucleus going?

My ambition is to build the most admired wealth management platform in the UK and that sits alongside the shareholder ambition to float the company sometime between 2015 and 2018.

I'd love to see Nucleus capitalise on the opportunity we have carved for ourselves, to see the great people that work here fulfil their potential at Nucleus and ultimately to generate a financial outcome which will allow me to fulfil my personal objectives.

What would you like to do after Nucleus?

I suspect this depends entirely on how long I am spared here! I've got no obvious financial services career ambitions beyond making Nucleus a phenomenal success but I have an interest in mentoring young people and in teaching deaf kids.

What is the biggest mistake you've made?

That's a pretty long list but I'd say the key one was not getting started sooner!

What really annoys you?

Those who believe the historic financial services industry was heroically wonderful. It was for those that worked in it but not for those who paid for it.

You're a prolific tweeter. How has social media like Twitter changed the way businesses interact with their customers?

It's opened up communication lines and created the opportunity for companies to engage in conversations with their market. Ultimately for Nucleus it has made us much more efficient and, together with the sense of community we've tried to create around the business, has allowed us to run with sales & marketing costs which are around 25% of the historic norm.

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Cheshire Insurance Brokers

In the main, homeowners assume that all insurances are the same. Heavy advertising on TV and in the newspapers encourages you to phone or visit comparison sites and to be honest, the cheapest price usually wins the day. It is probably more cost effective to have a 'standard' policy obtained through the bank or building society or the internet if you own the average 3 bedroom property. However, if you are in possession of a higher value property with contents, art, jewellery and antiques to match, then a standard policy is unlikely to give you adequate cover. Unfortunately, unless you decide to carry out your own investigations regarding your needs in this field, you will probably only find out that you don't have adequate cover in the event of a claim.

Lower prices are offered on a 'standard' policy but these are calculated by including restrictive conditions, limiting what cover is included and amounts paid out. Not having the right policy in place can result in losing thousands of pounds just to save a few of those pounds on the premium.

The option, for peace of mind, is High Net Worth insurance (in other words High Value Home Insurance). You don't have to live in a stately home or mansion, as is commonly thought, and it won't cost as much as you think. These policies are created for each individual household and lifestyle. High value insurance is directed at homes requiring higher levels of cover typically for properties with a rebuild cost of £350k and above and general contents upwards of £75k. As well as a bespoke service that you would expect from a high value home insurance policy, the additional benefits go much further. They will include World Wide cover for your contents as standard, appraisal and valuation services to make sure you have the appropriate level of cover and an option to include motor insurance for either a single vehicle or an entire family fleet giving you the convenience of just one common renewal date and just one policy to focus on.

A recent survey has exposed that at least 65% of 'quality' homes are under insured and if insured through a 'standard' policy, could risk financial consequences after a claim. You should carry out your own review on a regular basis. A specialist broker can assist you with this, and our Private Clients team at CIB offer a first class personal service in which we discuss your unique requirements in confidence and arrange an insurance programme that is bespoke to you and your family.

On a broader issue, CIB have specialists in every kind of insurance from established products to cutting edge innovations, and our commitment to high quality service is uncompromising.

Justin Urquhart Stewart

By Mike Deverell

Justin Urquhart Stewart of Seven Investment Management (7IM) is one of the most recognisable faces in financial services.

A regular on TV and radio, Justin has become as well known for the affable way in which he can explain even the most complex of subjects in an easy to understand way, as he has for his red braces!

"People are always asking me: 'Why do you wear braces?'" he says. "I just tell them it's to keep my trousers up!"

Cultural Shift

Prior to setting up 7IM in 2001 Urquhart Stewart was at Barclays Stockbrokers, where he met Tom Sheridan, now 7IMs CEO.

As the 1990s drew to a close with the tech bubble about to reach its peak, Justin and Tom were becoming more and more uncomfortable with the way parent division Barclays Capital was going under Bob Diamond, later CEO of Barclays as a whole and no stranger to the media himself this year!

"There was a real short term approach to client investing. There was an attitude to extract as much money from the client as possible as quickly as possible. It was a real cultural thing, it was difficult to put your finger on it, but it just felt wrong."

During this time, Tom and Justin could see how financial planning was evolving from commission based transactional advice to fee based planning.

"We certainly didn't foresee RDR (the Retail Distribution Review) but we could see the direction things were heading in. We joined the IFP (Institute of Financial Planning) but found that financial planning was much harder than we realised!

"We therefore decided to set up Seven to become the outsourced investment solution for this new breed of financial planner.

"I could not believe how bad most of the funds were that were made available for the intermediary market – expensive and terrible. It was obvious that those that were sold the most were those that paid the highest commissions."

7IM set out to offer something different. "We wanted to offer an institutional approach to the retail market. Low cost investing, with a focus on asset allocation," says Justin. "Everyone does it now, but back then it was very rare."

In addition, 7IM "also wanted to be completely open in terms of tax wrappers," which led 7IM to offer the UKs first wrap platform after initially offering just investment management.

"The wrap platform was an obvious extension of what we were doing. We needed a way of recording data and providing a consistent service, which alongside a dealing service essentially is what a wrap is."

Setting up 7IM was a massive challenge: "Basically my house was on the line and I was taking a huge paycut – to zero!"

Justin cites his biggest inspiration as being small business people: "Those that set up and run small businesses from humble beginnings; that can compete against the big corporates with imagination and flair". You can tell this is an issue close to his heart.

The Big Bang

Before he entered financial services, Justin trained as a barrister but decided it wasn't for him.

"I felt like a bit of a leech, making money from other peoples' disasters. I always remembered what my pupil master had told me when I was training - that there was much more money in crime than in defending it! It was therefore either crime or financial services – not that I could see much of a difference!"

Justin was interested in banking – "proper banking, not investment banking" - and joined Barclays DCO (Dominion, Commonwealth and Overseas) which he describes as a real throwback to colonial times: "They decided to send me off to Uganda, despite me telling them that there was a war on. They said that it was exactly why they needed more people!"

Whilst in Uganda, Justin was shot and in hospital for some time – something he seems understandably reluctant to talk about in detail: "I came back from Uganda slightly shorter then when I got there," he says, downplaying the seriousness.

It's all about trust. Financial advice is about selling trust to clients

Back in London, the "Big Bang" was happening, with deregulation of the financial markets and the change from an "open outcry" market to electronic, screen based trading. Justin could see the opportunity that this could create.

This led him to help set up Broker Services with five others. The company adapted to the new world brilliantly, becoming one of the biggest stockbrokers in the country. "You might not have heard of us, but we provided broker services for a number of the biggest investment banks."

Broker Services was such a success that Barclays, who had held a minor shareholding, then bought out the company, merging it with their failing BZW division and turning it into Barclays Stockbrokers. "I just couldn't get away from Barclays!" says Justin.

It was Barclays that indirectly led to Justin first making an appearance on TV. "Barclays decided to cut my marketing budget right back, so we had to find a different way of promoting ourselves. BZW had a camera on their trading floor which we 'stole' and started doing short market reports for TV, which seemed to work very well."

Justin continues his marketing role and still appears regularly on TV and radio, something he enjoys, although it has not always gone smoothly.

"I once went on a programme and they had said the guy before me was Justin Urquhart Stewart, so I was expecting them to get my name wrong too – I guessed they would call me the other guy." In fact, the name that was put on screen was "Slobodan Milosovic – ex president of Serbia. I know I sometimes upset people but really!"

Retail Distribution Review

Justin sees the forthcoming Retail Distribution Review as fantastic for the industry. "It's a big challenge for some but it's a continuation of what quality financial planners were doing anyway. The opportunity for the good advisers and investment houses is huge.

"Private banks and the like offer a terrible service for a really high cost, but they hide it in layers of charges. They tell clients they charge 0.5% but when you add it all up it can be as high as 4%! These people won't be able to get away with that after RDR."

Interestingly, Justin sees the biggest challenge as being one of education, and feels that politicians and regulators need just as much education as clients.

"It's vital that we educate. In the past, many clients did not even realise they were paying for advice as the commission was hidden. We need to educate them about this and about the value of advice.

"It's all about trust. Financial advice is about selling trust to clients, not products. It's about providing the confidence to clients that their money will work for them and that they can afford their retirement (for example) if they do the right things."

Justin regularly goes into schools and talks about finance. It is something he is passionate about. "We need to teach people about finance – not economics – just basic finance.

"People need to understand how to look after their money, making it work for them across the generations." He sees this as being the best way for financial advisers to evolve, "offering a 'family office' approach, looking after each generation and being a one stop shop for anything financial."

Justin is not planning to continue in financial services forever. A history buff, Justin tells me his plan is to go back to university and study archaeology. "I need to do this before I become an old fossil myself!" he says.

Wine Feature

Nick Reed of NR Wines 'Preaches the Gospel'

The nights draw in – more time to curl up by the fire (pet!) and reach for a nice glass of wine whilst catching up on more depressing news, or quaff whilst indulging in your favourite TV movie. Indeed invite some friends for dinner and show off your knowledge/expertise by producing on the table an array of fine wines to accompany the meal. Can't go wrong?!! The choices out there are mind boggling! Where do I start? Walk up and down aimlessly at your local supermarket , pretending to know what to gently place in the trolley. Feel a little intimidated walking in for the first time to the local independent wine shop, but there again you may obtain some useful advice as to what to purchase.

Easy drinking styles with some light nibbles, more complex fruit driven wines with food. Here are some guidelines to see you through over the next few months! Avoid if possible the brands/household retail names as more often than not you'll surface the next day with a dull headache – annoying! Poor winemaking skills, additives which can play havoc with the body can be disruptive. Same principle with dining out – 'the Chef is the winemaker.' There are some bargains to be had but £5 - £7 should be a benchmark to at least give you the opportunity to drink something of quality; you may then be tempted to purchase again?!

Now the average palate/taste buds are more refined, gone are the days the consumer is seeking out the oaky powerful styles, high alcohol to demonstrate to their buddies, 'look at this, its 14%'! bland wines with no character. Here are some of the big players in the field! I have included some recommendations which are featured on my wine portfolio;

please see contact details overleaf if you'd like one emailed.

Please note minimum quantity is 12 bottles which can be assorted.

All prices shown are including VAT.

France

More difficult finding something which smacks of quality for under £6 - £7 except for down in the South where there's plenty of sunshine in the Languedoc region, permitting the labels to state the grape varieties; some cracking good value wines to be had in White, Rose & Red.

JC Beauvoir Chardonnay
£6.47

Les Terrasses Rose, Grenache/Syrah
£5.82

Les Terrasses Merlot/Grenache
£5.82

Fine wines:
Macon Villages 'Clos de Condemine'
£10.20

Beaune Premier Cru - Nuiton Beaunoy
£17.88

Spain

Don't just think of Rioja! Great diversity all over the country and generally very good value, consistent sound quality. Penedes, Galicia in the far North West and Rueda are all regions producing some crackers! Reds certainly more distinctive, but there are some attractive whites to drink.

Galicia:
Las Brujas Sauvignon/Verdejo
£5.40

Las Brujas Tempranillo
£5.10

Penedes:
Ops de Loxarel (Cabernet Sauvignon/ Merlot/Tempranillo)
£8.88

Rueda:
Castelo de Medina Verdejo
£8.15

Syte – Syrah/Tempranillo
£19.19

Rioja:
Rioja Vallemayor Crianza
£8.99

Italy

'The wine lake' huge production but look carefully and some delightful smooth reds and flavoursome crisp whites – might you be thinking of Pinot Grigio?!

Veneto:
Pinot Grigio 'Corte Pitora'
£6.96

Valpolicella Classico Superiore Ripasso
£11.99

Germany

Stick to a nice grapey, fruity Riesling which can do the trick! The label is often just branded 'Riesling' and can glug on its own.

Flying Goose Riesling
£6.71

Argentina

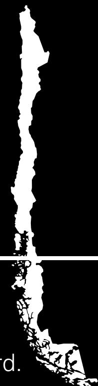
Over the last decade this is a country which has improved immeasurably for producing great value beefy reds and some elegant full flavoured whites.
The Malbec comes into its own in the Mendoza region, and the likes of the aromatic gently spiced Torrontes is very appealing.

Mendoza:
Cuesta del Madero Malbec
£7.27

Tiasta Reserve Cabernet Sauvignon
£8.50

Salta:
Tiasta Torrontes
£7.75

Chile



Some not so clever stuff coming into the UK but overall plenty of good value wines across the board.

Cantus Sauvignon Blanc
£5.76

Duette Indomita Pinot Noir
£9.36

New Zealand

Marlborough Sauvignon Blanc is the star of the 'show' plenty to go at!

Penny Lane Sauvignon Blanc
£7.50

Tohu Sauvignon Blanc
£13.19

Australia

Where do I start? For the lovers of the heavyweights, especially in the Hunter Valley, the more elegant lighter styles (some cooler areas in the South) are also appearing on the shelves to suit the UK market; the blend of two sometimes three grape varieties offer balance, silky fruit and long rounded finish.

Westend Richland Viognier
£8.39

Head Over Hills Chardonnay
£7.50

Head Over Hills Shiraz
£7.50

South Africa

Last but not least! Chenin Blanc is the popular white grape, Pinotage for the Reds. Good fruity wines with a reasonable price range accessible.

Lutzville Chenin Blanc
£6.66

Lutzville Pinotage
£6.66

Finally a cheeky little number!
If you can't be bothered to shop around be my guest!

Best wishes

Nick Reed M.D.
NR Wines Ltd - 'Quality, Service, Reliability'

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Views from the Frontline

In this section, we ask the managers from some of our favoured funds in each asset class to comment on markets and give us their outlook for the future.

Equity

Richard Buxton

Schroder UK Alpha Plus

The ongoing crisis in the Eurozone continues to move equity markets, but what is going on in the rest of the world has caught our attention.

While economic data in China remains soft, economic policy is becoming more stimulatory and leading indicators are picking up. In the US, economic data has been mixed but surveys indicate both an increase in banks' willingness to extend credit and an increase in demand from companies.

UK newspaper headlines declared 'The longest double-dip recession since records began' in July, but the second quarter UK GDP figure (-0.7%) is at odds with employment data (the private sector continues to grow) and with what companies are saying on the ground (no signs of slowing demand).

I think that we are going to be stuck in this current broad trading range for some time. It has been four years since the financial crisis of 2008. History suggests at least six years is needed for banks to work out losses from previous crises. The government, banks, and individuals have to retrench and this means economic activity will be low.

Other parts of the world will grow faster than the UK, but remember that the UK stockmarket is truly international and there are many companies that benefit from this. Clearly we have got to resolve the global debt overhang and the issues in Europe, but a lot of bad news is already priced in. Attractive valuations mean that we are compensated for the risks.

Equilibrium View

The Schroder UK Alpha fund takes a high conviction approach to investing. Richard Buxton tends to hold a very concentrated portfolio of between 30 to 40 stocks. He also takes a long view with his stock selection, generally only trading into or out of three or four stocks each year.

This approach means that the fund tends to have periods when it strongly outperforms but can underperform in more difficult market conditions. The fund has marginally underperformed of late, but it is one about which we are happy to take a long term view.

Equity

David Dudding

Threadneedle European Select fund

2012 has proved a more positive year than expected by many followers of European equities. The European market is one of the best performers in 2012, despite a backdrop of a weak Euro, falling economic growth, rising unemployment and turmoil in government debt markets. The ECBs' bond-purchasing programmes have prompted rallies in the market, and in particular supported the financial sector.

Investment in some parts of Europe will continue to pose huge problems, notably for many low-quality, domestically-oriented companies and those involved with the southern periphery (e.g. Greece, Spain, Portugal).

However not all countries in the Eurozone are facing the same degree of economic problems. The German economy, for example, is more stable, and companies can reap the benefits of low funding costs and a weak exchange rate, which boosts competitiveness and also the value of overseas earnings. Scandinavian companies have profited as the region has avoided the worst of the Eurozone crisis and boasts resilient economic growth.

We believe European shares offer good value compared with other asset classes. We favour high-quality growth companies, where their competitive position is sufficiently robust to ensure strong and predictable future returns on capital and they will be less affected by economic uncertainties.

Equilibrium View

We believe European equities could offer some potentially very good returns but due to the political situation there is more risk in Europe than many other equity markets. In these conditions we favour active fund managers who have a very flexible mandate, allowing them to focus on the best opportunities and avoid the biggest dangers.

The Threadneedle European Select fund has a good track record of outperforming in both rising and falling markets. Good fund management means it has actually been less volatile than the sector average over the past three years.

Fixed Interest

Ariel Bezalel

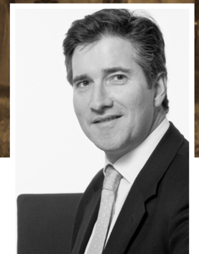
Jupiter Strategic Bond

Ongoing Eurozone concerns have dominated fixed interest markets as the borrowing costs of countries like Spain have fluctuated.

Following the recent EU summit we have taken encouragement from ECB chief Mario Draghi's comments that imply he will consider non-conventional measures to ensure the preservation of the Euro. However, we are still a long way short of the mutualisation of Eurozone debt that may ultimately be required to quell market volatility.

The Fund's positioning is, on the whole, cautious with limited bank exposure, no investments in peripheral European debt and many of our corporate bond investments secured on assets. However, we have slightly increased risk recently, reducing our holding in Australian government debt and increasing exposure to corporate credit.

We expect default rates, especially in Europe, to tick higher and it is therefore crucial to be highly selective. So, for example, we tend to avoid highly leveraged companies which are more susceptible to an economic slowdown and instead focus on corporates with steady revenue streams that are seeking to pay down debt.



Alternative Equity

Sebastian Lyon

Troy Trojan fund

We have endeavoured to construct a portfolio to withstand the prevailing economic challenges. The portfolio has four enduring pillars. The first contains our well-capitalised blue chip stocks. These businesses continue to enjoy global repeat revenues from goods or services that customers buy again and again, out of necessity or strong loyalty. Core holdings include: British American Tobacco, Coca-Cola, Colgate-Palmolive, Nestlé and Unilever.

The second pillar is constructed from index-linked bonds. These should withstand and protect us from the on-going inflationary policies instigated by governments and their central banks.

The third pillar of the fund is the holding of gold. Exposure is maintained by holding both bullion and three gold mining shares: Agnico-Eagle, Newcrest and Newmont. We believe that on-going money printing and central bank balance sheet expansions are bullish for gold.

Our final pillar is liquidity. For many, cash is currently trash. In an inherently inflationary environment, cash is seeing its purchasing power being eroded, in the same way dripping water slowly and imperceptibly hollows out a stone. However, it is also liquid. We expect to have a number of better opportunities to invest in during the years ahead and holding cash will give us the flexibility to exploit them.

Equilibrium View

A strategic bond fund has the ability to invest in any fixed interest instrument, from very safe government bonds to risky high yield bonds. The difficult bit is knowing when to move between the different types of bond, to increase or reduce risk. Ariel Bezalel has demonstrated an admirable ability to very quickly adapt his portfolio to market conditions.

The fund has been consistent, outperforming the sector over most time periods since launch in 2008. What's more, it has generally done so by a considerable margin. This remains one of our favourite fixed interest funds which continues to provide returns whilst adding stability to portfolios.

Equilibrium View

The Trojan fund is a multi-asset fund with relative freedom to move between the asset classes. The fund manager focuses on capital preservation as well as return. Although not styled as an absolute return fund, the fund has done well in all market conditions. Impressively, it has never had a negative calendar year of returns since it was launched in 2001.

If equity markets rise strongly then this fund will most likely underperform. However, with markets remaining volatile we believe this fund is a great way of reducing risk in portfolios and it has the potential to produce excellent, consistent returns.

Investment Review

Welcome to the investment review section of our magazine.

It's been another period of ups and downs. When we issued the spring edition of our magazine, the FTSE was at 5,874 (as at 2 April 2012). At close on 5 October 2012, the FTSE was 5,871. On the face of it, markets appear to have gone nowhere in six months. However, that does not tell even half the story!

In this section we will review the events of the past half year, explain how we've managed our way through it and let you know how your portfolios have been performing.

Mike Deverell
Investment Manager

6 Monthly Review

Looking back to our April edition, it was a time of relative optimism. Markets had risen from the very low level we saw towards the end of 2011 when the FTSE dropped below 5,000 points amidst worries about European sovereign debt.

The catalyst for this recovery had been actions by the European Central Bank (ECB) who agreed to lend to banks almost as much money as they required for a period of up to three years. This vastly reduced the risk of a bank going bust and allowed markets to recover.

When writing this edition I am struck with a sense of déjà vu! Whilst markets did not drop quite as far as they did last year, a new round of Euro concerns had a major impact in April and May, seeing the FTSE fall back as low as 5,260 at close of 1 June.

Once more, concerns that Greece would default and leave the Euro rose to the fore. More worrying - given the comparative sizes of their economies - was that Spain and Italy could run into severe difficulties.

Again, the ECB rode to the rescue and since Mr Draghi promised to "do whatever it takes to save the Euro" back in June, markets have rallied significantly.

One of the issues troubling Italy and particularly Spain is that their borrowing costs had soared to near unsustainable levels. To borrow money, Spain was having to pay upwards of 7% pa for a 10 year bond. To put that in context, that is more than you or I would have to pay for a personal unsecured loan!

Draghi has promised that the ECB will buy short term bonds with the aim of driving down borrowing costs for the likes of Italy and Spain. However, he will only do so if they apply to the European Stability Mechanism (the bailout fund set up last year) for help. By applying to the ESM, a country would have to commit to cutting spending and raising taxes.

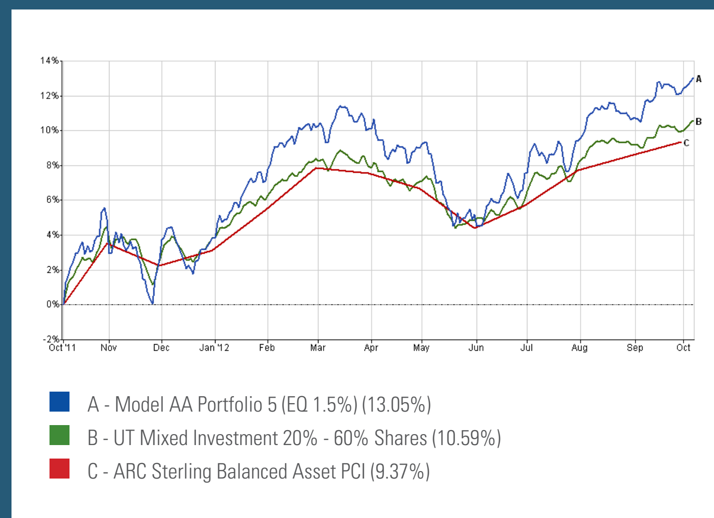
Naturally, Spain do not want to apply for a bailout unless they have to. However, even though the ECB are not currently buying Spanish bonds, just the very fact that they have said that they might has rapidly reduced Spain's borrowing costs. Spain now pays around 5.9% for a 10 year bond. That's still high, but well below the inflated levels of earlier this summer.

It is this change in rhetoric, to do "whatever it takes" - echoed by Germany's Angela Merkel and by Francoise Hollande in France, amongst others – which has changed things around. Markets now have much more confidence that there will not be a catastrophic disorderly default by one of Europe's largest economies.

The problem has not gone away but time has once again been bought. In the meantime, events across the pond are also having a significant effect. A third round of quantitative easing in the USA could potentially help stimulate global markets and economies.

We do feel that valuations of many markets look very attractive and hope to see a much better 6 months coming up.

In the meantime, despite markets going sideways we are relatively pleased to see our balanced model returning 3% over the past 6 months (3.29% from 1 April to 5 October). Over 12 months, the same portfolio is up over 13%, well ahead of the average managed fund and discretionary balanced portfolios*:



* Managed fund means the UT Mixed Investment 20% to 60% Shares sector, average discretionary manager means the ARC Sterling Balanced Asset PCI. Note that ARC data is published monthly and so is to 1 October).

Asset Allocation

The chart below shows how our asset allocation has evolved over the past 12 months:

For most of the year we were overweight equity. We increased and reduced equity as markets fell and rose, capturing returns by "volatility trading" (more of which later).

We gradually reduced property over the year, finally exiting completely in May. We introduced Defined Returns products in October last year which have really helped performance, and these products look set to "kick out" during October this year.

We have held higher than normal cash levels throughout the year, using this to trade volatility. We have now reduced this slightly, increasing fixed interest. However, we still hold 5% "tactical cash" in case markets drop back again.

Performance

As shown in the chart on page 30, our balanced portfolio has outperformed our main competitors; the average managed fund (UT Mixed Asset 20-60% shares) and the average discretionary manager (ARC Sterling Balanced PCI) over the past 12 months.

We do not benchmark our portfolios but show performance against these comparators so you can be sure that we are doing the best job in the circumstances.

Our real objective is to provide the returns you need, and beat cash and inflation as a minimum.

The below chart shows the balanced portfolio (blue line) since it was launched in the current format in January 2008. Again, the managed fund (green) and discretionary manager (red) benchmarks are shown. Also shown is the Retail Prices Index (RPI – black line), a measure of inflation, and the ING Direct Savings index (an indication of cash returns – pink):

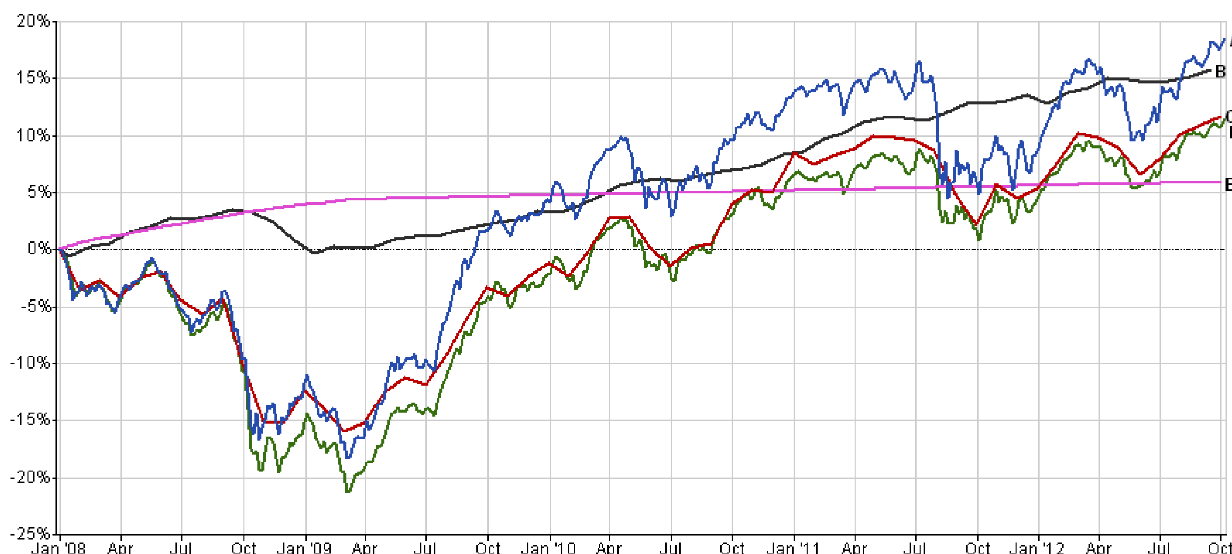
Note that the chart is to 5 October but ARC is only shown to 1 October as it is published monthly.

As you can see, as well as being well ahead of our competitors the portfolio has also provided above inflation returns over this period (note that RPI is announced monthly and that at the time of going to press Septembers' figures are not available), and beaten cash substantially.

Given the very difficult market conditions over the past 4 ¾ years, as well as the above target levels of inflation, RPI has been a very difficult measure to beat and we are therefore pleased to be at least ahead of inflation over this period.

More details of the different portfolios and how they performed are shown on page 36.

During this period we have seen huge market volatility. Below is a summary of how we have dealt with this and how we have had to be more innovative than ever before in order to achieve the returns you required.



A - Model AA Portfolio 5 (17.98%)
B - UK Retail Price Index (15.22%)
C - UT Mixed Investment 20-60% Shares (11.00%)
D - ARC Sterling Balanced Asset PCI (10.93%)
E - ING Direct Savings (5.89%)

> We have held higher than normal cash levels throughout the year, using this to trade volatility

Sideways Market

Over the past 2 ½ years, equity markets have effectively gone sideways. On 1 April 2010 the FTSE 100 closed at 5,744. At 5 October 2012 the FTSE closed at 5,871, only 127 points higher.

This naturally makes it quite difficult to generate returns. We have therefore taken three main steps to enhance performance in this environment.

1. Defined Returns

The Defined Returns plans only need markets not to fall in order to make their returns. They do not need markets to rise.

By purchasing one of these products we are lending money to a bank. They will pay us a set return provided the FTSE 100 is the same or higher than it was at the start. For example, the Barclays product we purchased on 6 October last year was designed to return 12.75% provided the FTSE was above 5,291 on 8 October 2012. In fact, on 8 October the market closed at 5,871 and so the product has indeed "kicked out".

If it had been below this level the product would have rolled on another year and provided the FTSE was above 5,291 in October 2013, Barclays would then pay 25.5%, double the return. This test would be repeated every 12 months with the return increasing by 12.75% each time (not the same as a 12.75% pa return as this is not compounded).

If, after six years, the FTSE had never been above its starting level, the product would end and the original capital will be returned, unless the Index is down 50% or more at that point. In this instance, clients would lose money on a 1:1 basis.

These products provide attractive potential returns even in sideways markets. There are two layers of risk to them:

- Default risk – the risk that the bank will not be able to repay the loan. This is similar to if you bought a corporate bond from that bank.
- Market risk – the risk that the market will not rise, or that it will fall more than 50%.

The default risk is very real and for this reason we are careful about which banks we use.

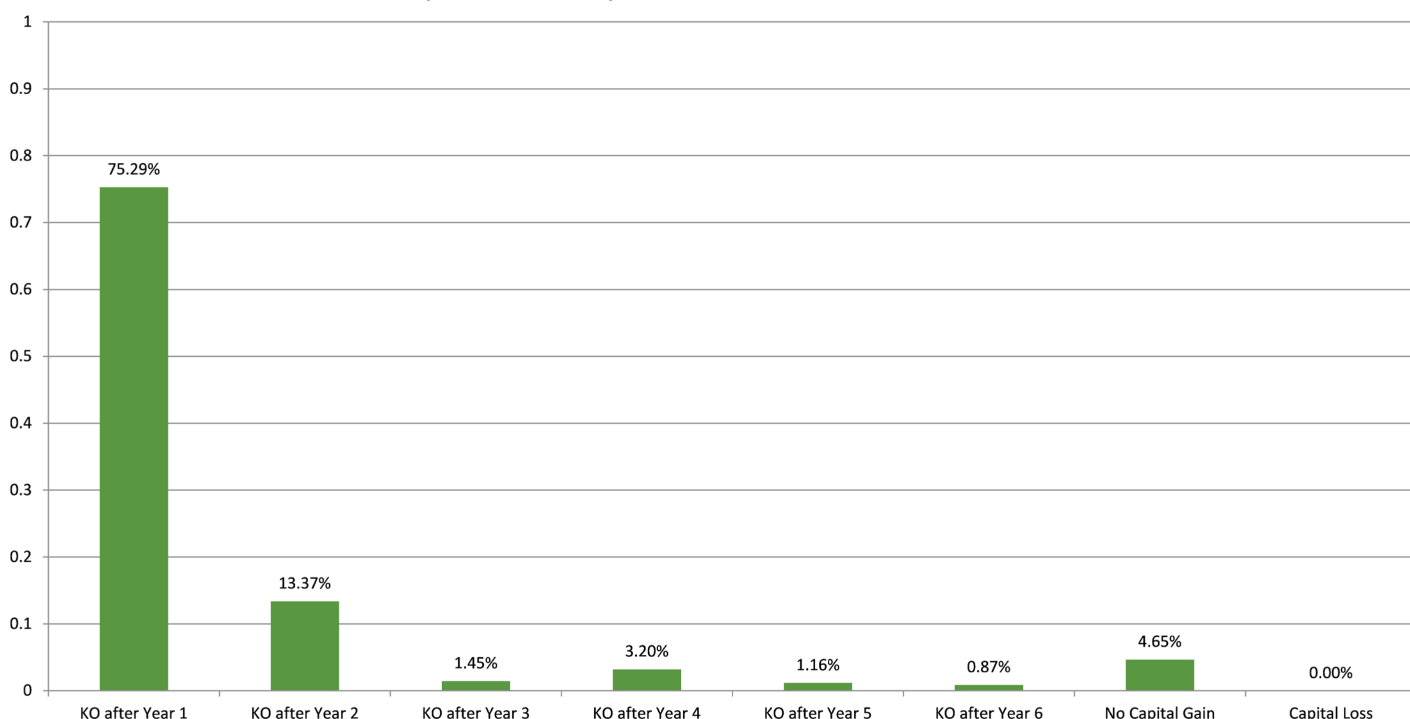
Looking historically, the market risk element has actually been relatively low (although this may not be the case in the future). We have carried out analysis on the FTSE 100 looking at each six year period beginning on the first of each month from 1 February 1978. We then worked out what would have happened had you bought a Defined Returns plan on that date. The results are shown in the graph below.

This shows that 78.2% of the time, a Defined Returns product would have "kicked out" after 12 months. Only 4% of the time would it have got to the end of the six year term and never kicked out. In the past, there has never been a six year period where the FTSE has fallen more than 50%, so creating a capital loss.

The worst FTSE 100 performance over six years was -26.72% from the period beginning May 1999. This is still more than 23% above the 50% barrier where we start to see losses.

This is purely historical analysis and things could of course be very different in the future. However, this does reassure us that the market risk element is perhaps lower than might be expected in these types of products.

We are likely to continue using these products in the future.



Source: Thomson Reuters Datastream, analysis by Equilibrium

2. Volatility Trading

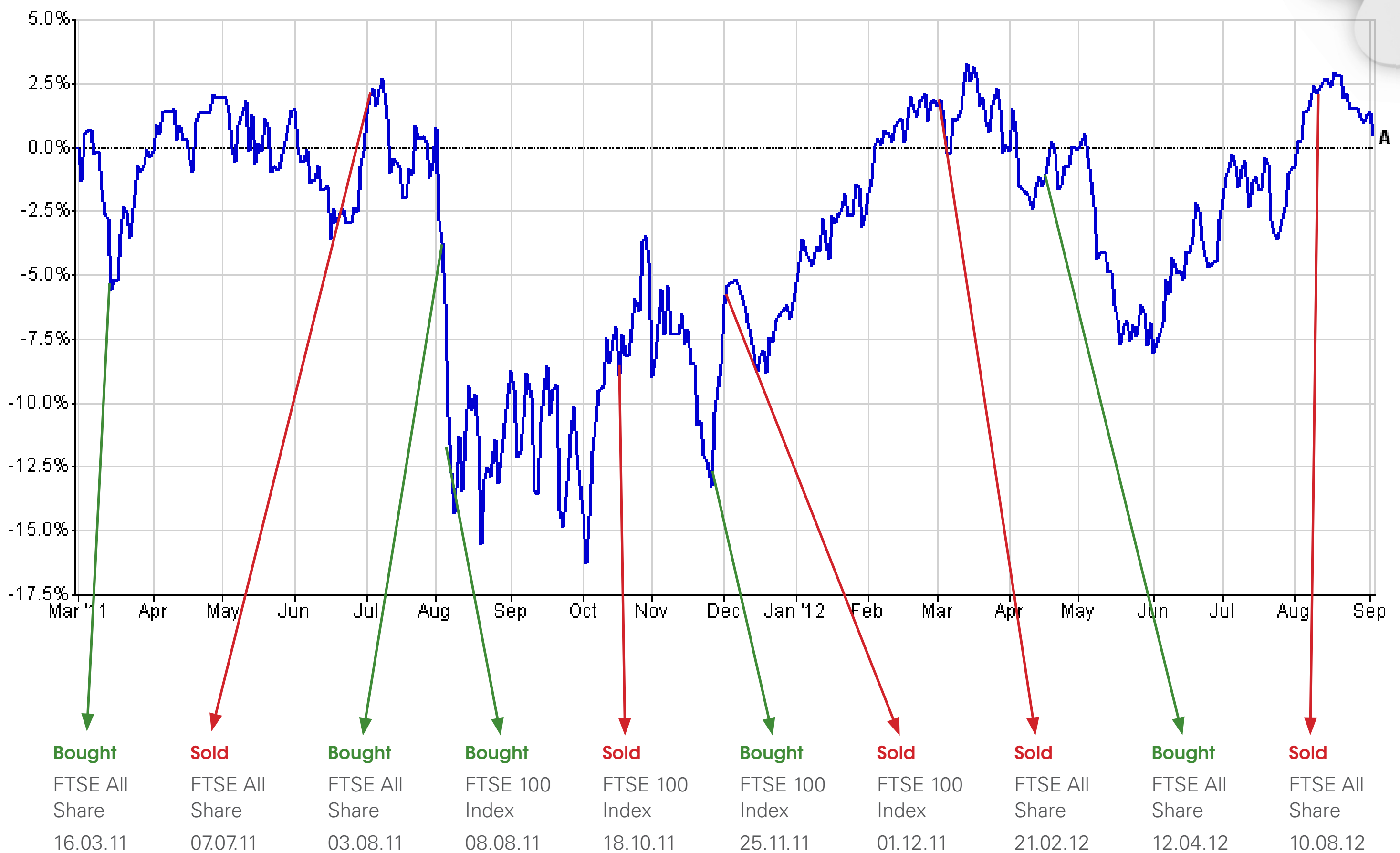
Having said earlier that the FTSE 100 has only moved from around 5,744 to 5,871 the past 2½ years, that hides a great deal of volatility.

In that period we have seen lows of 4,805 (1 July 2010), highs of 6,091 (8 February 2011), before returning to 4,944 on 4 October 2011 and back to 5,945 on 20 February 2012.

To combat this, we have traded in and out of markets as they fall and rise. This has generated returns of up to 13% on a small element of the portfolio.

We still hold 5% in tactical cash in portfolios for most clients. This gives us the liquidity to buy back into markets again, should they fall back.

HSBC FTSE 100 and All share Tracker switches



	16.03.11 - 07.07.11	03.08.11 - 21.02.12	08.08.11 - 18.10.11	25.11.11 - 01.12.11	12.04.12 - 10.08.12	Return to date
HSBC FTSE All Share (3%)	7.81%	5.35%	-	-	-	13.16%
HSBC FTSE 100 (3%)	-	-	3.97%	7.29%	-	11.26%
HSBC FTSE All Share (5%)	-	-	-	-	3.75%	3.75%

3. Income

Although the FTSE 100 is only 100 points higher than it was in April 2010, if we take into account dividends the picture changes.

The chart below shows the FTSE 100 *price only* in green, which excludes income, as well as the FTSE 100 total *return* (including dividends) in red.

Also included on the chart is our UK Large Companies portfolio in blue:

Even though markets have gone sideways in terms of price from 1 April 2010 to 5 October 2012, when we factor dividends into account the FTSE has produced a reasonable return of around 12%.

We increased exposure to our UK Large Companies portfolio for most clients at various points during the past few years. This invests in high dividend, profitable and stable companies. This portfolio has returned almost 20% over the same period.

We believe income will continue to be a good source of returns and are likely to remain overweight UK Large Companies for the near future at least.

Sector Performance

Equities

Although we expect markets to see further ups and downs, we remain convinced that equity is fundamentally the best value asset class.

Price/earnings ratios (P/E) remain well below long term averages across most markets. Our research shows that P/E ratios have historically a very strong correlation with the return you are likely to receive. We particularly favour the UK market.

UK Equities

As discussed in the previous section, UK Large Companies has done very well over the period returning 6.4% from 1 April to 5 October 2012. This compares to 5.3% for the UK Equity Income sector and 3.9% from the FTSE Allshare.

Conversely, our UK Dynamic portfolio where funds take additional risk to aim for higher long term returns, has struggled in relative terms. It returned 1.61% compared to the UK All Companies sector at 3.23%. The slight underperformance is perhaps to be expected in very volatile times where income has been a large proportion of returns. These types of funds tend to do very well when markets rise strongly.

Our worst performing UK fund has been the M&G Recovery fund. This is the first time we have seen this fund underperform for such a long period, after ten consecutive years of sector beating returns. Given the previous consistent track record, we are not especially concerned and believe this fund will pick up.

Global Established

Earlier this year we reduced exposure to Japan, which turned out to be a good move as Japan has struggled relative to other equity markets.

The US did very well towards the end of last year and beginning of 2012.

After being one of the worst performing asset classes last year (unsurprisingly), European equities have been the best performing asset class year to date.

We think there is still plenty of value in European equities but also a relatively high level of risk. We switched earlier this year from an index tracking fund to the Threadneedle European Select fund, a fund that can be very flexible in terms of which shares it can purchase. We believe this can both enhance returns and reduce risk, as the manager can (for example) avoid Greek or Spanish equities, whilst an index tracker cannot.

You can read the thoughts of the fund manager on page 27.

Our Global Established portfolio has returned 1.61% compared to our benchmark (40% UT Europe, 40% UT North America, 20% UT Japan) which returned 1.44%

Global Speculative

Emerging market equities have struggled in 2012, albeit after a strong start, as economic concerns in the West plus a slowdown in China reduced risk appetite.

We increased emerging market exposure earlier this year, although returns have continued to be disappointing since then.

We have recently made a change to the portfolio, dropping the underperforming Allianz BRIC (Brazil, Russia, India and China) Stars fund to invest in the DB-X Trackers MSCI China ETF. Effectively we are dropping the BRI and just keeping the C!

China has been one of the worst performing markets year to date but Chinese companies are still growing their earnings. We believe that this will turn at some point enhancing our Global Speculative portfolio in general and this fund in particular.

Alternative Equity

This portfolio has continued to do what it is meant to do, reducing losses when equity markets fall but providing decent returns when they rise.

Over 6 months this portfolio is up by 4.17%. This is marginally behind the FTSE Allshare at 4.3% but this portfolio has been much less volatile. We are therefore very pleased with this return.

During the last few months we dropped the Midas Balanced Income fund and bought the Troy Trojan fund. This fund is featured on page 28.

Property

We sold all remaining property funds in April and May. As detailed in the asset allocation section, at present we think the risks of investing in this asset class are too great for the likely return.

Commercial property prices are highly correlated to economic growth and so we are unlikely to want to reinvest in this asset class until the economy picks up.

Fixed Interest

In the last issue we explained how we had made a mistake in this sector in 2011 by positioning for rising inflation and interest rates.

This meant we saw some short term underperformance in the summer of 2011. Since then, we made a number of changes to our portfolio and have been pleased with the results. The changes we have made and the speed at which we made them meant we have more than made up the lost ground.

Over 12 months the portfolio is up 17.18% compared to the UT Sterling Corporate Bond sector which increased by 12.68%.

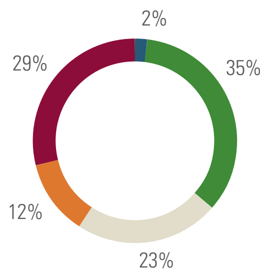
Corporate bonds have done very well as the spread between their yields and the record low yields on gilts increased. This made them more attractive in relative terms and increased demand, pushing up the price and pushing the yield down.

Fixed interest is unlikely to continue providing these levels of returns. Its principle job is to provide stability to the portfolio as well as beating cash. We believe it will achieve these objectives but if the current momentum continues we may wish to reduce exposure again.

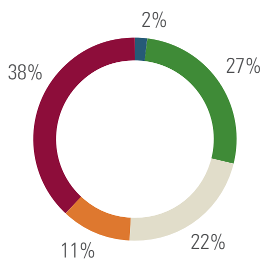
You can find performance statistics for all our different portfolios on pages 38 and 39.

Model Portfolio Returns

It is very pleasing to note that all our models are well ahead of both the average managed fund and average discretionary manager over the past 6 months. In addition, all apart from one have produced returns in excess of both benchmarks since their launch in January 2008.

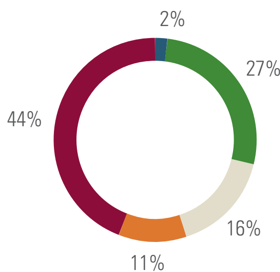


Cautious Models	6 Months %	1 Year %	3 Years %	Since Launch* %
Model AA 1 - Bluechip	3.98	12.47	17.44	20.39
Model AA 2 - Cautious	3.6	12.24	16.4	20.19
Model AA 3 - Growth	3.1	11.73	15.57	20.1
Mixed Asset 20-60% Shares Sector	2.75	10.59	17.09	11.41
ARC Sterling Cautious PCI	2.03	6.96	12.78	15.03



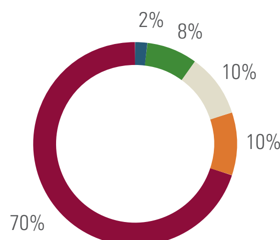
Balanced Models

Balanced Models				
Model AA 4 - Bluechip	3.83	13.46	18.98	19.39
Model AA 5 - Balanced	3.29	13.05	17.2	18.48
Model AA 6 - Growth	2.89	12.72	16.66	18.98
Mixed Asset 20-60% Shares Sector	2.75	10.59	17.09	11.41
ARC Sterling Balanced PCI	1.68	9.37	15.45	11.7



Adventurous Models

Adventurous Models				
Model AA 7 - Bluechip	3.75	14.1	19.06	16.61
Model AA 8 - Adventurous	3.22	13.79	17.51	16.3
Model AA 9 - Growth	2.78	13.43	16.9	16.75
Mixed Asset 20-60% Shares Sector	2.75	10.59	17.09	11.41
ARC Sterling Balanced PCI	1.68	9.37	15.45	11.7



Speculative Portfolios

Speculative Portfolios				
Model AA 10 - Speculative	2.87	15.38	17.33	20.59
Mixed Asset 40-85% Shares Sector	2.08	12.82	19.48	23.37
ARC Sterling Steady Growth PCI	1.64	11.32	17.94	22.31

* Launch date 1 January 2008 except Speculative Model AA 10 launched 1 September 2009

All data to 05/10/12

Cash | Fixed Interest | Property | Alternative Equity | Equity

Figures are highlighted in green where they are in excess of the relevant "Mixed Asset" sector

Sector Portfolio Returns

	6 Months %	1 Year %	3 Years %	Since Launch* %
Equity Portfolios				
UK Large Companies	7.07	19.84	31.43	11.2
UT UK Equity Income Sector	**6.38**	**20.09**	**31.12**	**9.14**
UK All Companies	5.12	21.54	31.71	9.8
UK Dynamic	3.67	20.76	26.3	8.47
UT UK All Companies Sector	**4.67**	**21.4**	**29.6**	**8**
Global Established	3.09	18.3	22.66	9.93
Global Established Benchmark **	**2.37**	**20.19**	**22.15**	**7.97**
Global Speculative	-3.23	15.42	9.35	-0.62
UT Glbl Emerging Mkts Sector	**-2.32**	**17.52**	**15.93**	**7.27**
Cautious Equity Mix	4.58	19.61	27.65	8.96
Cautious Equity Benchmark ***	**3.83**	**19.48**	**26.35**	**6.73**
Balanced Equity Mix	3.43	18.82	23.12	7.64
Balanced Equity Benchmark ***	**2.7**	**18.63**	**23.8**	**6.06**
Adventurous Equity Mix	2.48	17.98	21.19	7.48
Adventurous Equity Benchmark***	**1.75**	**18.44**	**22.26**	**5.89**
Alternative Equity	5.08	17.17	18.54	22.15
UT Mixed Asset 20-60% Shares	**2.75**	**10.59**	**17.09**	**11.41**
Fixed Interest Portfolio	6.64	17.18	23.58	35.67
UT Sterling Corp Bond Sector	**7.13**	**12.68**	**24.34**	**27.16**

* 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

*** Cautious, Balanced and Adventurous Equity benchmarks are an appropriate composite of the benchmark for each component of that equity mix

Market Returns

	6 Months %	1 Year %	3 Years %	Since Launch* %
Equity Markets				
FTSE 100 Index (UK)	4.72	19.57	29.96	7.63
FTSE Allshare Index (UK)	5.17	20.94	31.79	8.83
FTSE 250 Index (UK Mid Cap)	8.01	29.92	45.95	22.7
MSCI Europe Ex UK Index	4.14	14.87	1.26	-11.09
S&P 500 Index (USA)	3.14	23.78	44.77	28.02
Topix (Japan)	-8.1	-2.93	1.94	-7.41
MSCI Emerging Markets Index	-3.21	17.77	17.5	14.85
Fixed Interest				
IBOXX Sterling Corporate Bond Index	9	16.97	29.92	35.88
UT Sterling Corporate Bond Sector	7.13	12.68	24.34	28.6
FTSE British Government Allstocks (Gilt) Index	4.04	6.56	23.07	47.07
UT Gilt Sector	4.11	6.42	21.92	44.13
UT Sterling High Yield Sector	5.96	20.42	29.46	32.64
Property				
IPD UK All Property Index	0.73	3.25	37.63	-8.96
Property Benchmark*	-0.32	0.35	16.64	-18.73
Other Measures				
Bank of England Base Rate	0.91	2.14	12.87	16.83
RPI Inflation	0.25	0.5	1.51	8.24

* 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 may (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 2012.
- Model portfolio performance is stated after a 1.5% Equilibrium fee and a 0.35% platform charge, but with the discounts we receive from fund managers factored in.
- Your own performance may vary from the model due to 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 on which you are invested. We will also provide personalised performance information at your regular reviews.

Ideal Funds

Below are the funds currently in our different portfolios and the charges that apply to each fund.

Equity Portfolios

Portfolio	Fund name	Initial Charge %	Annual Management Charge %	Total Expense Ratio %
UK Large Companies	Artemis Income	0	0.750	0.790
	Invesco Perpetual Income	0	0.750	0.930
	Jupiter Income	0	0.750	0.940
	Vanguard FTSE UK Equity Income Index	0	0.250	0.250
UK All Companies	Vanguard FTSE UK Equity Index	0.5	0.150	0.150
UK Dynamic	Artemis UK Special Situations	0	0.750	0.810
	M&G Recovery	0	0.750	0.910
	Schroder UK Alpha Plus	0	0.750	0.910
Global Established	BlackRock European Dynamic	0	0.750	0.930
	Schroder Tokyo	0	0.750	0.900
	Threadneedle European Select	0	0.750	0.940
	Vanguard US Equity Index	0	0.200	0.200
Global Speculative	DB-X MSCI China ETF	0.6	0.200	0.650
	Dimensional Emerging Markets Core Equity	0	0.500	0.810
	Vanguard Emerging Markets Stock Index	0.4	0.550	0.550

Fixed Interest Funds

Portfolio	Fund name	Initial Charge %	Annual Management Charge %	Total Expense Ratio %
Fixed Interest	BlackRock Corporate Bond	0	0.230	0.260
	Invesco Perpetual Tactical Bond	0	0.625	0.935
	Jupiter Strategic Bond	0	0.630	0.890
	M&G Optimal Income	0	0.750	0.920

Alternative Equity

Portfolio	Fund name	Initial Charge %	Annual Management Charge %	Total Expense Ratio %
Alternative Equity	CF Odey UK Absolute Return	0	0.500	0.600
	Standard Life Inv Global Abs Ret Strategies	0	0.750	0.850
	Troy Trojan Fund	0.5	1.000	1.030

* Most fund managers do not charge an initial fee but other charges may apply such as stamp duty, dilution levy, or other dealing costs. These are included in the initial charge column above.
These are the funds in use in our standard portfolios at 5 October 2012. These will change periodically and have not all been held throughout the whole period covered by this document.

Equilibrium Spring Events 2013

Our seminars are suitable for High Net Worth individuals who are retired or approaching retirement, who may be worried about the Economy or other financial planning matters and the effect on their future.

Investing for Income

Thu Feb 14 The Hunting Lodge, Adlington Hall, Macclesfield
Tue Feb 26 DoubleTree by Hilton, Hoole, Chester
Thu Mar 7 The Mere Golf & Country Club, Mere, Knutsford

Current Financial Affairs

Tue Mar 19 The Hunting Lodge, Adlington Hall, Macclesfield
Thu Mar 21 DoubleTree by Hilton, Hoole, Chester
Tue Apr 16 The Mere Golf & Country Club, Mere, Knutsford

Successful Lifetime Investing

Wed Apr 24 The Hunting Lodge, Adlington Hall, Macclesfield
Wed May 15 The Mere Golf & Country Club, Mere, Knutsford
Wed May 22 DoubleTree by Hilton, Hoole, Chester

Live Well & Leave a Legacy

Tue Apr 30 DoubleTree by Hilton, Hoole, Chester

For more information please visit **www.eqasset.co.uk**

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