Stepping back and thinking long-term

2 March 2022

After the initial shock and awful consequences of Russia's move from lip service to the international order of a full assault on a neighbouring European country, this article seeks to take a step back and say: what should this mean for an individual's approach to their financial planning and wealth accumulation in the UK?

We will look in turn at potential shifts in political background and the likely outcomes in investment and tax planning.

Background

In the 33 years since the fall of the Berlin Wall we have seen a transition in the West from concern about existential threats to a focus on internal differences and issues. The rights and wrongs of a so-called left versus right, or rights versus responsibilities debate had been viewed as somewhat unimportant, as we have been more consumed by social issues, regulation and law and the desire to grow wealth across our nations. We have become less conscious of the risk of weaponised states cutting through the peaceful progress of our aims and future assumptions, and our respect for the law being at the very centre of our democratic political choices and processes.

Assuming the conflict remains confined to Ukraine, then however it plays out, from a full occupation of the country to a partial annexation of those predominantly Russian speaking parts, this will not fundamentally alter the global investment landscape in itself.

Clearly, European states are going to have to shore up their defences and spend a greater proportion of GDP on rearmament - personnel, equipment and technology. This comes after a period of democratic governments pretty much discounting mechanised warfare as a defence and they'll need to reverse their unpreparedness. At a time when governments are spending more than they raise in taxes, both from existing structured deficits and the financial support surrounding COVID. Whilst we also need to consider the impact of substantially higher inflation than we have experienced for many years and increases in long-term energy prices.

We now confront the return of Hobbesian realism, whereby interstate war in Europe is again a reality. The ability to maintain freedom is again a function of force of arms not faith in law.

What does this mean for my financial wellbeing?

How does this affect us as we all seek to protect and grow our wealth?

Different circumstances and views drive different behaviours, but common themes emerge:

- War and destruction will result in a humanitarian crisis
- Sanctions will be applied, with limited effect
- The invaders will struggle to stabilise and hold the territory
- Investors will soon return to business as usual
- An uneasy political compromise is eventually reached

However, it is hard to detect a lasting impact on global financial markets.

PARTNERS
WEALTH MANAGEMENT

If you believe that the immediate end to this crisis is an uneasy settlement with either all or part of Ukraine occupied, then this holds true as per figure 1 below. This is reinforced by the volatility of a near 3% market fall on day one of invasion being mostly clawed back the next day with a 2% rise. Volatility is to be expected but in the short term it is a trading phenomenon, not a theme to be played by long-term wealth accumulators.

Beyond the initial crisis our unique investment methodology comes into play. We have partnered with Asset Risk Consultants (ARC) who research the leading 150 wealth managers operating in the UK and their unique insights help create our investment panel. Each of them will look at the factors that flow and tilt portfolios within risk profiles to reduce threat and take advantage of opportunity.

For example, rising commodity inflation may well enhance energy or commodity stocks while reducing retail as spending power declines and rearmament by the West may be positive for aerospace and defence sectors. It is the role of our DFMs to orientate portfolios as they see fit and the role of advisers to map your portfolios to your risk appetite and any particular nuances you favour.

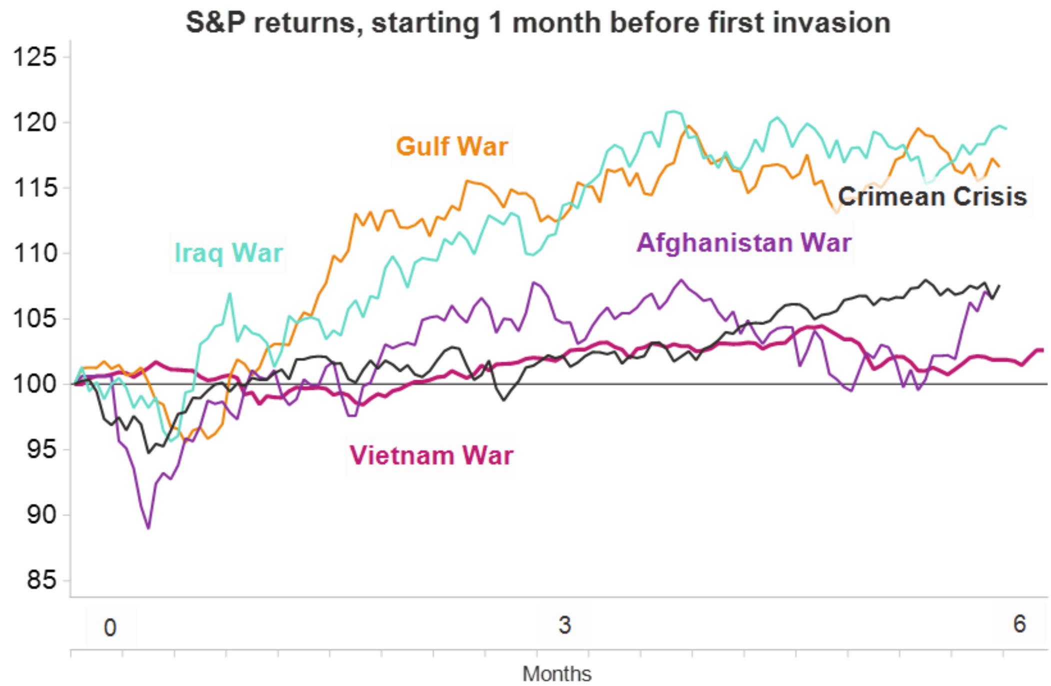

Figure 1
Source: 7IM, Bloomberg Finance L.P. Past performance is not a guide to future returns

Two questions we are often asked is *'should I sell everything'* and in contrast - *'are markets cheap'*?

The chart below answers the first question. If you missed just the best 30 days of the FTSE 100 return since 31 December 2001, you would have been hit with a negative return of – 2.3% p.a., as opposed to a return of 5.6% p.a., fully invested. It is a risk as great as being in a market to effectively 'short it' by coming out, hoping for a fall and agonising about reinvestment timing. At this time, when the crisis also looks likely to see inflation rise, holding cash in long-term portfolios looks a certain way to guarantee real value losses. The quietly forgotten but most inclusive measure of RPI has inflation at 7.8% in January. In the long run only 'real assets' (equities, commodities and property) can keep pace with inflation as 'fixed assets' (corporate bonds, cash, gilts) will be eroded in value.

The sensible approach for two types of clients differ here. Those in wealth accumulation – people earning monies so that each year fresh net income above expenditure means more investment routinely takes place – ought to enjoy the dips by buying more assets at lower prices. Those in decumulation will already have a defensive element to portfolios and we often suggest five years of income in low volatility assets is the optimal security for a retired high net worth individual. This allows you to ride out market dips without selling assets at low points in a cycle.

The advantage of engaging with a financial adviser is that whether you are in accumulation or decumulation, your plan ought already to be shaped to an extent. The default in a crisis is firstly *'stick to the plan'*. After examining the default, the next question is *'have circumstances changed enough that I wish to alter my plan, due to additional threat or unprecedented opportunity?'* For a well-defined plan the volatility to date and historical precedent suggest any change that is not fundamental is best left to your appointed investment managers titling portfolios within mandates defined to them.

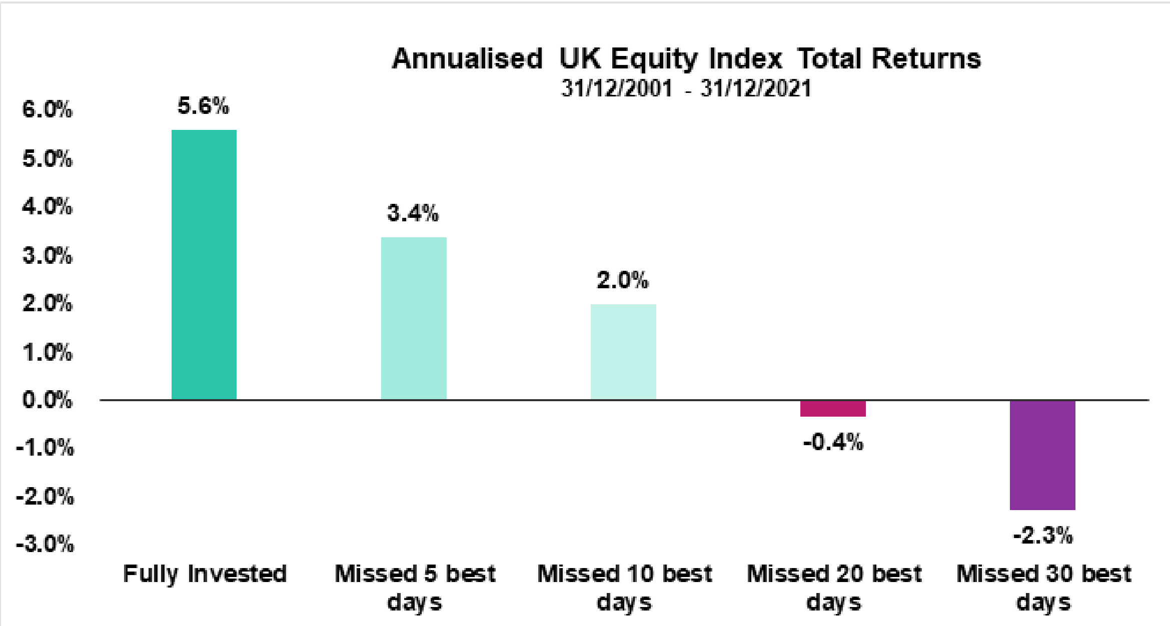

Figure 2
Source: Source: 7IM, Bloomberg Finance L.P. Past performance is not a guide to future returns, chart(s)/data for illustration

So, what action should I take?

The short- and medium-term economic impacts of war can only be negative. In addition to the tragic loss of life and general destruction of infrastructure, it will have a long-lasting negative effect on trade, and dramatically constrict energy and raw materials supply – with commensurate cost rises.

Despite the post-cold war peace dividend, since 2008 the West has built debt every year due to governments choosing spending levels higher than tax receipts. The debt has then risen to historic record peacetime levels to counter COVID and now we must increase defence spending to rearm and match the 2% of GDP NATO countries commit to, but only the US and recently the UK achieve. While in the very long-run this may lead governments back towards the cost savings of lower welfare spending, less regulation and focus on increased enterprise, governments (or perhaps we should say electorates) at present seem more inclined to listen to the calls for higher taxation as solutions. However, the debt accumulated will cost more to serve. In the UK inflation and interest rate rises already mean the £12 billion of tax raised from the National Insurance hike from April will be completely absorbed by servicing government borrowing cost rises. For the personal wealth accumulator this inflation and tax combination makes it more important than ever not to sit on cash but to actively invest and use all personal allowances to shelter assets and growth from potentially pernicious levels of taxation. Therefore, a simple set of steps becomes vital to effective wealth accumulation year on year – to be enacted depending on levels of wealth or income above expenditure:

- Pensions - Gain the 20% to 45% tax reliefs from pension allowances up to the point of maximum contribution or lifetime allowance caps
- ISAs - Ensure you use the £20,000 ISA allowance for all those 18 or over in a family, thus building pots of 0% tax on growth and 0% tax on interest/dividends
- JISAs - Consider funding the next generation's university fees or house deposit via the £9,000 per annum JISA allowance that again has 0% tax on growth on interest/dividends
- General Investment - Create portfolios to use your own and your partner's 0% taxable dividend allowance and £12,300 each 0% Capital Gains Tax allowance
- VCTs - Where you have the risk appetite given these are higher risk investments, consider the 30% income tax relief on Venture Capital Trusts.
- EISs - Where you have risk appetite given these are higher risk investments, consider the 30% income tax relief and Inheritance Tax relief on Enterprise Investment Schemes
- Offshore Bonds - Consider offshore bonds with their compound growth of 0% tax until maturity and the potential to shelter wealth until a lower rate taxpayer in retirement

Use of such allowances, coupled with the multi-asset and dynamic investment portfolio of an ARC overseen DFM could build wealth and in the event of a more aggressive tax regime will give you the best opportunity to shelter investments within statutory 'permitted' structures.

This combined, should help you over the long term, in line with your personal risk profile, negate the threats of volatile markets and take advantage of investment opportunities, without taking life changing short-term bets on wholesale engagement or disengagement with markets.

We're here to help

If you are not sure of your plan or want to review it, then now is the moment to act. Those more conscious of and organised around their wealth are likely to find they achieve the best results. We look forward to being of assistance.

The contents of the article have been prepared solely for information purposes. The article contains information on financial products and services and such information is designed for and addressed solely to individuals seeking generic industry information. This document reflects our understanding of current legislation. Past performance is no guide to future returns. Taxation depends on your individual circumstances and may be subject to future change.

partnerswealthmanagement.co.uk

Partners Wealth Management LLP is authorised and regulated by the Financial Conduct Authority FRN: 442303 and registered in England under No.OC307751.
Its registered address is 20 St Andrew Street, London, EC4A 3AG.

© (2022) Partners Wealth Management LLP