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Your Window on
Wealth

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Coronavirus – a black swan event?

When the COVID-19 pandemic struck, the severity of its impact on global societies and economies was shocking. Yet critics are insisting that the repercussions could (and should) have been foreseen. Does this make it a 'black swan' event?

Originally coined by financial theorist and writer Nassim Nicholas Taleb, the term 'black swan' has come to denote any event that:

- Is extremely rare
- Has a severe impact
- Is unpredictable (although some may claim in hindsight that it could have been predicted).

Historic black swans

Examples of black swans from history include the Spanish flu outbreak (1918), Wall Street Crash (1929), 'Black Monday' (1987), the terrorist attacks on the World Trade Center (2001), the SARS outbreak (2003) and, more recently, the global financial crisis (2008).

Black swan – or not?

While it may seem a textbook case on the surface, some are arguing that COVID-19 does not constitute a black swan event. Severe impact? Undoubtedly. Rare? Perhaps. But unpredictable? Maybe not.

History shows us that significant outbreaks of infectious diseases do happen. What's more, Bill Gates, George W. Bush, Barack

Obama – and Taleb himself – have all previously issued dire warnings about what could happen if we failed to prepare for future pandemics. Can we really say, then, that the coronavirus pandemic was completely unpredictable?

The COVID difference?

Those who say it is a black swan event have pointed to the unique brutality and speed with which the virus spread around the world and hit financial markets. In the words of one financial commentator: *"It has been incredibly fast-paced, faster than '29, faster than '87. The speed and ferocity has been utterly breathtaking."*

Even so, Taleb himself suggests that coronavirus does not fit his description of a black swan event. Yes, it has had a severe impact on the global economy and people's lives. But there are also multiple examples of serious global outbreaks from the 21st century alone – Ebola, SARS and the H1N1 influenza pandemic all spring to mind.

Weathering the storm

Black swan event or not, you can rely on us for advice and guidance on weathering any storms that lie ahead.

Kiss your cash goodbye

"Sorry, we don't accept cash" has become a familiar refrain in shops and eateries in recent months due to fears that handling cash could accelerate the spread of the virus. So, are we on our way to a cashless society?

Predictions of the death of cash are not solely a result of the pandemic. Discourse surrounding the 'cashless society' pre-dates lockdown by many years and trends such as the introduction of online and mobile banking, the disappearance of ATM machines and the rise of contactless payments have long been features of modern society.

The cashless society?

There is no doubt that the pandemic has accelerated this trend, with credit and debit card usage soaring. The maximum contactless spend was recently upped to £45 to facilitate this, with 66% of Mastercard transactions in the UK now contactless and 45% of people stating they have used cash less during the crisis[1].

However, research states that cash is still a necessity for 25 million people[2]. A 100% cashless society assumes that every person has the means, technological know-how and ability to pay by card for every transaction. So, while the grip of cash on Britain is undoubtedly being eroded, it will be important to maintain access to cash for certain groups of society, including the elderly.

[1]Mastercard, 2020, [2]Age UK, 2020

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UK investors return to funds

Following the highest ever monthly outflow from retail funds in March, UK savers invested more in the second quarter of 2020 than they did for the whole of last year. Figures show that £11.2bn was invested for the quarter, compared to £9.8bn in 2019[3]. In June, global shares were the best-selling geographic region, with net retail sales of £930m.

CGT overhaul on the cards?

Over the summer, the Chancellor, Rishi Sunak commissioned a review of Capital Gains Tax, to determine whether the current system is fit for purpose and to identify simplification opportunities. The Office of Tax Simplification (OTS) has published an online survey and call for evidence. They will explore the applicable rates, reliefs, exemptions, allowances and overall scope of the tax, in addition to its role in respect of the position of estates in administration, potential distortions to taxpayers' investment decisions and the selling or winding up of unincorporated businesses.

The OTS commented in their call for evidence, there have been, *'several changes to CGT'* over the last 10 years and that it *'may be helpful to consider the tax again in the current climate.'*

We will keep you up to date on any developments

Private pension age rise confirmed

In September, the government confirmed the private pension age will increase from 55 to 57 in 2028, meaning those retiring in future will have to wait longer to access their pension.

Are you on your best investor behaviour?

In uncertain times, where we've witnessed periods of stock market volatility, it's easy to let emotions influence investment decisions, but a good strategy for investors to adopt is not to react hastily. Human instinct is to be responsive, so traversing these behavioural biases can be challenging, but once mastered, resisting the urge to flight can be rewarding.

Unlike prehistoric times, when the fight or flight reaction meant the difference between life and death in the face of a carnivorous dinosaur on the prowl, survival depended on quick pattern recognition and decisive action. As an investor, controlling these hard-wired behavioural biases and learning to resist the urge to panic, can bear fruit.

Take stock market volatility in March this year as an example. Retail investors sold investment funds worth £10bn in just one month[3], with many selling just as the stock market was falling to its lowest level in eight years. In doing so, they missed out on the subsequent market bounce of almost 30%. If hindsight is a marvellous thing, by its very definition, foresight is insight gained by looking forward. In other words, when it comes to investing, look forward, because markets tend to bounce back over time, though it can't be guaranteed.

Different drivers

A number of factors lead people to respond differently to market occurrences – what your objectives are, your risk tolerance, beliefs, preferences, emotions and past experiences, can all result in different investor behaviour. One event, such as a market fall, can lead to different behaviours; ceasing investing until markets stabilise, selling in case it's the beginning of a market downturn, or contrarian investors may see the correction as an opportunity to invest. Some beliefs could lead to successful investment outcomes, others could result in behavioural biases that are counterproductive and endanger the prospect of successfully achieving your objectives.

Managing behavioural biases

As humans, we all suffer from some biases. The best defence mechanism to safeguard from knee-jerk reactions and defend against the influence of your biases, is to follow a robust, objective and disciplined process, and that's where we come in. In addition to having a well-thought-out investment process, investing with a clear idea of what you want to achieve, will determine how we structure your investments. Whether you are building your retirement nest egg or a fund to put children through university, you have a better chance of achieving your goals if they are used to frame all investment decision-making.

Foresight

You can rely on us; we take the time to understand your objectives, apply a rigorous investment process and advise you on the investment strategies and products most appropriate for you.

[3]The Investment Association, 2020

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A turning point for ESG investing?

Investing according to environmental, social and governance principles (ESG) has been a fast growth area, according to figures[4], UK-based ESG funds saw record inflows between March and July 2020, with £362m invested in July alone.

What is ESG?

The acronym, ESG, refers to three key factors used by investment companies to evaluate corporate behaviour:

- Environmental criteria – such as: carbon emissions, waste management and air/water pollution
- Social criteria – such as: human rights, labour standards and data security
- Governance – such as: board diversity, business ethics and executive remuneration.

By assessing these factors, investment companies measure the sustainability and ethical impact of an investment.

ESG has developed from Ethical Investing using positive screening to be a focus for individual companies, countries and therefore for investors.

Risk and performance

In the early days of sustainable and ethical investing there was a perception that investors were putting principles before profit, with such investments generally considered to be higher risk than their traditional counterparts. Nowadays, with a much wider choice of ESG products available, this style of investing is capable of generating long-term stable and sustainable returns.

A matter of principle

Selecting investments based on ESG principles offers no guarantee of performance but, as part of a diversified portfolio, they can allow you to make a positive impact without having to give up on the hope of good returns.

[4]Reuters, 2020

100-word briefing: the first Budget

In current terms *'The Budget is a statement made to the House of Commons by the Chancellor of the Exchequer on the nation's finances and the Government's proposals for changes to taxation.'* So, when was the earliest one? It was certainly before 1860, when William Gladstone was using the red despatch box discarded in 2011 by George Osborne. Indeed, the national Budget predates the House of Commons (1341), going back at least 800 years to soon after the Magna Carta of 1215, when the equivalent of the Chancellor's despatch box was a leather bag – called a 'bougette' in Old French.

Dividend cuts – not all bad?

UK dividends experienced their biggest quarterly fall on record in Q2 2020, dropping by over £22bn (57%) to give a total payout of £16bn. Dividends were cancelled by 176 companies and reduced by at least a further 30. BP cut its dividend for the first time in a decade, with a 50% reduction to 5.25 cents a share, compared to 10.5 cents in Q1.

Despite an array of dividend cuts in the wake of the pandemic and the subsequent impact on income, a contingent of fund managers see these cuts as prudent moves by the businesses who have made them to preserve their capital expenditure in the short-term:

"The rebasing of dividends across the UK stock market is an opportunity for companies to reallocate capital more sensibly."

Carl Stick, Rathbone Unit Trust Management

"In ordinary times, a dividend cut is a sign of failure. In these exceptional circumstances, however, it reflects sensible short-term capital allocation."

Martin Cholwill, Royal London

"The pandemic has resulted in a great deal of uncertainty for all businesses. Even those whose trading has been unaffected, have still faced issues with supply chains and distribution networks. So, reducing capital expenditures like dividends is prudent. There have been some big cuts but what is key is what happens over the longer term. Dividends will be back, but for now, balance sheets and liquidity are paramount."

Richard Colwell, Columbia Threadneedle

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Where now for the global economy?

With the release of Q2 data over the summer, the full extent of the impact COVID-19 has had on the global economy became apparent, as a succession of countries reported record falls in output, with lockdowns causing inevitable and acute economic disruption.

Although uncertainties surrounding the pandemic are still inflicting economic stress across the globe, there are signs that the worst may be over. Many economists believe the sharpest declines are now consigned to history, but the likely pace of recovery remains unclear.

On home shores

Preliminary Q2 gross domestic product (GDP) statistics show the UK economy was hit particularly hard, with a 20.4% reduction in output in Q2 compared with Q1. The country's largest ever quarterly decline pushed the UK into its first technical recession since the financial crisis.

Around the globe

Output across the Eurozone shrank a record 12.1% during Q2, with Spain suffering the largest decline, its economy shrinking by 18.5%. France and Italy were also badly hit, with quarterly declines of 13.8% and 12.4%, respectively.

Preliminary estimates for the US suggest the world's largest economy shrank at an annualised rate of 32.9% in Q2, the sharpest decline since government records began in 1947.

In Japan, the world's third-largest economy, GDP fell by 7.8% in Q2, which represents the fastest quarterly rate of decline since comparable figures were first recorded back in 1980.

A tentative recovery?

Despite Q2 data for advanced economies painting a bleak picture, a recovery of some sorts may be in the offing. In the UK, the Office for National Statistics said the decline was concentrated in April at the height of lockdown, with the economy bouncing back in June as restrictions eased.

Recovery seems underway in China; the economy returned to growth during Q2, the world's second-largest economy growing 3.2%. This follows a historic 6.8% Q1 slump, China's first contraction since at least 1992 when records began.

The International Monetary Fund (IMF) predicts the global economy will shrink 4.9% this year, a downgrade from previous projections. This downgrade reflects the likelihood of social distancing restrictions persisting for a longer period and the subsequent impact on consumer spending. Voluntary social distancing by people wary of exposing themselves to the risk of infection is also expected to make consumers cautious.

"The strength of this recovery is highly uncertain"

Next year, the IMF predict the global economy will expand by 5.4%; however, they stress there is a higher-than-usual degree of uncertainty surrounding its predictions. IMF Chief Economist Gita Gopinath commented: *"The strength of this recovery is highly uncertain. On the one hand, you could get positive news, you could have better news on vaccines and on treatments and greater policy support, and that can trigger a faster recovery. But on the other hand, there are important downside risks, too, which is that the virus could come back up. You could have financial tightening that could lead to debt distress. So, there are both upsides and downsides."*

It seems the only real certainty at the moment is that these are likely to remain uncertain times. Rest assured, we remain on hand to navigate any uncertainty together.

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Financial lifeboat for large balances

The Financial Services Compensation Scheme (FSCS) has extended its protection for savers amid concerns that the pandemic has increased the likelihood of financial firms failing.

The fund currently protects deposits with UK banks, building societies and credit unions to the tune of £85,000 per person. However, there is additional protection for consumers who temporarily have high balances of up to £1m. Having such a large balance for a relatively short period of time could be unavoidable for reasons such as a house sale, divorce settlement, insurance payout or redundancy.

These temporary high balances are normally protected for six months and the FSCS would automatically pay compensation if the financial institution failed. From 6 August 2020, the FSCS has extended its coverage to 12 months, with the scheme reverting to a six-month cover period from 1 February 2021.

The FSCS has introduced the temporary extension due to consumers' concerns that money could be on deposit for longer, due to a slowdown in the banking system and reduced access to banking services for many people.

It is important to take professional advice before making any decision relating to your personal finances. Information within this newsletter is based on our current understanding of taxation and can be subject to change in future. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK; please ask for details. We cannot assume legal liability for any errors or omissions it might contain. Levels and bases of, and reliefs from, taxation are those currently applying or proposed and are subject to change; their value depends on the individual circumstances of the investor.

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If you withdraw from an investment in the early years, you may not get back the full amount you invested. Changes in the rates of exchange may have an adverse effect on the value or price of an investment in sterling terms if it is denominated in a foreign currency. Taxation depends on individual circumstances as well as tax law and HMRC practice which can change.

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