UKSA
UK Shareholders' Association

THE PRIVATE INVESTOR

ISSUE 206 | JUNE 2020

Back to business

The pandemic is not over, of course, but the UK economy is slowly returning to life. After three months of lockdown this gradual reopening will be complex and difficult for many.

But there are grounds for optimism too. Interest in equities as an investment class seems undiminished. Approached selectively, shares can still offer attractive returns. Trading in recent months has been brisk. The measures taken by central banks in the UK and elsewhere to shore up the economy are pumping in more cash that will seek yield. Our role of defending the rights of shareholders is as relevant as ever.

It is against this backdrop that we are delighted to welcome our new chairman, **Mark Cardale**.

Having spent most of his working life as a corporate finance lawyer with leading law firms in the City of London and gained wide-ranging experience in that field, Mark has developed a specialist expertise in corporate governance.

He first took a special interest in governance while working in New York at the time of Enron's collapse, when he started to attend classes in the subject at New York University. On returning to London, he acted as a company law and governance adviser in major litigation concerning the insurance held by Enron's bankers prior to its collapse.

He subsequently became a partner in a small law firm advising AIM companies on governance issues, and a charity trustee. This led to his being asked to co-author and edit a new edition of a leading textbook on governance, covering each of the corporate, charity and public sectors.

Mark has a wealth of experience working with boards in different situations, and has written and lectured extensively on corporate and charity governance and on related legal topics.

Mark is a qualified governance professional with ICSA: the Governance Institute, and is an External Examiner for the MSc in Corporate Governance at London South Bank University.

We are also delighted to welcome Charles Henderson, who is joining UKSA as a director and brings extensive experience of the Funds industry. Charles will significantly strengthen UKSA's Policy Team. More details can be found on page 5.

Peter Parry and Rob McDonald have now retired as directors after several years of first-class service, but they will continue to support UKSA in the Policy and Membership areas.

Helen Gibbons

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Published by United Kingdom Shareholders' Association Limited (UKSA)

Registered in England no. 4541415

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Do stock prices move too much relative to subsequent changes in dividends?

by Dean Buckner

Dividends have been very much in the news recently. On 18 May the Times reported UKSA as saying that L&G should ‘postpone’ its dividend (actually we said that “A dividend that, in retrospect, could not have been afforded causes major damage for the company and all of its stakeholders going forwards. In the current crisis, therefore, a dividend payment is not in shareholders’ interests”). On 9 April, Cliff Weight of ShareSoc told the Financial Times that investors should not be dependent on income from investments. “You should have a sufficient cash buffer so that if the worst does happen then you’re not financially destroyed.”

Thus the Covid crisis has not been easy for those who, like me, rely partly or wholly on dividend payments in retirement. Like many, I have a few defined benefit pensions whose income I can rely on, but the income is not enough to live on, and I top it up by the dividend stream from a portfolio of equities. The portfolio is well-diversified, but diversification does not help in this case, given that 46% of FTSE 100 companies have either cut or suspended dividends as a result of the covid crisis. My broker estimates that by the end of the tax year dividend income could fall by 30%.

Notwithstanding, I have full confidence in the investment strategy I began when I started investing in 2000, inspired by the seminal work of Nobel laureate Robert Shiller, Professor of Economics at Yale University, which depends on the assumption that, over the long term, dividend income is more stable than fluctuations in stock value would suggest.

Shiller wrote a famous paper in the American Economic Review in January 1981: “Do Stock Prices Move Too Much to Be Justified by Subsequent Changes in Dividends?” His idea was that the value of a stock is the discounted value of all future dividends in perpetuity. If we have enough historical data on stock prices and dividends, we can work out what the then-present value of stocks would have been in the past, using the then-future dividend data and a suitable discount rate, and compare this *ex post* rational stock value with the *ex ante* value given by the stock price.

To the surprise of many, perhaps not his, he found that the stock prices were too volatile: they consistently overestimated or underestimated the present value of future dividends. The two charts on the right show his results; the one at the top is his original published work with a price series from 1871 to the late 1970s, while the one at the bottom is my reconstruction of his model to the present. In both cases (particularly now) you see that the stock price moves much more than the *ex post* value implied by the future dividend stream. Shiller used a fancy statistical model to prove that the stock price was “too volatile”, but his result is apparent merely from the chart.

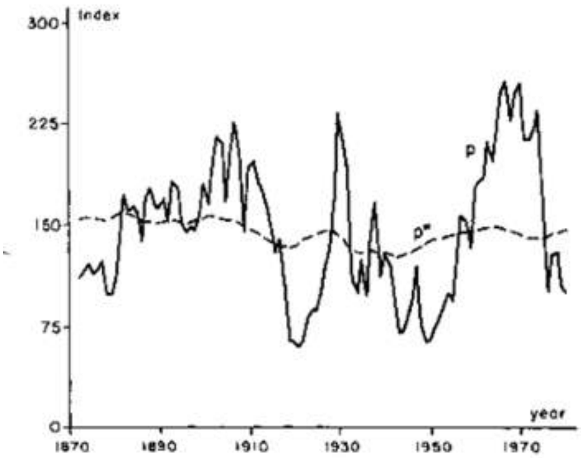

Figure 1: Shiller’s chart from his prize-winning 1981 paper. The solid line is the real S&P composite index, the dotted line the ex post rational price, 1871-1979.

Figure 2: My extension of Shiller’s model using data to 2020. The blue line is the S&P price, the red line the ex post rational price.

Put simply, sometimes markets overshoot, sometimes they undershoot. The message for the investor if Shiller is correct – and 150 years of data suggest he is – is not to panic either when markets collapse as recently, or when dividend cuts are announced. History suggests you should keep your chin up. The gloomy states of affairs are only temporary.

At least, I hope so. The future is always *ex ante*.

Build back better

by Sue Milton

"Build Back Better" was coined in 2015 by Japanese Prime Minister Abe Shinzo, creating the concept of building more resilient nations and societies from disasters (https://www.mofa.go.jp/ic/gic/page4e_000203.html). Building better means implementing well-balanced disaster risk reduction measures by design, not as an after-thought. Within scope are such things as restoration of infrastructure and the revitalisation of livelihoods via the economy, industry, local culture and the environment.

When the COVID 19 crisis hit, the focus was on saving lives. Lockdown, as the solution, was a one-to-many relationship, resulting in most economic and social activities ceasing to achieve one narrowly-focused result. But now we need to manage the reverse, a many-to-one relationship, with no obvious area of focus. In addition, COVID 19 remains with us, so we are having to build containment contingencies at the same time as building expansion strategies for revitalisation.

Without doubt, any recovery will take far longer than the duration of lockdown. What approach should companies take? What can retail shareholders and investors do to assist? There are opportunities such as implementing ESG initiatives that are, in many ways, a follow-on from what we have experienced during lockdown – working from home; customer and employee safety; innovation; less need to travel. But that, through necessity, comes a close second to first finding the ways and means to survive. Some searching questions need to be asked by owners of their managers on how well they did during the crisis and what results they are expecting in the short term to get them back on the road of strategic recovery. Some work is necessary to provide context in which to raise questions with the management. This is my personal approach.[1]

1. Think from the position of the CEO

It helps owners ask better question if we understand the issues the CEO may face. After a crisis, engagement is key to achieving the right outcomes, covering:

- Customer focus.
- Understanding others' positions and the reasons for them.
- Teamwork and cooperation, seeking and valuing the input of others.

2. What is there to worry about?

There are three 'buckets' of worry – externalities, regulatory, operational – with the lists in no particular order and not exhaustive.

Externalities include:

- Collapse of local currency; US$ strength/weakness; FX volatility.
- COVID 19 resurgence stops all economic and social activity again.
- Bank failures.
- Misleading media stories.
- Political actions.

Regulatory includes:

- Changes in regulations that seriously impacted the business model.
- Zealous regulators applying judgements on necessary but hastily constructed emergency regulations.
- Auditors who refuse to sign off on various reporting requirements.
- Policy requirements, such as ESG and climate change.

Operational includes:

- Cash flow, and dealing with potential bankruptcy.
- Credit ratings.
- Bank charges.
- Insurance coverage and costs.
- Cyber security and physical health and safety weaknesses arising from lockdown.
- Weakened supply chain.
- Potentially dangerous service and product failures.
- Litigation as a result of failing to meet contractual obligations.

3. Obtaining assurance

In my role as the owner, I would ask my managers to demonstrate where resilience is proven to have worked, and where improvements have been identified but yet to be put in place.

Good results include:

- Tests provide demonstrable proof there are no problems with systems, products and services.
- The company gets credit in the media for being extra careful.
- The company reacted quickly and appropriately to maintain, or even obtain, competitive advantage.
- The team is better prepared to deal with any future crisis.
- People are interested in their work again and working well.
- Realistic optimism exists across the supply chain that we are all going to pull through.

Defining ways of avoiding:

- Total disaster.
- The wrong solutions.
- Losing sight of the bigger and longer-term picture.
- Stakeholder disappointment.
- Legal battles.
- Fines from the government.
- Adverse publicity.
- Increases in cost without solving the underlying issue.
- A part of the business having to be sold.

UKSA has a strong reputation for asking difficult but very useful questions of boards and policymakers. Let COVID19's aftermath be an opportunity to lead on building better.

[1] My main source is the Korn Ferry Institute.

Introducing Charles Henderson

We are pleased to confirm that Charles Henderson has joined the Board of UKSA. He will work in the Policy Team alongside Dean Buckner, Peter Parry and Mohammed Amin.

Charles started his career over 40 years ago, training as a chartered accountant and carrying out external audits of UK companies. After specialising in the audits of financial services companies, mainly building societies, fund managers and banks, at Touche Ross & Co, now Deloitte, he spent the last 25 years of his full-time working life in operational roles at the fund managers Perpetual and then Invesco, after it took over Perpetual. This included spells as a director of Perpetual's and Invesco's regulated UK companies. Towards the end of his career at Invesco, he was appointed as a non-executive member to the FRC's Audit Quality Review Committee, which he continues, and contributed to the Quoted Company Alliance's 2019 edition of their Audit Committee Guide.

His interest in investing stems from a working lifetime close to fund managers and a keen interest on how UK plc reports to the markets and in governance, company reporting and auditing related matters. His investments include shares in the US listed company Invesco Limited, ISA mutual funds and his defined contribution pension pots. The ISA and pension funds are invested mainly in UK equities and he keeps a close eye on their fund managers' major investments in UK companies. This interest in investing has led to his becoming a director of UKSA in the hope that he may contribute to relevant policy matters, help the way UK companies report to their shareholders and reduce the intermediation between companies and their shareholders.

His hobbies and spare-time interests are foil fencing, films, theatre, fell walking, gaming and reading.

UKSA Policy Team – Current projects and activity

The Policy Team continues to engage with government departments, regulators, the media and other agencies as well as companies and investors on issues which are of importance and relevance to members and the wider shareholder community. Current activities include:

Consultations and discussion documents

- Response to a BEIS enquiry on 'Delivering audit reform'. This consultation seeks views on recommendations made by Sir Donald Brydon, Sir John Kingman and the CMA on the audit market, the FRC and the provision of audit services respectively.
- Response to the FRC Endorsement Board on IFRS 17 Insurance Contracts.
- Response to an FRC discussion paper on Using Technology to Enhance Audit Quality.

Meetings and dialogue

- Discussions with BEIS, the FRC and the FCA on company responses to new guidance on AGMs during lockdown. The scope for the introduction of 'hybrid' AGMs (physical + online) has longer-term implications, which we shall continue to pursue beyond the current lockdown period.
- Woodford and Hargreaves Lansdown: dialogue continuing with Leigh Day over possible collective action following investor losses on Woodford funds.
- Law Commission: ongoing discussion and input to the Law Commission's review of intermediated securities (nominee accounts).

Other collaboration

- UKSA has recently co-signed letters with a number of other organisations including investment funds, the Environment Agency and the Church of England seeking to engage with major fossil fuel companies (Shell, BP, Total ENI) on improved standards of reporting on climate-related and environmental risks.
- We have engaged with and received coverage in the media on a range of topical issues (many Covid-related), including:
    - AGMs
    - Dividends
    - Insurance reporting on potential defaults
    - HSBC, Hong Kong and China.

Fund charges and discounts – a fine dogs' dinner

by Peter Parry

Alan Reeder, a member of ShareSoc, recently decided to do some research into the thorny subject of investment fund charges and discounts. This has been much discussed in the press recently – along with the pros and cons of investing in Investment Trusts versus Funds.

Recent examples

Alan writes that, amid all the discussions of where to invest, a factor often overlooked is the difference in the Annual Management Charge (AMC) levied by the Fund Manager. It is important to bear in mind that although the AMC can vary from one broking house to another, it is the fund manager itself that levies this fee and not the broker. Despite this fact, it is Hargreaves Lansdown who have ended up at the centre of the latest discussion and who are seen as the culprits – or angels – depending on where you are sitting.

Take for example Rathbones Global Opportunities Fund. Just last month, HL sent out an updated Research Note in which they boasted that they had negotiated a discount for their investors, reducing the AMC from 0.78% to 0.52%. Of course, there is HL's own platform fee of 0.45% to pay on top of this. But how is it that Rathbones can justify charging all investors through other platforms a significantly higher fee? Are Rathbones taking pity on HL investors who, by and large, are charged a far higher platform fee than investors through other platforms? Are they suggesting that it is so much cheaper to administer holdings through HL than through other brokers? Or are Rathbones (who we might assume want to be featured in the HL Beauty Parade) being bullied by HL who are, let's face it, far bigger than any other platform?

A quick perusal of this Beauty Parade shows many other examples of so called 'discounts' – many of them for funds you just might not want to go near, with or without a discount. Closer investigation shows there is a fund which is not on the preferred list and which has been doing very well since its launch in October 2017: Blue Whale. This fund, established by Peter Hargreaves (with a controlling share in the BW Fund management company and still the largest shareholder in his old shop – HL), charges an AMC of 1.14% through all platforms except HL, who are charged just 0.89%.

Investigate further and it is intriguing to find fund managers who want nothing to do with 'discounts'; they charge all investors through all platforms the same AMC. Fundsmith is on this list, along with Baillie Gifford and Buffetology and many of the smaller fund names.

Alan concludes by noting that fund Managers have to earn their keep – and the AMC provides this income. But shouldn't all investors be treated fairly in accordance with FCA regulations? Several years ago, the FCA rapped the knuckles of the insurance brokers who demanded extra discounts from insurers (and indeed insurers who offered sweeteners to certain brokers). Isn't it now time that the FCA stepped in to tackle the fund managers and/or the platforms and brokers?

A feeling of *déjà vu*

That is a good question, but much of this debate seems depressingly familiar. Between 2015 and 2017, the FCA reviewed and consulted on the asset management industry and one of its key recommendations was greater clarity on charges. One of the problems seems to have been that the MiFID II rules, which require asset managers to disclose more detail than before about costs and charges, have only added to the confusion. As well as publishing an Ongoing Charges Figure (OCF), which is the fund industry's standard measure of running costs, fund managers must also give estimates of their transaction costs for buying and selling securities along with details of other charges.

That all sounds eminently sensible, you might say, and just what investors want. Somewhat perversely, however, the new rules permit asset managers to use different methodologies to calculate estimates of transaction costs. Results vary widely, with asset managers supplying zero or even negative estimates for transactions costs for hundreds of funds traded across Europe, while other funds show estimated annual transaction costs of up to 2%. Negative transaction fees – caused by slippage in a security's price as it is traded – can also reduce the total cost of investing to investors.

Stuart Hegerty, head of Vanguard's business in Europe, commented to the Financial Times as long ago as January 2018: "Consumers would benefit from a commitment by policymakers and regulators to re-examine this critical issue in due course. If necessary this should include a reconsideration of the methodology for calculating transactions costs and how all costs and charges are presented."

Better Finance, the European umbrella organisation for investor rights groups throughout Europe – of which UKSA and ShareSoc are members – has been ringing alarm bells ever since October 2016. Guillaume Prache, Managing Director of Better Finance, commented at the time: "We have repeatedly warned EU policymakers of the risks that the new methodology for calculating transaction costs entails. It will produce confusing, unreliable and sometimes even negative cost data which are not a reality."

Given the warnings from Better Finance and industry insiders, one wonders what on earth regulators, policymakers and others involved in drafting and signing off MiFID II were thinking of.

Editor's note:
Peter Parry worked with Charles Henderson on the analysis of investment fund charges. Members might be interested in some of the observations Charles makes, drawing on his experience described on page 5.

"I have the following comments on charges in general:

The annual management charge ("AMC") is what the fund manager charges the fund and in the Rathbones Global Opportunities Fund there are three AMCs as far as I can see:

R share class = 1.50%
I share class = 0.75%
S share class = 0.49%

The ongoing charges figure ("OCF") is the AMC plus other fund costs, such as audit fees, bank and custody fees etc., and for this example:

R share class = 1.53%
I share class = 0.78%
S share class = 0.52%

The total MiFID II costs are the OCF plus fund transaction costs plus, I think, other investment costs such as stamp duty:

R share class = 1.66%
I share class = 0.91%
S share class = 0.65%

These can be found in the fund documents on Rathbones' website (https://www.rathbonefunds.com/uk/financial-adviser/literature-library) and in particular in the Rathbones Global Opps Fund assessment of value report for the year ended 31 January 2020 and the fund's annual report. The example seems to be using the OCF.

What I struggle with is how fund accounting keeps track of the different share classes' AMCs, ensuring the right amounts get charged to the fund, and the ongoing fund value for each share classes' portion of assets recognises what has been charged. If you look at p. 12 of the AR, you can see the expenses of £13,537,805. Note 4 on p.16 then shows that of this the AMC is £13,084,256. The regulatory disclosed AMCs above can then be sanity-checked by dividing this by the average AUM in the AR of £1,685,327,789 (see pages 12 and 13 = 1,934,424,514+1,436,231,063/2) = 0.78% (not quite 0.75%).

On p. 22 in note 13 you can see the equity transactions dealing costs being roughly 0.07% of the value of the equity transactions. These dealing costs total £503,518 for the year ended 31 January 2020, being 0.03% of average AUM and therefore only adding this to the OCF, taking the I class, of 0.78% to give 0.81%, so what the other 0.10% in the MiFID II costs figure for the I class is I don't know.

The R share class also appears to be the old retail class where retail investors were charged a lot more than institutional investors (I class?), which is why everyone was switched in the year to the I class (see "Assessment summary" towards the top of p. 6 of the VFM report).

It's complicated, but the article is making a fair point as, assuming in your example the S share class above is HL's just from the coincidence of numbers tying up, why should HL investors get charged less by Rathbones?

If other platforms are only charging up to 0.19%, their investors will be getting cheaper total charges than HL (0.78% + up to 0.19% compared to 0.52% + 0.45%)?"

Regional Zoom meetings hailed a success

Following a recent UKSA regional Zoom meeting, members commented:

'Thank you for arranging the Zoom session … which raised some interesting questions'

'I think it is perfectly sensible to swap individual shares to investment trusts/companies and maybe some ETFs as one grows older. It is what I intend to do as time goes on and reduce the overall number of holdings. It should then be necessary to do very little, unless one wants to'

'Thank you very much for the (Zoom) meeting and the discussion subject, which I imagine could have gone on a lot longer. It makes me think you could revisit the topic at a future meeting.'

'I am looking forward to next month's meeting.'

These comments demonstrate the value of UKSA meetings where members have opportunities to discuss difficult personal financial concerns under the assurance of Chatham House Rules. A detailed report on one of the South-West region Zoom meetings appears on page 16.

Inheritance – families at war – don't inflict it on your heirs

The author of this brief article is remarried and offers some thoughts, but naturally wishes to remain anonymous.

Introduction

It was recently reported that there are more Will disputes going to Court than previously and the primary reason for the increase was not poor legal drafting but conflict between two families where their parents had remarried.

Understandably in some instances each partner's children from a previous marriage may feel that money is being unfairly transferred from one family to another during lifetime, or by accident, or by Will bequests. Instances of this may be:-

1. The property which the newly reweds bought together, each paying half, but the whole went to the family of the survivor.

2. The contents, including valuable antiquities and paintings contributed mainly by the first to die, stayed in the home and on the second death were assumed to be those of the survivor's heirs.

3. The deceased left a large sum of money outright to their partner to ensure that the survivor had sufficient funds to live on to death when the capital then went to the survivors family and the first predecessor's heirs felt this was wrong.

4. On death the will of one of the remarried couple seems to favour the other's children.

Matters can be even worse if the couple have together a third family, which may well take precedent in their affections. Such disputes tend to hit the headlines when they relate to oft remarried, rich celebrities, but they are just as real for ordinary families when assets are modest so meaningful gifts could not afford to be given to anticipated heirs during a lifetime.

What to do about it

Of course, the simple answer is to let logic rather than emotion take precedence. Get remarried to someone with no children, no nephews and/nieces and lots of money: a rare occasion.

It is hard and mercenary, but on remarriage, if there is significant money, let's say a house and £500,000 minimum, and more so a business or estate, then inheritance arrangements need to be considered from the outset.

1.The house can be the main asset and from the outset it may suit to own the home as Tenants in Common. The advantage of owning a property as Tenants in Common is that any property owner may leave their share in the property under their own will to another person of their choice, but their will can provide on death for their partner to have lifetime occupancy rights.

2. The capital assets of each need to be managed separately throughout the marriage so that, although a partner may inherit a life interest in the income, the capital goes to the deceased family ultimately.

3. Valuable household contents are bequeathed to the right family.

However, the aim should be avoid misunderstandings or heirs feeling aggrieved, so at an appropriate time before a first death, openness is urged; discuss what is intended and alongside wills draft a guidance note which all heirs understand and are happy to accept, and make sure the wills reflect what is in the guidance note.

A tortuous process, but then Will disputes can be ruinous.

UKSA in the press

UKSA appears regularly in the press. Here is a selection of recent appearances:

20 February – Financial Times – Peter Parry quoted on the risk of broker failures and the nominee problem

6 March – Financial Times – John Hunter quoted on the campaign for clear pension charges

9 April – Financial Times – Peter Parry quoted on the risk to dividend payments

29 April – Financial Times – Mark Cardale and Dean Buckner on correct pricing of capital

16 May – Financial Times – Peter Parry quoted on the government's furlough scheme

18 May – The Times – Dean Buckner on dividends and a disclosure issue affecting Legal & General

6 June – Daily Mail This is Money – Peter Parry quoted on HSBC and Hong Kong

Fundraisings, share placings and a new service: Primary Bid

by Peter Parry

The problem

There has been an unprecedented flow of share offers and placings recently as companies scramble to raise cash to shore up their finances to see them through the lockdown and its aftermath. A significant bone of contention has always been the way in which retail investors are often excluded from share placings, leaving them with the option either of being diluted when shares are placed at a hefty discount or of having to buy in the market once the placing is complete – incurring dealing costs, as well as possibly having to pay a higher price. This process of excluding certain classes of shareholder from placings and fundraisings, known as the disapplication of pre-emption rights, has always been justified by companies and their advisors on the grounds that including private investors in fundraisings would be expensive and time-consuming.

In a recent article in the Financial Times, Fidelity International boss Anne Richards warned that the asset management industry will struggle to provide enough capital to fix the solvency problems public businesses face as economies emerge from lockdown. She went on to say that, although there were times when it made sense to set aside pre-emption rights, it was important for companies to be able to tap retail shareholders. She added that it was unfair that retail shareholders were missing out on good opportunities.

The answer

A system is now being offered by Primary Bid [https://www.primarybid.com] which links shareholders with companies and allows them to participate in fundraisings. The Primary Bid service, which some members will already be aware of, has been in development for a while but was up and running just in time for the surge in demand caused by the lockdown. According to Peel Hunt, between mid-March and early June, 67 listed companies – 34 Aim companies and 33 main market groups – raised just under £10bn between them at average discounts of 20%. Primary Bid has provided a route to participation for private shareholders in a number of these placings.

Any investor can set up an account with Primary Bid and download their app. This should get them onto the list to get an immediate notification when an offering is under way. Investors can see all the same documentation as institutional investors and either use their debit card to buy and pay for the shares themselves or, in certain cases, send an instruction to their broker or platform to buy shares on their behalf to be paid for from their account with the broker. Direct transfer of shares into ISAs is more complex (involving a bed-and-ISA arrangement), but Primary Bid is working on a process to simplify this.

So far, many of the placings in which Primary Bid has been involved have been for AIM companies, although it was involved in the recent £2bn Compass Group fundraise. One of Primary Bid's goals is to be involved in more of the FTSE350 fundraisings that seem likely to be on the cards.

Primary Bid is a commercial business and although UKSA has met the management team it has no connection with the company and no financial interest in it or in its activities. However, it does appear to provide a valuable service for retail investors. It is one that is well worth checking out.

UKSA's way forward

Previous editions of The Private Investor have announced new directions for UKSA:

• The introduction of Associate Membership

• The programme of Savers Take Control

• The broadening of our reach to all Savers and Investors (those who might loosely be described as present and future shareholders, and all those who ought to be shareholders but don't realise it)

• The resulting emphasis on grassroots education, as exemplified by HonestMoneyNow.co.uk

• The need for funding over and above membership fees to realise this ambition

This ambition requires our administrative and IT function to be strengthened. At the least we need a safety net to cover for any unexpected loss in the service provided by David Riches.

We are therefore appealing for volunteers to shadow David in defined fragments of his role. These might be basic record-keeping or aspects of IT support (e.g. learning about the technicalities of our IT, website or social media and shadowing David in those central office functions). That would depend on your skills and what you enjoy doing.

The roles will initially be unpaid, apart from *ex gratia* 'thank yous' depending on finance. They could develop into paid roles as we expand and we test the water of voluntary funding.

You are welcome to contact David Riches or any of the directors to discuss how you could help.

The price of conscience: analysing ethical performance

Dr Quintin Rayer

DPhil, FInstP, Chartered FCSI, SIPC, Chartered Wealth Manager

Head of Research and Ethical Investing at P1 Investment Management

Biography

Quintin has worked for actuarial and investment consultancy firms and a multi-national European bank, including wide experience in quantitative fund and risk analysis. He is a Fellow of the Institute of Physics, a Chartered Fellow of the CISI and a Chartered Wealth Manager. Quintin has applied skills gained from his Oxford University Physics Doctorate and while working in engineering to finance. He is the second UK graduate from the Sustainable Investment Professional Certification (SIPC) programme and joined P1 Investment Management in January 2017, founding their ethical and sustainable investing proposition.

Introduction

Earlier articles asked why ethical investment matters [1], introduced sustainable (environmental, social and governance, or ESG) investing [2]; or looked at different approaches [3], [4], including fund selection [5]. This article is the second examining the 'price of conscience', testing the view that ethical investments are more likely to underperform. The earlier article explored arguments for ethical out-performance [6]; the focus here is on performance studies.

Might ethical investments tend to under-perform their conventional counterparts? Could 'ethical' or 'green' labels have been applied for marketing advantage? One issue is distinguishing between fund providers with only a superficial commitment to ethical investing and those with genuine skills. This is an area where investors may benefit from input from wealth managers experienced in this field [5].

Apart from identifying genuine ethical funds, might such funds underperform? The argument for underperformance seems to be that ethical investment requires screening, thus reducing investment choices and diversification, resulting in worse returns, higher risk, or both [7]. However, several academic studies suggest the reverse, i.e that ethical investing may instead generate out-performance relative to broader markets, even after allowing for risk and other factors.

Should we expect out-performance?

Reasons to expect out-performance by ethical investment strategies were reviewed previously [6]. They focused on risk and competitive advantage. In terms of risk, harmful corporate behaviours eventually lead to negative consequences, harming growth and share price. These can include community opposition to projects, increased insurance premiums, decreased access to capital markets, damage to reputation, and litigation threats. Essentially, the share prices of unethical companies may not fully reflect their risks.

On the other hand, ethical companies have a competitive advantage from a good reputation to attract customers. They also enjoy enhanced trust with trading partners reducing costs and increasing business opportunities, the ability to attract the best staff and access to capital markets on better terms.

Evidence on performance

Is there evidence to support this? Academic studies suggest that various ethical approaches have resulted in out-performance, with portfolios of more 'ethical' companies out-performing the broad market.

The studies below covered periods from eight to 27 years between 1984 and 2011, using a variety of ethical strategies. Out-performance 'alphas' of 1.3% to 5.2% per annum relative to the market were seen for long-only portfolios. Market models ranging in sophistication up to the Carhart four-factor model [8] were used to allow for the effects of market risk (beta), company capitalisation, value-growth style bias and momentum effects. In many cases, the alphas proved to be statistically significant.

The table summarises how in these studies long-only portfolios of more 'ethical' companies out-performed the broad market. The analyses covered various time-periods with differing criteria to define which companies were more (or less) ethical.

Alpha, per year	Period Analysed	Ethical Criteria	Source
1.3 – 4.0%	1995-2003	Environmental	[9]
2.3 – 3.6%	1992-2004	Environmental, Social	[10]
2.3 – 3.8%	1984-2011	Employment quality	[11]
3.5%	1990-1999	Governance	[12]
3.7 – 5.2% (estimated)	1990-2003	Governance	[13]

Table: Studies showing out-performance by ethical strategies

Of course, out-performance cannot be guaranteed and much depends on the skill of the fund manager not only screening, but also in selecting in which companies to invest.

For another perspective, consider the argument that ethical investing reduces investment choice, resulting in worse performance. A Grantham Institute study suggests that this may not be so [14]. The initial focus was fossil divestment, particularly the exclusion of oil extraction companies from portfolios. Using the S&P500 (the index of 500 large companies listed on the New York Stock Exchange), they excluded one of ten different sectors from a portfolio. They found that over the period 1989-2017 this changed annualised returns by 0.5%. The annualised S&P500 return was 9.71%, while portfolios with one sector excluded returned between 9.44% and 9.94%. Over lengthier periods, the results remained similar. From 1957-2017 a sector exclusion changed annualised returns by 0.61%, and over 1925-2017 by 0.54%. They concluded that one could divest from oil, or pretty much any other sector, without much consequence. While this does not point to out-performance, it undermines the notion that ethical sector exclusions are likely to cause underperformance.

Historical analyses should be challenged on the basis that they offer no guarantee of future performance (which is undoubtedly true). Also, market conditions may be different in future, and perhaps several environmental, social and governance factors are now better addressed by companies. However, they should give pause for thought for those who are tempted to assume that it is ‘obvious’ that ethical portfolios ‘must’ underperform the broader market. This may help allay the dilemma faced by those considering investing ethically.

How this helps Investors

Individuals increasingly wish to invest ethically, often with specific concerns in mind. Younger people may give this a higher priority than older generations, with twice as many 18- to 34-year-olds feeling their pensions should be invested ethically, compared with those above 45 [15]. The Investment Association reports £25.5 billion assets in the UK responsible funds sector in March 2020, an increase of £7.3 billion since March 2019 [16].

Individuals will wish to be confident that ethical investing is unlikely to be detrimental to portfolio performance, but must remember that, in common with more traditional approaches, capital is at risk; an investor may get back less than originally invested. The academic studies indicate periods when ethical strategies have outperformed, or where exclusions have made little difference, which may offer reassurance. However, the selection of suitable ethical funds is a complex area. So, some investors are likely to wish to access the skills of wealth managers who can support them in this significant and growing field.

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STC

Improving capitalism for the public good – what do we have in mind? – and can it be done?

by Martin White

By way of introduction, our STC-related articles this month will inevitably cover at least some ground that we have covered in previous issues. However, with new readers in mind, including people completely new to UKSA, the idea is that, taken together, they are sufficient to give a good idea what it's all about.

Back to the title of this article, ultimately, "improving capitalism" is what we are trying to do our bit towards.

What do we want to influence, exactly? Company behaviour is one thing.

We'll start with expectations of, and within, companies. The corporate world is currently getting a lot of criticism. The **headline problems** are well understood throughout the country, with discussions in the media and in political debate frequently covering them at some length:

- Corporate short-termism; leading to a focus on today's profit and today's share price;
- Executive pay, especially bonuses and "performance" pay, out of control, with an upward trend still, in spite of decades of regulatory attempts to get a grip;
- Increasing concern at the growing disparity between top incomes and the bottom;
- Increasing concern about productivity – and thus employability of people in our competitive world. There is a suggestion that this is in part a consequence of under-investment.

Andrew Smithers is an economist with a long career in the world of finance. He is perhaps best known for the book he co-wrote with Andrew Wright "valuing wall street", which came out in March 2000. This argued, using a couple of measures which had proved to be good long-term indicators of whether general stock market levels were relatively expensive or cheap, that the market at the time was particularly expensive. Nine years later, a follow-up book emerged entitled "Wall Street Revalued: Imperfect Markets and Inept Central Bankers". More recently, in 2019, his book "Productivity and the Bonus Culture" was published.

If you look up the 2019 book on Amazon, you will find the following description:

> "Living standards in the UK and US are in danger of falling. A decline in growth due to poor productivity and an unfavourable change in demography has weakened the stand of liberal democracy, and voter dissatisfaction is encouraging populist policies that threaten even worse outcomes. Whilst living standards once grew faster than productivity, they now grow more slowly, and the working population is no longer growing faster than the population as a whole. To avoid falling living standards the productivity problem must be addressed.
>
> Andrew Smithers argues that faster productivity does not depend, as many suggest, on technology; it also relies on investment. Current growth theory is based on a faulty model which has induced pessimism about our ability to encourage more growth. Productivity and the Bonus Culture sets out a revised model which demonstrates that weakness in productivity is the result of the bonus culture, and suggests ways to change this flawed system so that investment is encouraged and growth returns."

At the root of corporate culture is what is perceived to get the "well done". The biggest "well done" for senior executives is often something tied in some way to measures which are, at least in the short term, capable of targeting. Smithers suggests that today's profits will come at the expense of under-investment, with a long-term price for workers and society generally.

We could use many column inches on this. Much work has been done on the problem of short-termism, including on behalf of Government. In TPI issue 204, we quoted John Kay on remuneration as follows:-

> "No one company can easily shift from current norms in terms of remuneration quantum and norms. Initiative in changing the bonus culture must come from investors acting collectively with the strong support of government.
>
> Such government support should be expressed in general, not over-prescriptive terms. Regulation of pay is likely (as with much regulation of the financial sector) to lead to avoidance activity and a tendency for the limits of what is permissible to become the norm."

In the quote above, "investors acting collectively" is more about managers of collective investments than it is about individuals. And they will not act collectively unless there is a public demand for them to do so. Which links us to our next change.

The other change we want to see is to do with individuals and their relationship with long-term savings

Put simply, individuals are in a weak position when it comes to long-term savings. A small number of people have enough knowledge to manage their long-term savings with confidence, understanding the importance of minimising expenses, and knowing how to achieve this. The essential knowledge you need starts with compound interest. Not only do investment returns compound over time, but so do expenses. And the same applies to inflation. Einstein is reputed to have said: "Compound interest is the eighth wonder of the world. He who understands it, earns it." Achieving a better understanding of essential investment principles within the general population will be hard grind; the education system certainly hasn't achieved it. For one thing, understanding the principles should help protect people from marketing spin. These principles include a number of investment facts of life, especially facing up to uncertainties, and the importance of diversification.

UKSA played our part some years ago in lobbying the regulators to attack commission bias in the financial advice world – and the result was the Retail Distribution Review (RDR). We did at least some good there, though there are always voices arguing to weaken the rules. But the financial sector is still unique in terms of information asymmetry between the industry and the customer. Look at almost all other goods and services you can buy – you can quite easily compare costs between alternatives. You can compare the price of a pound of sugar between Sainsburys, Tesco, Asda, Aldi and Lidl easily enough. It gets more difficult as the "deal" gets more complicated – a good example is mobile phones, another is home electricity and gas tariffs. For both mobile phones and home utility tariffs, most people, if they put the effort in, especially with the internet to help, could find themselves a reasonably good deal and avoid the worst. But businesses make more money when their customers don't put in the effort they could.

These more complicated consumer pricing and shopping-around challenges tend to have one thing in common; to analyse the situation you have to look at the problem over time. Such as asking "if a mobile phone will last five years, what will be the total cost over time using different combinations of phone and tariff?" – for me, buying the phone myself and then separately paying £7 per month as a relatively low user turned out best.

But for long-term savings, there are hidden costs as well as the explicit costs. And, as we explained in the front page editorial of TPI 204, it is easy to demonstrate how the impact of expenses can reduce your ultimate outcome, but we'll give another illustration here too. Let's say you can reduce the expenses on your savings by 2% per annum – how many years before your fund is double what it would have been? The answer is just over 34 years. For those interested in the maths, this works out as 0.98*0.98*0.98… (multiplied together 34.3 times) = 0.5. Put this into a retirement context – the fund you would have from the amount you saved 34 years before retirement would have been twice as big if you had managed to avoid annual charges to the extent of 2% per annum. That means double the retirement income from that bit of saving. You then have to consider the impact of expenses post retirement, of course – yet more complications!

Now understanding this sort of stuff is completely essential if you are to work things out for yourself. But what if you aren't in a position to do this – who can you trust to help you?

Which brings us to the nub of the problem. If you can only navigate the financial future with the aid of an adviser, that adviser is going to have to put in a fair amount of time with you. Which is expensive. And if you really know how much you are paying the adviser – transparency – you may well be put off seeking the advice at all. This is one reason the financial sector didn't like the Retail Distribution Review – with transparency, it was harder to levy the sort of charges that make the business viable, so you hear the spin in this form: "now only the rich can afford advice". Never take any industry's lobbying at face value!

Can it be done? Start with diagnosis.

So the battle lines are beginning to become clear. The first step in determining your strategy, if you want to change a situation from where it is today, is to ask "what is really going on here?" And you have to do this very thoroughly; we live in a very complex world where if you change one thing, it is hard to be sure what the ultimate consequences will be. Even identifying the questions to ask is not easy. But getting to a diagnosis of "the problem" is not so hard now, as a number of good analysts have thought deeply and written about it. One of the most accessible writers is John Kay, and we are always recommending people to read his books "The Long and the Short of It" and "Other People's Money". The point is that the intellectual heavy lifting in terms of diagnosing the problem has been done. Readers can look at the various presentations and articles relating to our "Savers Take Control" project that are now in the public domain via our UKSA website.

So what is really going on today, in terms of the corporate world on the one hand, and the retail savings business on the other?

It is important to stress the general point that things can evolve in an unfortunate direction without any particular evil design on the part of any individual. To a great extent, our behaviour is governed by the system of relationships, beliefs and expectations that we find ourselves in. As regards corporate behaviour, there is really no "owner" power at work. Paul Myners has argued that corporations are essentially "ownerless". What he means by this is that those with the power are not looking after their own money – we are miles away from a Victorian time in which some important businesses were owned and directly controlled by Quaker families with a strong social conscience. And stock market investment has become depersonalised – with what used to be individual shareholders on the company register, with a vote and ability to attend and speak up in company AGMs now disenfranchised behind nominee accounts. And most people don't even think of buying individual shares. They aren't encouraged to do so by the financial sector, which makes much more money marketing "funds".

There is a huge "corporate governance" industry, largely created by regulatory "improvements". But step back a moment and ask what this has achieved. For example, executive pay transparency didn't have the desired effect; instead it had a ratcheting effect.

Parliament pays huge attention to scandals in business and major failings of all sorts. We had the Banking Standards Commission. We have had the PPI mis-selling scandal. Every now and then we have another corporate governance review. The Kay Review of Equity Markets and Long-Term Decision Making was published in 2012. But does anything ever really change? No. And the most vital reason? That's quite simple. And because it's so important and so fundamental, we have decided to put it first in small print: vested interests.

Why are the vested interests so powerful? The simple answer is that there is no effective countervailing people power. There are lots of reasons why this is, but it's where we are today. Politicians definitely can act to change things – in theory at least – but look what happens when some technical reform is contemplated. Vast numbers of paid lobbyists and senior industry people will dominate the representations made to any consultation put out by

Government. Whilst there are indeed a number of very good charitable foundations working to make a difference, true people power is largely lacking.

Savers Take Control is all about a radical, ambitious, but very simple idea for altering the balance of power and influence, which we don't believe has been tried before. We believe that we can bring about a gentle revolution in the way people think about finance and relate to the world of business. We explain this magic ingredient in the next article.

STC

The magic ingredient: Savers and Investors helping each other for free – would you like to help?

What we most need in new volunteers is specialist knowledge and, vitally, independence.

Ultimately, once you have met the essential needs of food, shelter etc., a really strong motivating force for most of us it to feel useful and appreciated. As well as working with people we like.

Savers Take Control (STC) is all about a few highly knowledgeable volunteers putting in their knowledge, time and effort for free. We need all sorts of skills and energies to make things happen, of course, especially organisational and people skills, but it's the people with the critical investment knowledge that will be the key to making the greatest impact.

Knowledge is the first requirement of the magic ingredient. The second requirement, independence, is even more important.

It is vital that people in our STC core team are completely independent of both the financial and corporate world.

For this reason, many of our most active volunteers are retired. Typically, they have worked in the financial sector, and want to "give something back". It is vital that you are not squeamish about, indeed that you fully buy into, the two key themes of STC:

- Empowered savers and investors sharing information and working together to ensure that the amount taken by the financial advice and investment chain is much reduced. This means becoming recognised as a trusted voice, completely independent of any part of the financial sector. At present the financial world exists first to make money and second to serve the interests of the customers. This needs to reversed, with the customers taking control, in the way in which the customer is king in the high street. It is a pity that the mutual model is so rare these days. The shining exception, as a financial mutual which is growing in influence, is Vanguard.

- A change to the culture of all business, bringing top pay, especially bonus pay, down to a level that is more generally regarded as fair. And with the removal of the damaging incentives that focus on share price performance. Only when the conflicts between senior management of companies and the rest of society can be brought under control will business stand a chance of being appreciated as it should be. See the articles in TPI 204 quoting John Kay, and the Institute of Business Ethics to get an idea of the principles we support.

These are not going to be simple aims to achieve. For example, how do we get to a situation on executive pay which is sufficiently widely understood that there can be an informed consensus on what is "fair"? We have to find ways to trigger and energise public discussions about business and its place in society. As it happens, there seems to be more appetite for such discussions today than ever before, so we could be pushing on an already opening door.

We intend to build UKSA's Savers Take Control into a well-recognised movement, with a clear brief to share financially empowering knowledge with everyone in society – not just members of UKSA. We want to help people develop the confidence to make good decisions in their personal financial management, but also to be more aware how the world of business works, how it generates good employment, how profits are essential to affording pensions, and to feel they have a voice they can use to influence the world of business. This is not an overthrowing of capitalism – indeed, we believe that to survive and deliver the best it can for society, we need a more intelligent, more patient, less greedy and more long-term focused capitalism.

We would like to appeal to anyone who meets the independence criteria who feels they have special relevant knowledge, especially in the world of investment, to come forward and talk to us. Similarly, please also talk to us if you think you can help in any other way, such as helping organise membership activities.

There is a long road ahead, and all this is going to take time.

In order to succeed, rather than fall flat on our faces, we need to go very carefully. This is what we might call a "system" problem, which needs very deep thought. And we need to encourage as much dialogue as possible with all interested parties, whilst jealously guarding and never compromising on our own independence.

We must also never forget the extent to which the "establishment" will feel threatened by what we are doing. Again, only with complete independence can we hope to make a real difference. And that includes financial independence – our member subscriptions are all we have. That greatly limits our ability to have paid staff. We can accept donations, but never if they come with strings or expectations of influencing us.

Importance of a team player mentality

The mindset we all need within the STC team is one of personal growth. It is more important to work to learn from each other than to rush to persuade others of your personal ideas for solutions. From personal experience of years of voluntary research work with fellow actuaries, this is actually huge fun and very stimulating.

So if you think you might be interested in helping, first explore the STC pages on our website, including the articles reproduced from our magazine, The Private Investor, and also our developing basic education site honestmoneynow. Then please contact us at STC@UKSA.org.uk.

STC

Developing the UKSA experience

With a stronger public profile for UKSA brought about by additional publicity for STC, we need to ensure that we have the logistics in place to support activity. Since the founding of UKSA, we have had many concurrent activities happening. These include member-to-member discussions at different venues around the country, policy representative work carried out by a set of volunteers, and contact with companies that members invest in. The member-to-member discussions vary in character, but a social element is always present and important. Post the coronavirus lockdown, there have been a number of online meetings – and we even had to have our AGM online this year. Once face-to-face meetings are possible again, there is no doubt that online meetings, which have been quite a success, will also continue in the future. For members who are not within easy reach of a number of fellow members, online meetings are the easiest way of achieving contact. Our most active members, in terms of attending meetings, tend to be retired and thus more flexible in terms of meeting times. But online meetings can offer a way for those with jobs to participate as well. And if you want to have a discussion on a particular topic, we can use the UKSA network to see if anyone else would like to join in, and arrange an online discussion.

Existing members have an important role, with many years of investment experience to share. Helping other members by sharing knowledge and experience is of course happening all the time at meetings. It is vital that we never transgress the law in relation to regulated investment "advice". Unless you are a regulated investment or financial adviser, you are not allowed to actually advise any specific investment decision – such as to buy a particular product, or to invest in a particular stock. But "generic" ideas and saying "I'm doing x for this reason" are fine.

To participate in UKSA events, you generally need to be a full member, and pay the annual subscription, which is £50 per annum. We need this money to meet our modest central expenses, which include our secretarial function, website costs, audit, etc. We occasionally have special conferences, which have to be priced to pay for themselves. To help with STC, you need to be a full member.

As set out in TPI 205, we are now also introducing **Associate Membership**, which costs nothing, does not generally permit participation in UKSA events, but does enable us to keep people informed by email.

Extending our reach beyond our membership

The other category of involvement is simply **registering a particular interest**, or interests – again free of charge; you don't have to be a member. This facility will be essential as STC develops and as we generate and test educational material, and look for ways in which people can help each other with financial capability. Once again, communication will be by email whenever we have something to share which people have expressed an interest in. There is no limit to the number of people that can register with us in this way, but it all has to be entirely automatic. As soon as people want to talk to us, we won't have the resources to cope, which is why anyone who actually wants to talk to us will generally have to be a full member.

Over time, we will always be looking for ways in which we can contribute to financial education generally. It would be good, for example, to contribute to and road-test teaching material which could be used as the basis for adult education classes run by local authorities throughout the country. Improving financial education and empowerment is, as mentioned in TPI 205, going to be a hard grind. But we are not totally alone in this of course; there are a number of charitable organisations dedicated to financial education in schools.

But what about shareholding? Yes, fair question. We believe that for many people, investing in individual shares makes sense and can also be enjoyable. And we need individuals to act as shareholders, and take part in the governance of companies. But that supply of individuals has fallen off a cliff following the widespread requirement to hold investments in nominee names, and we have to work to change the rules around nominees so that all owners through nominees have the same rights of communication with companies as shareholders on the company register still have. If you are able to make your own decisions around investment, it can be the very lowest-cost way of investing. You can avoid annual percentage charges altogether through this route. But over-confidence can be disastrous, and having a network of friends to talk to can be very helpful.

Most personal investing these days is carried out through pooled vehicles – "funds". Go to a financial adviser, and you will be put into funds. But the impact of expenses of going this route <u>can</u> be huge, and it is a tough ask for people to work it all out for themselves and decide what is good value. Hence the need for Savers Take Control.

Most people will never think about buying individual shares, and that is completely sensible, though in the US the ownership of individual shares is more widespread than in the UK. But there will be people who could be encouraged to learn more about their personal finances and for most people the place to start will not be experimenting with individual shares. Instead, you need the knowledge to take control of your own finances. Once your finances are under control, you can start thinking more about how you are going to invest, including whether individual shares might be right for you. Our website honestmoneynow can be viewed by anyone and is designed to be accessible, especially to people who are at the beginning of the journey.

Even though most people will never take the decision to select individual shares, it is important to appreciate that most of us are actually shareholders, albeit indirectly. With auto-enrolment, most people will have some pension savings, for example. Much of this money will be invested in companies. Being aware of this is important – if we criticise a particular company, it is very likely that we indirectly own a tiny bit of it! And if we feel that companies should behave in a particular way, it should be possible to speak up and for our voice to be heard. That's a topic for another day, but an important one – are there some core principles that we should be asking for, in relation to corporate behaviour? And how can we encourage a discussion throughout society about what those principles should be?

STC

Being prepared for growth in numbers, being flexible

As UKSA membership grows, and as our STC movement becomes more widely known, we have to be prepared to absorb many more volunteers into the band of people who really make things happen within UKSA. Our public messaging will include some detail about the kinds of tasks and projects we are currently working on, and are considering at the time, and this messaging will have to be kept up to date. If it all sounds too vague, that can be off-putting. But there is an army of potential volunteers out there, especially people who are retired; the older generation helping younger generations is one of the important dynamics of UKSA.

It's all about volunteers – if you join us you can make a real difference

The UKSA culture is very much centred on our members; our legal structure is that the members elect the Board that serves the members, and that we are technically a company limited by guarantee. The Board members are all volunteers, and so are our regional organisers. We have minimal paid administrative support, and to stay financially viable we have to keep our administration budget and any other spending down to what the £50 member subscriptions and any donations will permit. If, as we hope, our current push to expand our activities and our public profile bears fruit, we will need our voluntary organisation to adapt, whilst trying to grow our surplus funds a little in order to give flexibility to undertake risky projects such as the occasional conference.

Organising volunteers is not like running a normal company – a command and control mentality will not work. Instead, we have to respect the particular interests of our new volunteers and help them to organise themselves into new task groups. So precisely what we can do, and the order in which we can do it, will be largely determined by exactly who hears about STC and comes forward to volunteer.

So to any non-member reading these articles in response to hearing about STC and checking out our website, do consider whether joining our ranks is something you would like to try – we would love to hear from you.

News from the South-West and Midlands

We are very grateful to Peter Wilson for keeping us up to speed on the meetings he holds in the South-West and Midlands. The last meeting was held using the Zoom videoconferencing platform.

In the article below Peter draws heavily on comments made during and subsequent to the meeting by members participating in the seminar. Peter rightly points out that readers should seek professional advice before making financial decisions. UKSA does not provide financial advice. This article seeks only to raise some of the issues readers may wish to consider.

This second South-West and Midland members' Zoom meeting was to discuss the value of investing in Quoted Investment Companies, such as investment trusts, with the aim of easing the burden on family members who may have to manage a member's money during latter years.

Quoted Investment Companies

The benefits identified were:

1. **Less work** as specialist sector or region professional managers manage investments

2. **Expertise** with decisions based on detailed lifetime knowledge of specific market sectors

3. **Spread** with fewer shares and yet less risk achieved through holding a single share

4. **Worldwide exposure** to markets where the private individual has little chance of acquiring sufficient knowledge to choose wisely

5. **Less demanding on family members** or ultimate beneficiaries if they have to take over managing a Portfolio

6. **Less volatility** as the companies can use reserves to cushion market downturns.

However, the downside could be:

1. **Lower dividends** because the managers' time has to be paid for

2. **Lower Gains** because the arrangements may give the managers a share of the gains, against the interests of shareholders

3. **Increased risk**: members quoted, for example:

> one large investment company where 30% of the Portfolio was in one company; tendency of companies in the same market/ sector to hold similar shares; two investment companies in the Chinese market were found to both hold the same two shares, and in each case they were 20% of the portfolio

4. **Information not always easy to discover** may still require persistent research to get the facts on Managing Charges and Investments.

There was general agreement that Quoted Investment Companies should be a part of a balanced portfolio, especially if seeking to have less hands-on day-to-day oversight and if authority is delegated in later years to non-professionals, they can reduce the demands on their time and the level of risk, but at the price of a reduction in income similar to that when delegating to professional managers.

A key advantage of Quoted Investment Companies is that it makes it possible to simplify investments and so cut management time. In the meantime. you can get rid of minor holdings, those still held for emotional reasons, and, amongst others, those which ought to have recovered but so far have not.

Essential requirements for latter years

There was unanimity that retired persons should:

Appoint persons with Power of Attorney
Make a Will
Appoint Trustees with their prior agreement where a Trust is needed
Provide guidance to help those with Power of Attorney and Trustees.

To leave these until retirement was considered a big mistake and whenever executed they should be reviewed at least once every five years. Remember those appointed with Power of Attorney or Trustees, as those chosen may not be available when called upon. Without such arrangements there can be considerable delay and costs in getting Court permission to replace those not available.

Trustees/Power of Attorney

In the past the norm was to appoint a beneficiary and at least one professional person, an accountant, a bank manager, a solicitor, a financial adviser or a stockbroker to support them as Trustees, if circumstances necessitated leaving money in Trust. The same applied if a Power of Attorney was required during a lifetime. Members immediately pointed out that was fine in the past when for years you had dealt an adviser on a person-to-person basis and got to know who to rely upon and trust, but in the modern corporate world this may no longer be the case. For example, in a legal firm one partner now deals with Wills, another with house purchases, a third with investments, and there may be a range of specialists for other issues. Banks rarely now assign you to a named manager.

Examples were quoted where, even in the past, a sole solicitor had held Trust money very safely in a Building Society for 25 years, during times of high inflation, until the life beneficiary died. The heirs then inherited very little in real value terms. Another example was of a stockbroker taking a fee to manage funds and then investing them through a firm he owned and which took a further fee. Members observed:

‘Family solicitors’ (are) less able these days to take on such a role if there’s no trusted family member.’

The general feeling was to give maximum discretion/authority, with authority to use professional advisers if they wished, ideally to an ultimate beneficiary to manage savings/investments when you no longer could. Guidance, if offered, should not be about what to invest in but what the money is there for.

Get beneficiaries involved*

This is often a natural process where an estate, a farm, or any other family business is involved in that family members who may be ultimate beneficiaries have often helped run the business. The problem comes when family members have left home and are pursuing their careers elsewhere, maybe even abroad. Equally there can be a reluctance to burden or even discuss with them investment of savings which generate income supporting a lifestyle. Seminar participants commented:

‘The issue with younger generations' engagement is problematic’

‘The dilemma of how to manage investments as we face higher risks from senility and terminal illness…in the face of the pandemic (is) a particularly important topic which deserves deep thought and close attention.’

Probably the most important suggestion was the ‘apprenticeship’ idea, which meant, as soon as possible after retirement, discussing regularly with those chosen your investment policy, changes to it and the reasons, plus sometimes actual investment decisions, but not placing them in a position where they feel responsibility for such decisions**. Members’ observations included:

‘Could be further advantages if they’d take an interest / play a supporting ‘apprentice’ role in management of the assets.’

The inevitable question

Before the meeting adjourned the inevitable question was asked: ***‘Where are the markets going, especially in the next five years?’***

Three views soon formed:

1. The first that the lack of or low interest on savings would sustain a steady flow of money in the immediate future with:

Prices being kept up by quantitative easing;

Net inflow to pension funds gives impetus to invest in shares.

But members said investors should expect a very significant reduction in dividends during 2020 and should avoid, even sell if held, companies lacking decent cash reserves which could be vulnerable to another banking crisis or change in government economic strategies.

2. The second was that there is some complacency as regards our present situation. All the signs are we are going into a recession or worse, man-made. Unemployment is bound to rise, with businesses going to the wall. The country is being saddled with enormous debt, most likely worse than the banking crisis. It is not a pretty picture and it is worldwide.

3. Who can guess!

10 actions to remember

1. Regularly review the purposes of your savings and therefore investments which are there to serve your needs, which will change, and adjust investment policy accordingly.

2. Make a will and tell executors where it is. Review regularly.

3. Set up Power of Attorney as soon as you have dependants. Review regularly and think ‘apprenticeships’.

4. If you can, discuss contents of your will with beneficiaries and explain why it is so arranged so as to defuse potential hurt or dispute later.

5. Don’t just write guidance notes but before you sign them discuss with Trustees/Attorneys and make sure they are understood and acceptable to them. Review regularly.

6. Keep a record of your types of investments and other assets and list where the relevant documentation and professional contacts etc. can be found. Give them to relevant people and keep them up to date. Doing so requires discipline, but it is vital that a spouse, children, executors and trustees know where to get the information. Members indicated that they tend to have pots of savings which may

be kept apart from those managed by a Financial Advisor/ Investment manager. These can include funds in banks, building societies, National Savings, Premium Bonds, VCTs, EISs and life insurance in trust policies.

Ensure there is access to the passwords and awareness of direct debits and standing orders.

And members added:

7. Make sure on death/incapacity there is access to interim cash.

8. Let family know your funeral wishes including style/hymns/ orations (if any).

9. Keep in mind that costs of care if incapacitated can be £50,000 a year and are rising faster than inflation. Average time spent in care, where needed, is two and a half years, but that is an average, so it could be five years.

10. Remember following incapacity/death it is now their money to manage and clearly the policy on managing one's own investments will not necessarily be appropriate for those to whom your money is entrusted.

**Attention is drawn to the paper published in TPI written by an anonymous member on the issues which may arise when involving families.*

UKSA's AGM

UKSA's AGM took place by video on Sunday 14 June. We were delighted that around 20 members were able to attend and ask questions.

The social gathering that follows our usual AGMs is important to us, so we invite members to join us at the RAF Club in London from 2pm to 5.30pm on Monday 26 October. This will be confirmed nearer the time in the light of any restrictions then applying.

The 2020 AGM season

by Peter Parry and Phil Clarke

When the lockdown due to Covid-19 was coming into force in mid-March of this year the AGM season was just about to get under way. With prohibition of all public meetings there were questions in many investors' minds about how companies would deal with the situation. There were basically three options:

- Postpone or adjourn the AGM until the lockdown had been lifted and a meeting could be held; one problem with this was that no one knew how long the lockdown would last;
- Hold the AGM behind closed doors with the appropriate quorum (often only four or five people) necessary for the meeting to take place and with investors voting by proxy and/or in advance of the meeting;
- Hold a hybrid AGM with the actual meeting taking place behind closed doors but with investors being given the chance to ask questions, receive responses, and vote – and with the additional option of the meeting being live-streamed.

The FRC, wisely in our view, avoided being too prescriptive about what companies should do. However, it offered very clear guidance on what the outcomes of alternative arrangements should be – in particular the need to ensure that companies continued to engage as fully as possible with shareholders. It also placed heavy emphasis on the need for shareholders to be kept fully informed, stating in its guidance:

'Investors and other users of corporate reports want to understand a company's resilience in the face of current uncertainty and to understand the key assumptions and judgements a board is making when assessing resilience and in preparing company financial statements.'

The latter was particularly relevant to companies with a 31 December year-end giving updates on first quarter trading for 2020 in March and April.

Here we are now in early June, so how has the whole AGM process been working?

A few good responses but a half-hearted response from many companies

The Policy teams at UKSA and ShareSoc carried out early monitoring of AGM experiences and reported back to the FRC, the FCA and BEIS on the Shell and RBS AGMs.

Shell announced a webcast for all shareholders ahead of the proxy voting deadline for its AGM. We felt it slightly disappointing that only written questions were taken, preferably submitted ahead of the webcast. The webcast was only two days before the proxy voting deadline, leaving very limited time for those holding shares in nominee accounts to submit their votes. Understandably, Shell may not have been able to set a more relaxed timetable, given that this was new to everyone. We applauded Shell for trying to do their best.

RBS announced a shareholder virtual meeting on the day of the

AGM and followed this up with a promise that further information about future shareholder events would be provided. Votes had to be lodged by proxy three days before the AGM. Shareholders were able to submit questions in writing but the board's replies were in many cases received too late for shareholders to take them into account in their voting. Q1 Results were announced on 1 May, three days after the AGM. It would have been better if the company had provided a trading update before the AGM in time for shareholders to digest the information and make their voting decisions.

By far the most comprehensive review has come from UKSA member Phil Clarke, who has engaged with some 40 companies between April and the end of May. This excellent sample includes a mixture of FTSE-100, FTSE-250, operating companies and investment trusts.

Phil summarises his experiences as follows:

1. All companies prevented shareholders physically attending AGMs, in line with government guidance on face-to-face meetings.

2. Out of the 40 companies, only 10 webcast or broadcast their AGMs; most held them behind closed doors.

3. Out of the 40 companies, only 11 communicated with shareholders by providing management presentations, some in real time, but many by posting a video on their websites following the meeting. ASTONISHING, given events this year.

4. All but one company allowed questions to be submitted prior to the meeting (surprising that one FTSE-100 company did not invite questions!), but had very different approaches to answering questions. Most sent email replies, some answered questions during a broadcast meeting or in a video after the meeting and some "lost" questions submitted and failed to answer them in the manner they proscribed. I asked questions of 34 of the 40 companies; nine of these have yet to reply and some of these are a month overdue. It is important for all shareholders and directors to hear all questions and answers, but the approach taken by most companies was to reply to my questions directly by email. Consequently, I am not aware of the questions asked by other shareholders – except in only six instances where the companies answered questions publicly. This is awful, as in most cases I am not aware of other shareholders' concerns, and have NO IDEA whether any of the directors ever saw my, or other shareholders', questions.

5. Other question problems included:

a. Some companies used "forms" on their websites to collect questions which were largely problematical, for example requiring a Shareholder ID number (impossible if shares held via a nominee) or limiting questions to under 150 characters (impossible to comply with if asking a detailed question);

b. One FTSE-100 company held a live meeting, but restricted Q&A time to an arbitrary 35 minutes. This irritation was exacerbated when pre-submitted questions were not answered and the meeting was curtailed early;

6. Very few companies allowed live, real-time voting (probably sensible as would require technology to be 100% reliable, which is implausible). This meant all voting had to be completed several days before the meeting, meaning that the logical sequence of events I set out above could not happen – shareholders had to vote before they could listen to management or ask questions;

7. Furthermore, there is definitely a massive problem for shareholders who hold shares via a nominee. In order for me to attend one meeting and vote, I had to ask the nominee to raise a letter of representation. Then the nominee had to telephone the company registrars to get a code so I could log on, and then communicate that to me securely. Unsurprisingly this could never work, as nominees have very clearly been impacted by lockdown, and their limited staff are unable to attempt anything so complicated. Inevitably, disenfranchisement is the consequence.

Most companies sought to disengage from shareholders through limited management interaction or having questions fielded by functions such as investor relations. I appreciate these are difficult times, but most companies deliberately used FRC guidance to reduce shareholder interaction to an absolute minimum.

Setting the pace

Phil made special note of a few companies that really made an effort to engage. These included:

1. The Man Group – held a high-quality video meeting featuring all directors, management presentations AND answered pre-submitted and live questions. Undoubtedly the BEST response by any company. Heroes;

2. BP – high-quality video meeting, with a few directors, good management presentation and answers to pre-submitted questions;

3. Taylor Wimpey – held a very good audiocast, with management presentations, and answers to pre-submitted and live questions;

4. Standard Chartered – recognised shareholder engagement is vital, and committed to a shareholder event later in the year.

Recommendations and action

Phil concludes:

1. All companies should hold a video or audio meeting where management update shareholders;

2. A mechanism should be provided so that shareholder questions are answered in an open manner, so that other shareholders and directors hear and understand concerns being expressed. Ideally all Q&As should be posted on the website;

3. Companies should be flexible so as to engage with shareholders in nominees without excessive, unrealistic bureaucracy;

4. Electronic, online real-time voting is unrealistic as the technology is not sufficiently reliable, so we should (regrettably) persist with current practices.

UKSA and ShareSoc will follow up these findings with BEIS and the FRC. They provide an excellent basis for further constructive debate.

When Genius failed – the rise and fall of Long Term Capital Management

by Rob McDonald

Review of a book by Roger Lowenstein, published by Fourth Estate

Author's note: Not all the facts are taken from the book itself. Some are from other sources within the public domain. Explanations and expressions of opinion are those of the author alone.

During lockdown I, like many others probably, have spent considerable time indoors reading and one book has stood out amongst all others for me. It is the third time I have read it since purchase, and I rarely read a book twice and hardly ever three times. I first read it not long after the dot com debacle in 2002, again during the financial crisis of 2008/9 and for the third time in March this year when the stock markets were tumbling. I have found it a strangely comforting distraction from major stock market turbulence and Lowenstein gives a fascinating insight into the personalities, greed and the ultimate failure of intellect to overcome irrational investor behaviour in his book. I confess also to having a fascination with bonds and derivatives.

So why review a book in TPI and particularly one that is nearly two decades old? I'll address that at the end of the article. For now, I give a synopsis of the book, but I cannot match Lowenstein's gift for capturing the tension and excitement as the drama played out. I encourage you to read it for yourself.

In September 1998 the extremely buoyant bull market in global equities was showing signs of fatigue. The New York Federal Reserve, a branch of the US Federal Reserve system, had been alerted to a problem and organised a secret meeting of a number of major US and European banks. The meeting was called because a little-known hedge fund was on the cusp of insolvency. It had run out of the necessary reserve capital to clear its trades. The hedge fund had fewer than 100 individual investors and no more than 200 employees, so it was unsurprising that it slipped under the governance radar of the New York Fed. Most investors had never heard of it, it didn't advertise and its investors were by invitation only, yet it had amassed assets of $125 billion, nearly all of it borrowed from the very same banks in that secret meeting. (At the beginning of that year, LCTM's own equity amounted only to $4.7 billion.) Beguiled by LCTM's impressive record of uninterrupted annual gains of 30/40% and its reputation, the banks had clamoured to do business with the secretive hedge fund. Because of that extreme secretiveness, the banks were unaware of the extent of each other's involvement. To make matters worse, the $125 billion of mostly loan capital was used to invest in highly leveraged derivative contracts, taking the total exposure of LCTM close to $1.25 trillion with the banks sitting on the other side of many of those trades. If the hedge fund became insolvent, it threatened to bring down the global financial system in a frenzy of selling, as banks and institutions endeavoured to liquidate those trades as a matter of self-protection.

Long Term Capital Management had been the creation of John Meriwether, who had previously run the very successful bond arbitrage group at Salomon Brothers bank. Some may remember him as the chief protagonist in the best seller 'Liar's Poker' by Michael Lewis about Lewis's own experience of working in that department (a book that I also recommend).

Meriwether's belief was that the raucous atmosphere of Salomon's bond dealing room, dominated by alpha male types, long on machismo but short on quantitative technical ability, led to suboptimal results in the bond arbitrage markets. Bond arbitrage is particularly attractive to studious mathematical types and Meriwether began recruiting such employees for LCTM.

He built up a team of highly intellectual individuals from academia including two renowned Nobel Prize-winning Harvard Economics professors, Robert Merton and Myron Scholes, as senior partners. The core focus of LCTM was on the fixed-income market and in particular, bond arbitrage.[1]

The partners at LCTM deployed literally thousands of convergence trades, each one subjected to statistical modelling using history to carefully calculate the probability of ultimate convergence. They were careful not to gamble on the overall direction of any markets as essentially their strategies were designed to be market-neutral.

After three years of astonishing returns on the initial equity capital employed, the partners' own wealth had increased enormously from the $150 million of their own money initially invested to $1.4 billion.

By now LCTM were finding it difficult to unearth trades that did not rely solely on market direction. The shortage of opportunities persuaded the partners to reduce their invested capital by forcibly returning some of it to displeased investors, including their own employees. They did not, however, reduce their own personal holdings.

As convergence opportunities dried up, they began to take directional bets, and the newly introduced Volatility Index[2] was one that caught their attention. They believed that using historical behavioural patterns and empirical data, stock market volatility eventually reverts to a mean and the timing of that reversion was predictable within a range. They began to sell volatility protection to those investors who they believed were more driven by emotion and psychology.

In the summer of that year there were a number of market events that Lowenstein covers in intriguing detail and included the Asian debt crisis upon which they profited and the Russian debt default and ensuing currency devaluation. In LCTM's economic assumptions it made no sense for a sovereign nation to default on its own debt raised in its own currency. Russian bond yields doubled, global credit spreads[3] widened and there was contagion to other markets and by August LTCM was haemorrhaging money at a rapid rate as the world's capital markets took flight to safety. In five weeks the partners own investments would be lost. One partner's entire investments were with LTCM, valued at $500 million early that year and worthless by the end of the year.

LCTM was eventually bailed out under Federal pressure by the consortium of 14 banks that had initially refused to advance any more money. There are schools of thought that believe that setting the precedent that some institutions were simply too big to fail laid the foundations for greater risk-taking and the Great Financial Crisis a decade later.

Commentary

I'm a believer in capitalism; for all its very many flaws I've yet to see a more efficient way of directing resources to the most viable enterprises in order to raise living standards for the masses. It does raise the question, however, as to how capitalism has managed to arrange itself such that the highest rewards go to those who achieve the very minimum of societal benefit.

LCTM existed solely to make a few very wealthy individuals even wealthier, and not by wealth creation, but by wealth transference from sleepy pension funds and pooled investments. It did not produce widgets, nor feed hungry mouths nor find a cure or indeed anything to enhance life for the general population, so it's hard to find sympathy for the partners.

So why review a book like this in TPI? Well, I suspect that during the market crash in March there will be some members who feel they made investment missteps. Some may have sold down as equity markets plummeted; some may have been tempted to buy more equities but were too fearful. Some indeed may have done nothing, not knowing which way to go but stuck with it, as long-term investors.

Whatever members did or did not do, in my opinion, there was no rational information upon which to make a decision. There was no visibility on future earnings of companies. The state of affairs was so unprecedented (and still is in my opinion despite the rally since) that any view or actions taken were largely an act of faith and self-belief based on their own experience.

The takeaway from the story of LCTM is that if the mighty genii of Long Term can get it catastrophically wrong, then so can you.

Sources

Long Term Capital Management – Roger Lowenstein – Published by Fourth Estate

Federal Reserve Bank of Cleveland – 'Some Lessons on the Rescue of Long-Term Capital Management'

Notes

1 Bond arbitrage involves seeking out and exploiting temporary price inconsistencies between bonds of similar characteristics and capitalising on their expected ultimate convergence. The strategy relied heavily on using the history over many years of thousands of bond pricings and minimising (at least in their eyes) uncertainty by the use of mathematical and statistical probability models.

An early simple example was 30-year US Treasuries which, because of heavy demand and their liquidity at issuance, traded at a premium to previously issued bonds of slightly less maturity and liquidity. So a freshly issued bond with a 30-year maturity would be bid upwards to have a slightly lower yield than a not-so-liquid bond with 29½ years to maturity. Two of the big risk drivers of bond yield behaviour are inflation and interest rate outlook and they are pretty much the same risks for both of these bonds. The professors, with their historical data and mathematical models, predicted that eventually the yields on these bonds must converge. They weren't interested in whether yields would go up or down, just that they would converge. So in this example the trade was to short (i.e. borrow and sell) the newly issued 30-year bond and use the proceeds to buy existing 30-year bonds less than 12 months old. As the bond yields converged, the trade would be closed out at a profit and, although tiny, it would be magnified through the use of massive leverage using cheaply borrowed money.

2 Volatility Index – From the Chicago Board Options Exchange represents the market's expectation of 30-day forward-looking volatility. It is sometimes referred to as the Fear Index.

3 Credit Spread is the difference in yield between bonds of similar maturity but different credit quality, usually where one bond is a risk-free government bond and the other a corporate bond where the risk of default is factored in. When the economic cycle is buoyant, credit spreads narrow, reflecting a reduced risk of default and vice versa.

Volunteers needed!

Would you like to contribute to the running of UKSA events, mailings and company visits? We are looking for volunteers who would like to learn and become proficient in the use of CiviCRM. This relationship management tool is now being used for our membership processing and event management. Previous experience using it or similar packages is an advantage but not essential.

Opportunities also exist for a more technical role working on website enhancements and experience of or a willingness to learn Drupal is essential. Please email admin@uksa.org.uk if interested in either role.

Why on earth are we still in lockdown?

by Charles Henderson

In this opinion piece Charles Henderson offers his personal view of the current situation in the UK

Could anyone have predicted the events of the last two to five months? Should anyone have predicted the draconian closing down of the UK economy in response to a viral pandemic? The probable, and easy with hindsight, answers to these questions are no.

How did we end up here?

From an ordinary person's point of view, the lockdown was accepted because other countries were doing it, it seemed a sensible thing to do with an unknown supposedly new virus that may have caused the NHS to be overwhelmed and our authorities were telling us to do it. However, no one in government nor any of their advisers seemed to be asking whether a lockdown was sensible in a wider perspective. This may be because of the way the education system grew up. It seems to have moved away from teaching knowledge and understanding beyond the immediate and how to learn. Instead it teaches to get good test results by knowing the binary right-or-wrong answers to tests. You can see this with the response to the current pandemic compared to previous ones, when technology was not as advanced as it is today and did not result in lockdowns. They were reacted to proportionately as they would have considered other factors or problems that may be caused by an over-reaction, such as a lockdown.

From an investor's point of view, reading companies' risk reports before the lockdown, it could appear that the lockdown was an over-reaction. The companies' risk reporting did not have pandemics as major risks nor resulting lockdowns of economies as mitigating plans to such a risk or even a risk in itself. If companies' risk reports had been better thought through, properly planned and reported on, those companies may have been better placed to resist the heavy handed approach that our government felt they had to implement. It is not that pandemics have not been on people's risk radar at all in the past five to ten years. It cannot have been hard to imagine, if you were in the travel, hotel, other hospitality, entertainment and similar industries, that the risks of a pandemic could result in shutting down your business.

I believe most companies' contingency plans (business continuity plans or disaster recovery plans) will not have considered lockdowns of a country's economy as needing to be dealt with, as such an idea would have been a very remote probability. Why then are the companies we have invested in still accepting lockdown or not lobbying for the economy to get back to normal immediately? Again, some better risk management and proper planning preventing poor performance processes could have better enabled companies to resist the shutdown of our economy.

Political quagmire?

While the original lockdown period continues to appear acceptable to ensure the NHS was not overwhelmed, the continuation of lockdown, even with some relaxations, may be seen as damaging to the UK economy with knock-on detrimental impacts on our general financial welfare and wellbeing. It is even worse for the millions of people either at the lower end of the wealth ladder or dependent on work to live, who are now beginning to face unemployment or being out of business or having their years of hard work completely ruined in a matter of months. Investors, including those who do not see themselves as such because their investments are in pension funds, are facing significant reductions in wealth and income from dividends, both of which now need a strong recovery. The longer the lockdown or even the relaxed restrictions continue, the greater the economic damage and the length and pain of any recovery will be.

Our government seem to be stuck in a political quagmire of their own making. To justify their knee-jerk reaction to the pandemic, which UK corporates were not best placed to resist, they now must continue to follow the thinking that has got us into this mess to begin with.

Where next?

Our privilege of living in a reasonably wealthy, developing and evolving capitalist economy has depended on people assessing and taking any risks holistically and heuristically. This has come to an almost complete standstill. We now need to kickstart ourselves back to pre-lockdown normality, taking and living with risks but, at the same time, not ignoring what we have learned in the last two to five months. Focused solutions to keep the most vulnerable from the virus safe need to be thought through and implemented where necessary, freeing the majority from lockdown. We now need to lead by example by getting back to living as normal; or at least our investments need to as they probably have more economic clout to do so. Many public (and private) services, such as the NHS, that we enjoy or depend on will be paid for only by a thriving and well-functioning economy. We destroy such an economy, for example by continuing the shutdown of normality, at our peril.

Social media

Over the past month UKSA's Twitter account has covered stories on the future of AGMs, attempts to water down the Shareholder Rights Directive, the FRC, environmental, social and governance policies and more besides. Follow us at @UKshareholders. You don't need to sign up to Twitter to view. Just go to https://twitter.com/ukshareholders from any web browser.

Letter to the Editor

From John Hunter

Good to read Phil Clarke's predictably interesting comments on executive pay in the April edition – a debate that, as he says, 'is almost always a fact-free discussion'. It made me think about a few things.

First: data. Phil quotes 'single figures for CEO pay', noting they have declined from 2011 to 2018. That may be so, but he may not know that there is a fundamental flaw in the definition of 'pay', which is that LTIP awards are recorded on vesting instead of being spread in some sensible way over the grant period. As both the popularity and the duration of LTIPs increased, so the amount of what you and I would call 'pay deferred' would have increased. The Persimmon CEO, for example, in round numbers started with £50 million over 10 years (which could sensibly have been reported at £5 million per year to start with, maybe with some actuarial fussing over discounting) and ended up with £100 million over seven years (which could sensibly have been reported in increasing annual amounts as the Persimmon prospects improved). So I'm not denying Phil's observation. Just saying 'not proven'.

But I don't want to make a big thing about this – the really interesting point in this debate is the subjective question of 'worth'.

In any data set there are outliers. The truth of a general proposition and the characteristics of outliers are two separate discussions. What was Steve Jobs worth? What is Jeff Bezos worth? $5 million per year? $50 million per year? $500 million per year? Arguments for all. What is the average FTSE100 CEO worth? Different question, very different discussion.

As a matter of interest I think the economics of footballer Kevin De Bruyne at only £17m is much stronger than the economics of a top FTSE100 CEO at the same number. The former is irreplaceable and in a sense is the business. The latter is the leader of an enormous team – the tip of an iceberg that is the business. (A throwaway comment I can't resist: being CEO of a strong company without getting fired is one of the easier jobs. Your mistakes – usually sins of omission not sins of commission – will take several years to show up. I am sure the person who used to run Nokia was well-regarded and well-paid at the time.)

The retention argument for high pay that Phil notes is a good one. You must match the market price for an executive or risk the consequences. But hang on. 'Price' is more than money. If Kevin de Bruyne was offered £20 million by Bristol City, would he move? Or £50 million? Of course not, no need to spell out the reasons.

The threat of an executive talent drain to the US meets the same argument. If you are earning £2 million, say, and the US offers you £4 million, what is the extra £2 million going to get you to compensate for moving to a strange country, disrupting your family, struggling with different business practices, having to rebuild your reputation in a different environment and risking your future career? Actually there is a reason for making the move and that is the challenge, the excitement, the experience for your children and the refreshment of your family. It is nothing to do with money. There has been a significant US/UK pay differential for some time, but no sign of a flood of able executives moving to the US to take advantage of it.

The 'need to match overseas pay levels' is a self-serving argument quite devoid of any understanding of what motivates people to work. As indeed is the whole structure of 'incentive' pay. It is 25 years since the Greenbury Report established remuneration committees for quoted companies. In all that time I am not aware of one single word of official 'guidance' on remuneration that shows an understanding that people are driven by anything other than money. The occasional reference to a book such as Samuel Bowles 'The Moral Economy: Why good Incentives are no substitute for good citizens' (2016, Yale University Press) might have been encouraging; and worth reading just for the story of the Boston Fire Department and its revised 2001 policy about sick days (beginning of Chapter 2).

Phil points out that even huge CEO pay is trivial in the context of a company's profits and questions whether the upside of a confrontation with a CEO over pay is worth the downside risk. And he is right. And that is exactly the point. The question of fair pay for one particular class of society (senior executives) is a moral issue separate from profit maximisation (as indeed are environmental and other social issues). Responsible individual investors can and should have a say in this, instead of it being left to committees drawn from that same class; and elected by institutional shareholders without, shall we say, a strong record of preferring morals over money.

Save the dates – Future Zooms

Upcoming South-West and Midlands Zoom meetings will be from 4.30pm to 6pm on:

Friday 3 July when Sunil Chadda will continue his revelations on investment management costs

Friday 7 August when Alan Cane will explore managing portfolio diversity to reduce risk and yet simplifying it to reduce the time to manage a portfolio

Future topics: Managing savings to minimise income tax and later IHT

Further topic ideas are invited.

CURRENT UKSA EVENTS

Company meetings

UKSA's programme of meetings has been suspended during the current health crisis.

Meetings of UKSA Croydon & Purley Group

Location	**Spread Eagle, High Street, Croydon CRO 1QD** **Meeting dates will appear here. Chairman: Harry Braund harrycb@gmail.com**

UKSA BRANCHES – If no contact name or number is given, please contact UKSA office

Branch name	Leader	Administration	Main purpose	Description
London & South East Region	Harry Braund 020 8680 5872 harrycb@ gmail.com	Andrew Girvan 020 8788 1665 agirvan247@btinternet.com	To co-ordinate activities in London and the South-East	Meetings in Croydon three times a year
London company visits	Nick Steiner	Individual meeting organisers	To arrange private meetings with companies	20/30 meetings per year individually arranged
Specialist company visits	Adrian Phillips	Under review	To arrange and/or participate in events in conjunction with investor service companies	Meetings with small-company management, for experienced investors only
Croydon & Purley	Harry Braund 020 8680 5872 harrycb@gmail.com	Tony Birks 01322 669120 ahbirks@btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly
South West	Peter Wilson 01453 834486 07712 591032	Peter Wilson 01453 834486 07712 591032	To arrange and develop activities for members in the region	Company visits and social events as arranged
North East	Brian Peart 01388 488419	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
North West	Julian Mole 07870 890973 julian.mole@ btinternet.com	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
SmartCo	Charles Breese	Charles Breese	Arranging access to 'Smart Companies'	Programme awaiting start-up
Northern Rock Small Shareholders Action Group	Dennis Grainger nrssag@uksa.org.uk	Dennis Grainger nrssag@uksa.org.uk	Pursuing compensation for small shareholders affected by NR's collapse	Lobbying and awareness-raising activities