UKSA
UK Shareholders' Association

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Newbies and tech moving markets

A poignant story that emerged from the lockdown was that of the suicide of Alex Kearns, a 20-year-old student at the University of Nebraska who traded stocks as a hobby. During lockdown he got out of his depth when trading options and wrongly believed he had racked up a loss of $750,000 on Robinhood, one of the new-style online brokerages. In fact, he had mistaken the potential loss on one leg of an options trade for the outcome of the overall transaction. There was a delay in posting the other leg of the transaction to his user interface. He actually had a balance of $16,000.

It is not hard to see how lockdown accelerated the growth of retail trading and cheap offerings from online brokerages. Bored staff furloughed at home with spare cash turned to them in their droves. In April and May, after stock markets around the world plummeted in the wake of Covid-19, online platforms saw an upsurge in trading activity driving prices to levels detached from fundamental realities.

The huge growth of commission-free trading and fractional trading – ideal for those who, for example, want to buy $100 of Amazon stock rather than waiting to buy one share at $3,000 – are unquestionably bringing many more investors into the market.

As anyone who has ever traded shares on a mobile phone knows, there is something alluring about that stream of prices, updates and real-time profit-and-loss data. The display has the compulsive pull of a video game.

This market of tech-savvy but financially inexperienced investors is clearly attractive to unscrupulous providers.

One such provider that ranks highly in internet searches claims an association with Elon Musk and hails the advent of a new economy driven by artificial intelligence of which 99.9% of the world population is unaware. The technology, so it is claimed, can find trades able to generate thousands of pounds of income per month. "I'm scooping up cash like ice cream," is a quote from a supposedly satisfied user. That's a sure way to hook distressed citizens thrown into uncertainty by unemployment or Covid job insecurity.

Trading shares and other assets, such as cryptocurrencies, on computers and mobile devices is popular and here to stay. What is astonishing is that users often lack a basic understanding of – or even interest in – the underlying asset they are trading. They are essentially betting, driven as much by celebrity endorsements and social media coverage as by serious newsflow on the assets they are trading.

As part of our remit of promoting shareholder rights, UKSA will need to be mindful of this new cohort of share 'investors' in a fast-changing and sometimes unscrupulous market.

Helen Gibbons

Volunteers needed!

We need volunteers to fill new roles and to support existing roles.

If you have any spare time and would like to learn new skills, see the information on pages 6 and 7.

In this issue

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Note that the share-price graphs are courtesy of the leading investment website Digital Look www.digitallook.com.

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The Fear Factor might damage our investments

by Malcolm Howard

It has been reported that the government knew about Covid-19 in January, but believing herd immunity was the solution they did nothing. It was only when in March infections were doubling on a daily basis that they panicked and brought in ‘lockdown’.

What is known about Covid-19 is that it is highly contagious and thrives in air conditioning such as found in care homes, hospitals and cruise ships. It appears that if indoors it could attach itself to surfaces such as door handles. What the virus does not like is heat and fresh air, so in probability terms the safest option is to be outdoors; if indoors the key is proper ventilation.

The government had organised a number of pilot studies whereby a limited number of spectators would be allowed at sporting events. An early pilot was to take place at Goodwood racecourse on 1 August, but the government cancelled it a day before. Inaction has been replaced by blind panic.

Since early March the virus has been in the news every day and many people seem terrified. Some people are afraid to leave the house even to get a haircut. Trying to see a doctor or dentist is a difficult task. It takes a long time to get a passport or driving licence; the country is grinding to a halt. All of this seems a little unnecessary as the odds (official government statistics) of meeting someone with the virus were 1,720 to 1. But the fear factor has taken over.

Given this fear factor we need to assess how it is going to impact our investments. So let us assess what we have learnt.

1. Diversification

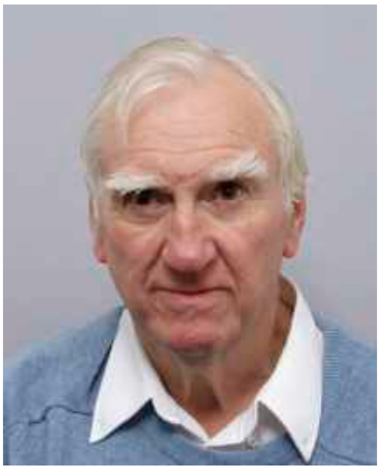
The concept of diversification has been proven. While much of my portfolio is in the doldrums, my gambling and IT focused shares are soaring. Dividends have dried up, but premium bonds are still paying out.

2. Don’t try to be clever!

I always knew that Intu Properties was a high-risk investment. A few years ago when the shares were changing hands at 300p I was urging investors to sell as their debt-to-property ratio was above 50%. The price of the shares went steadily down and then in early 2020 the company produced an updated report. I calculated that if property values halved in value, then net of everything the shares had to be worth a lot more than the (then) 12.5p. So I had a small punt at 20% of my normal investment size. Then Covid-19 struck and property values collapsed. I have written off this investment.

3. Auditors

There is no doubt that since the financial crisis auditors have been lax. They have not taken sufficient steps to verify dubious accounts, an example being Ernst & Young’s alleged failure to check whether a bank in Singapore actually held $1.8 billion of Wirecard’s cash. But times are changing; auditors are under the cosh. The Financial Reporting Council (FRC) recently announced that 29 out of 88 audits they reviewed required more than limited improvements. Apparently, the FRC gave the Big Four auditors a dressing down. It has also been recognised that the conflict of interest between auditing and consultancy has not been addressed and now firm proposals to deal with this are required by the end of October. In this regard, the FRC have fined Grant Thornton nearly £2 million for repeated breaches of ethical standards, including failure to maintain its independence over its audit of Conviviality (Times July 9).



Grant Thornton is also in trouble over its auditing of Patisserie Holdings and may face legal action (Times July 19).

But there is evidence coming through that auditors are beginning to get the message. First Group runs trains and buses in the UK and Greyhound buses in the USA. The company said it has strong liquidity, but the company’s auditor, Deloitte, was reported as saying, “Material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern.”

In the light of Covid-19, auditors may be more cautious; such prudence may impact on share prices, so it might be wise to assess our portfolios.

We can work out which companies are likely to take the biggest hit:

Property companies

Many people are currently working from home and enjoying it. In London they are saving up to three hours' travelling time and are avoiding the hassle of being crushed on the Tube. Assuming they are working harder, this still means they have more leisure time. In turn employers are thinking that maybe they don’t need such large offices. It is a varied picture; for example, Barclays have said they want their employees back in the office, while Google have said the majority of their staff can work from home until 30 June 2021. It is likely that the ‘new norm’ will be splitting working from home and being in the office. Then we have retail, including restaurants, where footfall has collapsed. It seems a number of retail outlets will not reopen.

Property valuations are based on the level of rents that can be achieved. But it seems that the days of fixed rents uplifted every five years may be over. Instead, in future it is likely that rents will be based on a percentage of revenue; a fixed cost will become a variable cost.

For the last few years, property companies have been declaring losses, but such losses have been ‘imaginary’ as they have merely cancelled out ‘imaginary’ gains of fair value based on the IFRS accounting system. But now property companies are likely to suffer real losses as the value of their property falls below cost.

Travel and aviation

It seems obvious that travel and aviation will suffer for some time.

In particular, cruise companies are in deep trouble. The government has warned the public to avoid cruising, for while the virus is around it is unsafe. Of course, the public can ignore this advice, but if they do they will find their insurance is invalid.

Retail

With footfall being in freefall, retailers will rely more and more on online business. Investors will have to work out which ones are likely to be successful.

Event management companies

Major events such as the London Marathon and major exhibitions in (say) Birmingham have dried up completely. Only those companies that are diversified into providing other services will likely survive.

Oil companies

Oil prices have collapsed. For a short time in the USA they actually went negative. Demand for oil is decreasing, with car sales nearly at an all time low; pressure to move to a 'greener' environment is clearly not helping.

Given that dividends have been cut and many companies are having to borrow huge amounts of money to stay alive, there is little doubt that the share prices of companies taking a big hit should have fallen much further than they have. It seems that investors have fled into gambling stocks forcing their prices up and up. There is little doubt that based on current financials the stock market is way too high.

However, we know that share prices depend upon supply and demand and bear little relationship to financial theory. After the failure of Long Term Capital Management, Lawrence Summers, at the time a US Treasury Secretary, is quoted as saying, 'the efficient market hypothesis is the most remarkable error in the history of economic theory.' Robert J Schiller, an American economist, agreed and dared to suggest that 'markets are too volatile to fit the model of perfect markets'. (Both quotations are from the book *'Where Genius Failed – The Rise and Fall of Long Term Capital Management,* Roger Lowenstein, Harper Collins, 2001).

What causes volatility is uncertainty and we are certainly living in uncertain times. At the moment we are gambling rather than investing, but that is the way it is.

STC

Savers Take Control update

by Martin White

With the excellent material from Alistair Blair in this edition of TPI, I don't want to eat into his space any more than I can avoid, so I am keeping this month's update short. I will cover a number of related things, including some potential media coverage in the near future, and discussion items to watch out for on the STC part of our website, as we begin to increase our efforts on financial education.

Media coverage

We have deliberately kept things low-key to date, ensuring that we are as prepared as we can be when we raise a bit more public awareness about STC. But we were recently asked to contribute a couple of articles to a special feature on sustainable and responsible investing. Assuming all goes to plan, this feature will shortly appear as an insert that will be published alongside an issue of the Guardian newspaper, as well as online. When we know for sure, we will send a message to members to watch out for it, and also include a news item on our website.

We owe UKSA's original founding in 1992 and the influx of new members we recruited soon after that to media coverage. For our STC project, media coverage will be critical, both to spread the message about what we wish to achieve, and also, critically, to attract volunteers, especially those with high levels of financial knowledge they would like to contribute. The "what we wish to achieve" message will have to develop over time as our capabilities develop.

Yet another relevant new book – and a free online event

Professors Paul Collier and John Kay have been busy post-lockdown: their new book "Greed is Dead: Politics after Individualism" was recently published, and there is a free online event you can watch at 6 pm on Tuesday 15 September. You have to register here. We will include a review of the book in the next TPI.

The challenges of financial education and empowerment

Everybody's needs are different. People's levels of interest in the topic vary hugely, and along with numeracy, financial capability is something that governments always say they want to improve. There are all sorts of bodies with a brief to help in one way or another. And we will work with them to the extent possible. Numeracy is not so hard, but when we really get to financial capability, it can become a bit more contentious! The gentle revolution we are looking to bring about will mean less of the national cake being taken by the financial sector. Among other things, we will be looking to get more publicity for our honestmoneynow.co.uk website. If members were able to have a look at this and give us any feedback, we would be very grateful.

Realistically, only a limited proportion of the population is ever going to be interested enough in investment to think about which companies to invest in. Delegated investment is always going to be the route for the majority. But if there is an independent voice out there that points the way to choices that minimise expenses, and that is respected and listened to, that is going to transform things. And in the absence of any other independent trusted voice, that is the gap we wish to fill. It's a status that has to be earned – we need patience and determination – and more volunteers!

You have to start with what is possible. Who are the people who are likely to engage with us where we are today – apart from those who already think of themselves as shareholders and use self-select stockbroking services for their ISAs or their SIPPs?

Many people who have been working for more than just a few years will be worrying about the problem of managing long-term savings, aware of and stressed by the need to tackle the problem, nervous that they don't know much about the principles of investment, but also put off by the poor reputation of the financial sector. These people will not be attracted by the idea of reading about the subject and working things out for themselves – or they would not be in this situation. But if they were aware of a body which is clearly independent, and which is not out to make money from them, it might be sufficient to engage their interest.

For those people who are already minded to do the work to become better clued up about investment, they may welcome a few pointers – for example we will be developing recommended reading lists with commentaries to publish on our website, and we will ask members for comments and suggestions. More on this in a future issue.

I believe that a particularly rewarding initiative would be to tackle universities, and to target young people generally. From the few discussions I have had, I believe there is an appetite within universities to welcome guest speakers. The special cachet would be UKSA's independence – we would not be trying to sell anything. So developing material for this is high on the agenda. If anyone would like to help….

Better awareness of the importance of expenses, and the zero-sum nature of most delegated investment management – what might this lead to?

The logical thing is that as more people learn that passive investment can be expected to outperform active investment, more money should move to managers like Vanguard. Some will argue that this leaves a vacuum in corporate control. We will advance two ideas, first that ordinary savers' voices need to be heard – and second that we need to search for some principles for passive managers to factor into their voting policies. You will find Alistair's piece on page 10 expresses similar sentiments. We need to engage ordinary people in this; if we leave it to the financial sector, we won't get away from the combination of both bonus-related pay and short-termism.

In the financial pages, you will read lots of arguments that we "need" active investment managers for the purpose of "price formation". I am afraid this is simply a response to the threat from passive managers. It would be much more convincing if the active managers were to use their voting power to influence the companies whose shares they hold to operate in a better way. But they don't. If anything, the view appears to be that they do more damage than good. A great example is executive pay – high executive pay in the fund management sector means that there is little appetite to control it in the corporate sector. There are hosts of studies concluding this.

I have mentioned this before in passing, but I'd really like to encourage you to watch Lord Paul Myners' 2018 Autumn Lecture to the Actuarial profession. It's on YouTube here. In this lecture, which is titled "in investment, how do we define long term" Lord Myners explains how, when leading a successful fund manager, he came to understand the problem of the ownerless corporation. His company controlled a meaningful proportion of many UK companies, but he realised that there was no appetite amongst his individual managers to put time into actually engaging with the companies in which they invested. In his presentation, and in the Q&A which is also recorded, he touches on a range of issues, including some pretty controversial questions. He is very explicit about the huge amounts extracted by the financial sector – which he has worked in himself.

The changing world – what if there is much less growth?

I will be writing a discussion piece on this for the website before the next edition of TPI. Suffice for now to say that if we are in for lower real investment returns, both the societal importance of corporate behaviour and the expenses suffered by savers from the intermediation chain become even more important.

UKSA's planned social event in London

At the time of going to press, UKSA's social event scheduled for 26 October remains on. However, we are very mindful of the Covid-19 situation and will take a final decision on whether or not to go ahead in the coming weeks.

We will notify members by e-mail. Any members who do not receive e-mail are kindly requested to check the website or call the office from 9 September.

Latest twist in the Unilever saga

by Helen Gibbons

Back in September 2018 Unilever proposed to rationalise its structure and move its HQ to the Netherlands, scrapping the dual UK-Dutch structure that had existed since the 1930s. Unilever plc shares would be replaced by NV shares listed in the Netherlands and would no longer be part of the FTSE100.

The plan came after the Dutch government announced plans to scrap its 15 per cent withholding tax on dividends. The Dutch Prime Minister, Mark Rutte, is himself a former Unilever executive.

UKSA campaigned against the move, believing it would not be in the interests of most private shareholders. Among other points, we argued that:

• there would be a loss of transparency for UK shareholders with no opportunity to question directors at a UK AGM;

• the UK would lose £113bn of market capitalisation to the Netherlands in a nil premium takeover.

• removal from the FTSE 100 index would force many funds to divest, impacting the share price.

The plan drew fire from many quarters and was finally abandoned.

A reverse move then came in June this year when Unilever announced plans to move its Rotterdam headquarters to London. It would keep its main market listing in London alongside secondary listings in Amsterdam and New York. ‘Any move that contributes to Unilever becoming a more agile machine is a step in the right direction – particularly as coronavirus has accelerated the challenges being seen by a lot of the big brands,’ the company said.

Shell, the other major dual-listed group, did not rule out following the Unilever move. Unilever shareholders will have a chance to vote on the plan on 21 September in Rotterdam and 12 October in London.

A few days ago came news of yet another twist. The Dutch left-wing green party GroenLinks proposed a bill to penalise companies with revenues over €750m that leave the Netherlands for low-tax jurisdictions. The UK would be deemed ‘low-tax’ because it levies no withholding tax on dividends. Unilever has calculated the cost of such a penalty at €11 billion, which would be enough for it to abandon the move to London ‘in the best interests of Unilever, its shareholders and other stakeholders’ according to a note to shareholders.

Proponents of the plan, which has garnered support across the Dutch parliament, argue that the law would stop a 'race to the bottom' in corporate taxation, with companies being prevented from ‘shopping’ for the lowest-tax jurisdiction. The move has been dubbed a ‘Hotel California tax' after the famous Eagles lyric ‘You can check out any time you like / But you can never leave!’

The planned exit tax has drawn accusations of hypocrisy from some commentators. The Netherlands has a tax system that is harsh on small businesses and sole traders while casting a benign eye on sweetheart deals with multinational companies. The Tax Justice Network’s Corporate Tax Haven Index ranks the Netherlands fourth, just after the Cayman Islands. And who can forget the famous (or infamous) ‘Double Irish with a Dutch Sandwich’ tax arrangement?

The Dutch Council of State still has to give its opinion on the exit tax proposal. The fear is that even if it is eventually thrown out, possibly by the European Court of Justice, such a judgement could be years away and in the meantime the company could fall foul of the ‘pay up now and argue later’ principle.

Donations

UKSA is run entirely by volunteers and is funded by membership fees and individual donations. We believe this is important to maintain absolute independence from the financial sector so that we can continue to work without fear or favour.

Donations of any size are always welcome. If you are interesting in supporting UKSA's work, please call the office or click the 'Donate' button on our website.

The nominee issue – then and now

Ten years ago, writing in issue 138 of The Private Investor, **John Hunter** said:

“Congratulations on getting UKSA up front on the nominee issue through the contributions of Roger Lawson and Peter Raynes to Mark Atherton’s article in The Times. Could I just raise a little flag on policy?

I would hate to see the main plank of UKSA's attack to be encouraging individuals to use the mechanisms currently available.

To me there is a fundamental structural – maybe even moral – issue here; and that is that shareholding comes with stewardship rights and obligations that cannot be impaired. If you buy (or an intermediary sells to you) a voting share, it should not be optional whether you take up some of the rights and obligations attached. Even more so, it should not be optional for you to renounce those rights in favour of someone else – which is what happens with nominee shareholdings. The damaging consequences are only too obvious in current corporate governance practice, where governance systems based on the presumption that shareholders will behave as concerned beneficial owners have been hijacked by those with a different agenda.

So I think we want to be very careful in promoting Crest membership as a solution (and certainly not information rights – which are to governance what table-dancing is to sex: look but don’t touch). To be more positive, although concerned ownership should be compulsory, not optional, the Crest system does provide a ready-made vehicle to implement that policy for private shareholders.”

Ten years on there have been legal changes, including a new iteration of the Shareholder Rights Directive, and above all technological advances, but the fundamental issue remains unresolved, so we have to keep banging the drum.

John reports that he would write the same today, although the Crest remarks would be stronger.

Letter to the Editor

From Mr G. Miller

Dear Madam

I am writing to say that I will not be renewing my membership of the UKSA when my current sub expires later this month. I have not done so lightly because I have been a member for I guess upwards of 20 years and was Chairman of the Scottish Region for several of those.

However, things are not what they were with the UKSA particularly in the last 12 months or so. Firstly, UKSA would not take a stance on the bullying tactics of the PRA with regard to the cancellation of the bank dividends in March this year and then we had headlines in the Times at least, where Dean Buckner, Policy Director of UKSA, ably assisted by Peter Parry, was calling for the Legal & General Final Dividend for 2019 to be cancelled. Fortunately, the Company ignored his overtures and went ahead anyway. These are not the actions of an organisation standing up for private investors.

Furthermore in the June issue of the PI you were delighted to welcome your new chairman, Mark Cardale, then on 11 July an e-mail was sent presumably to all members to say that he had stepped down and that there would be an update after your Board Meeting the next week. I reminded John Hunter of this today but he has declined to say anything except that UKSA ‘will not be taking a public position on this’.

Thus I will resign my membership. UKSA is not what it was.

Yours sincerely

G. Miller

A reply to Mr Miller

Many members will know George Miller, a long-time UKSA member and former outstanding leader of the Scottish region of UKSA. It is sad to receive such a letter, but his past contribution to UKSA has earned him the right of publication.

We exchanged many e-mails with George explaining our position, but he remained adamant.

In summary, we were not calling for the L&G dividend to be cancelled. We simply pointed out that the L&G board’s responsibilities included the appropriate preservation of capital and the consequences of the Covid-19 crisis could justify that decision.

It has always been UKSA’s position that the narrow interests of individual investors should not override actions necessary for the long-term health of their company – indeed that is the essence of responsible investing.

If such calls had been made at the time of the 2008 financial crisis, maybe there would have been less need for taxpayer bailouts.

With regard to the promise to give updates on our plans to attract a wider range of members, this will be continuous in this and future editions of The Private Investor.

The UKSA Board

Michelmersh Brick Holdings plc

by John Hunter

Here is a cautionary tale about modern accounting.

I have been researching this company for my investment club. It is a typical small AIM company, family controlled, long-established, well-regarded, niche product in a core industry. Its operating profits for the last three years (also calendar years), as reported by Sharescope, are £3.3m - £6.4m - £10.4m and its historical p/e is 10.0. This looks a pretty good deal.

I glanced at the financial statements and noticed an exceptional profit of £2.4m described as 'bargain purchase' (also exceptional acquisition costs of £0.6m). I am directed to note 14 that goes on for about a page but in summary reports:

- In February 2019 Michelmersh acquired a small Belgian brick company for £8.8m. Various independent valuers earned their fees by establishing the 'fair' value of the net assets acquired. This included a valuation of the company's 'brand value'. Plant and equipment was 'valued by group personnel';
- The total of 'fair value' came to £11.2m;
- Here's the rub. The assets were entered in Michelmersh's balance sheet at 'fair value' and the excess over cost of £2.4m booked to operating profit (and in the balance sheet to 'retained earnings', so presumably also to 'distributable reserves').

So let's see if I've got this right:

- The company makes a small acquisition in the same industry;
- The sellers, presumably knowledgeable, agree a price. The buyers (or their advisers) go through an exercise to deconstruct the business into its component parts and find the supposed market value of the parts. This totals 25% more than the agreed price;
- The sellers nevertheless proceed with the sale (this is because they are sensible people not accountants);
- The buyers enhance their operating profit for the year by 20%.

There is a word to describe this process, and it is 'fatuous'. The potential for manipulation is obvious, the resulting obfuscation of a perfectly simple business self-evident. The profession that promotes it should be ashamed of itself.

Oh, and the annual report itself is 70 pages. If you need 70 pages to report annually to stakeholders on a simple brick company, supplementing an active website and other statutory communications, you have taken a wrong turning somewhere.

No criticism is intended of the company or the auditors, who simply followed the requirements of the accounting standards. The opinions expressed are my own and not necessarily those of UKSA.

Introducing Anastasia Ouzouni

My name is Anastasia Ouzouni and I am a Greek national. I have been a resident in the UK since 2016 and have lived in the cities of Birmingham, London and Nottingham. I currently work as a Customer Services Manager at Evolve Retail Ltd and I have previously worked for Deliveroo and Saddle Point Technologies. I have a BSc in Finance and Accounting from the University of Macedonia, Greece, and an MA in International Relations (Diplomacy) from the University of Birmingham, UK.

I decided to volunteer for UKSA as it presents a great opportunity to further my knowledge and understanding of the financial markets and how they function. By improving the services UKSA offers, especially working with the new membership management software, I believe I will be able to provide support to the plethora of UK shareholders and work to ameliorate the treatment and attention they receive. In addition, I will expand my analytical and report-producing skills while researching different ways to approach the younger generations and educate them on how to benefit from the financial markets.

UKSA offers a unique opportunity to differentiate my CV, apply previously gained knowledge and at the same time acquire new skills. As I am in the process of applying for a second Master's Degree (Master's in Business Administration, MBA). I can see that this experience produces a significant advantage that will assist me in achieving this goal and progress my future career goals.

Another cautionary tale

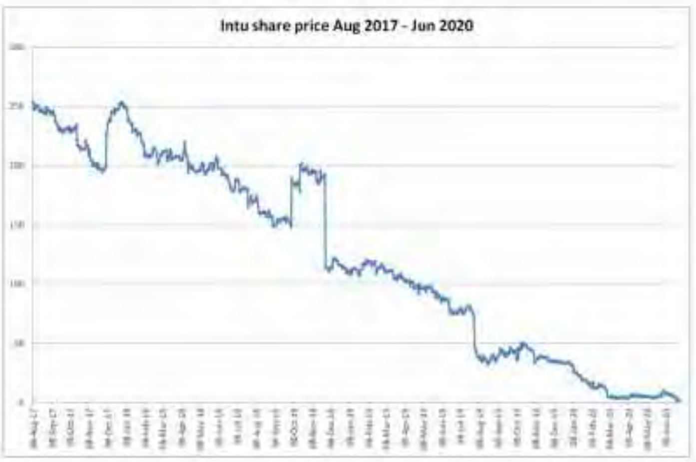
by Dean Buckner

John Hunter (this issue) warns of brick companies with optimistic book values. Here is another cautionary tale.

Many readers will have heard of Intu Properties, which collapsed into administration on 26 June 2020 after failing to secure an agreement with its creditors. The company owns shopping centres across the UK, including Lakeside in Essex, the Trafford Centre in Manchester and Gateshead's Metrocentre. Intu's business model is fairly simple. It leases out retail space in its shopping centres, receiving a total income of about £350m in 2019. Against this it has been paying around £300m in financing costs. The model seems sustainable, but the company was clearly exposed to variations in rental income. You are guaranteed to have to pay your creditors, but it isn't guaranteed that your tenants pay you.

Sadly the worst happened. Net rental income had been declining for some time, from £423m in 2017 to £398m in 2018 and £348m in 2019. For a few years now the trend has been towards online shopping at the expense of visiting actual shops. Covid-19 was merely the last straw (thanks to the lockdown, many people stayed away from shops and 'footfall' went into 'freefall').

The share price had been in steady decline from a healthy 250p in August 2017 to 113p at the end of 2018 and a mere 34p by December 2019, then below 2p at the end of June 2020, when the company went into administration (see chart). Yet the book value – the estimate of the present value of assets against the present value of obligations, was given at 147p per share in the 2019 report. How could the accountants have got it so wrong?



We don't have to look very far for the culprit: IFRS accounting. The value of debt is fairly simple to ascertain, derivable from the discounted value of principal at maturity plus periodic cashflows. But the value of a collection of shopping malls with tenants that come and go, and occasionally default on their rental, is a different business. Intu relied on a team of external specialist valuers who used information such as current lease and tenant data to come up with an estimate – really a guess – about how much the shopping centres were worth.

These estimates were highly variable: £9,208m in 2017, £8,058m in 2018, £5,946m in 2019. It does not take a rocket scientist to see that a further negative change in estimated asset value could easily exhaust the available equity of £1,846m.

And here we are faced with the fundamental problem of current accounting standards, that they have no conception of the adequacy of capital. Another firm might have declared identical equity of £1,846m, but based on income which, unlike shopping centre income, was relatively stable. Financial reports, as they currently stand, provide little information on how 'good' the capital is.

This situation must change.

I am currently representing UKSA on the Technical Advisory Group on the IFRS 17 standard and we are nominating Charles Henderson for the Endorsement Board. We think that preparers should provide more information on the safety of capital and should avoid clearly optimistic or wishful estimates of asset value. Auditors should be putting pressure on preparers in the interpretation and application of IFRS and disclosing this in the extended audit reports where the preparers are not being cautious enough.

As John Hunter says, the potential for bad practice is manifest and, yes, the profession that has allowed it should be ashamed of itself.

More on volunteering

In the December TPI, when we first announced UKSA's new ambitions, we said that 'we need a different approach to two critical resources: people and money'. In respect of people, we need to greatly expand the contribution of volunteers, and we recognise that those who are willing to contribute to our aims reflect a much wider population than those with enough interest to become full members.

Anastasia (story opposite) is the first fruit of this approach. But we need many more like her to help in admininstration, IT, communications, marketing and social media. The word 'help' includes understudying those who bear the main burden of these roles and the range of options is infinite.

If you can help, or know someone who might, or just want to make further enquiries, please contact the office or any board member.

How did the investment industry get so rich?

by Alistair Blair

We are very grateful to Alistair Blair for permission to reproduce this article. It was first published during the fifteen years in which Alistair wrote the No Free Lunch column in The Investors Chronicle. This article was first published by the RSA.

Alistair is an UKSA member and previously worked in investment banking and fund management. He is now less active in commentary on the investment scene, preferring to concentrate on his own enterprise, the UK's premier online fishmonger (www.thefishsociety.co.uk).

Coincidentally, the editor has been a customer of The Fish Society since 2011 and can thoroughly recommend its products.

Since the Second World War the ordinary man (and woman) has achieved a level of wealth beyond the dreams of his forbears. Economic growth, social advance, and in particular the widespread launch of corporate pension schemes in the 1950s—which painlessly turned the mass of ordinary people into purposeful savers—these have over the last half a century delivered majority ownership of the economy to the greater part of the populations of all western nations.

It’s true that these very pension schemes are now in retreat. The final salary scheme is already virtually extinct in terms of new entrants. Their replacements —skimpy “defined contribution schemes”—will not deliver the wealth accumulation to current generations which the old schemes achieved for the returning heroes of World War II (in the West), and their offspring, the early baby-boomers.

Nevertheless, by any historical measure, ordinary people are astonishingly wealthy in aggregate and even reasonably wealthy as individuals. In addition to pension savings, they hold a very significant amount of money in insurance policies, and the ordinary man who still has cash to spare after ticking those two boxes generally puts it into a unit trust: in the UK, this sector is about half the size of the pension sector.

70 years ago, 70 per cent of the UK stock market was held by a relatively few very wealthy individuals who owned shares directly. Today, 70 per cent is held by institutional investors on behalf of the population at large.

For most of the last few decades, they have been very happy (although this mood may now be on the wane). They have been so happy, that they have not spotted how badly they have been served by the investment industry.

The City of London and Wall Street are conspicuously the richest sectors in the UK and US economies. Other western financial centres lack the international scale of these two but emulate them in terms of economic style. Throughout the west, indeed—since the fall of communism and the emergence of China—throughout the world, investment bankers, corporate bankers, fund managers, private equity executives, brokers, accountants, corporate lawyers and other advisers of every hue occupy palatial offices and earn impressive salaries.

They could be thought of as the “ringmaster class” in a giant circus. The ringmasters’ role is investment, or “running money”. The money they run comprises the acts which they summon into the ring. These acts are known as companies and their performers are CEOs, CFOs and chairmen (lesser corporate actors aren’t senior enough to get into the ring). Although the ringmasters are ostensibly in charge, the underlying fact is that all the performers are employees of the same circus. Therefore, there is necessarily a single pay structure and the remuneration of top corporate executives broadly matches that of top investment executives.

The business of the big top is to manage the huge aggregate wealth of the ordinary man. The privileges it exacts for doing so are out of all proportion to its success in providing this service.

A multi-decade endeavour

Investing is a multi-decade endeavour. Ordinary man commences his investing career in his early twenties and typically completes it forty to fifty years later when he is well into his pension phase and beginning to plan the dispersal of his life-end wealth. In the meantime, he accumulates his savings with any of thousands of pension schemes, insurance companies or mutual funds.

Amongst these thousands, only the barest handful can boast a successful 50 year investment record. This handful, foremost amongst whom stands Warren Buffett, manages only a tiny proportion of global wealth. Success in investment requires the performer to beat the broad stock market indexes consistently. This is extraordinarily challenging to do, since the information necessary to make successful investments is available to everybody. True, its interpretation is difficult, but since the investment industry rewards employees so highly, it draws in plenty of interpretive talent. Thus competition amongst investment players is immense, and success—in terms of consistently beating the indexes—necessarily elusive.

There is a paradox here, for the common view is that the City and Wall Street are successful, and it is certainly the case that their customers have by and large done very well over the last 50—in fact, 60—years. What has happened over this time is not that the investment industry has performed well on behalf of its customers, but that the global economy has performed well on behalf of everybody.

Between 1900 and 1950, US equities returned 4.9 per cent a year in real terms. The UK figure was 3.0 per cent. Between 1950 and 2000, US returns rose by three quarters to 8.5 per cent and UK returns almost tripled, to 8.6 per cent. (These figures are from “Triumph of the Optimists”, 2002, by Dimson, March and Staunton. Other researchers’ statistics differ in detail but confirm the overall picture of accelerating wealth creation over the course of the 20th century.)

These were tremendous gains and the benefits were widespread as the number of people saving meaningful amounts of money via pension schemes and life insurance multiplied.

It’s now necessary to review some arithmetic. With returns reinvested, a sum of money invested at 8.6 per cent a year doubles every eight and a half years (see Table 1 – ref 1). This means that over 50 years—starting in say 1950—one hundred pounds invested in the UK stock market grew to 62 times the original investment by 2000 (ref 3).

to 1950 investor with one of £438. £6,187 is "1400 per cent better" than £438, *and the disparity is even more significant if one calculates the return on the proper basis of excluding the initial investment).*

Table 1 RETURNS ON EQUITIES 1900-2000*

1900-1950		1950-2000			
	real return		real return		*nominal return§*
	3.0%		8.6%		*14.7%*
1900	**100**	**1950**	**100**		***100***
1901	103	1951	109		*115*
1902	106	1952	118		*132*
1903	109	1953	128		*151*
1904	113	1954	139		*173*
1905	116	1955	151		*199*
1906	119	1956	164		*228*
1907	123	1957	178		*261*
1908	127	1958	193	ref	*300*
1909	130	1959	210	1	*344*
1910	134	1960	228		*394*
1911	138	1961	248		*452*
1912	143	1962	269		*519*
1913	147	1963	292		*595*
1914	151	1964	317		*682*
1915	156	1965	345		*782*
1916	160	1966	374		*897*
1917	165	1967	407		*1,029*
1918	170	1968	442		*1,181*
1919	175	1969	479		*1,354*
1920	181	1970	521		*1,553*
1921	186	1971	565		*1,782*
1922	192	1972	614		*2,044*
1923	197	1973	667		*2,344*
1924	203	1974	724		*2,689*
1925	209	1975	787		*3,084*
1926	216	1976	854		*3,537*
1927	222	1977	928		*4,057*
1928	229	1978	1,007		*4,653*
1929	236	1979	1,094		*5,338*
1930	243	1980	1,188		*6,122*
1931	250	1981	1,290		*7,022*
1932	258	1982	1,401		*8,054*
1933	265	1983	1,522		*9,238*
1934	273	1984	1,653		*10,596*
1935	281	1985	1,795		*12,154*
1936	290	1986	1,949		*13,941*
1937	299	1987	2,117		*15,990*
1938	307	1988	2,299		*18,340*
1939	317	1989	2,497		*21,036*
1940	326	1990	2,711		*24,129*
1941	336	1991	2,945		*27,678*
1942	346	1992	3,198		*31,744*
1943	356	1993	3,473		*36,411*
1944	367	1994	3,771		*41,763*
1945	378	1995	4,096		*47,902*
1946	390	1996	4,448		*54,944*
1947	401	1997	4,831		*63,020*
1948	413	1998	5,246		*72,284*
1949	426	1999	5,697		*82,910*
1950	**438 ref 2**	**2000**	**6,187 ref 3**		***95,098 ref 5***

"percent better" = 6,187 / 438 = 14.1 =1400% ref 4

*based on: Triumph of the Optimists by Dimson, Marsh & Staunton
§ nominal return = real return of 8.6% + inflation at 6.1%

Laid on top of the mystery of compound interest was the illusion-laden miasma of inflation. The figures quoted so far are in real (or inflation-adjusted) terms, but consider them as they appeared to the saver himself. Having in 1950 invested £100 in the FT 30 share index (and having made no further investments save for reinvesting dividends), he was by 2000 receiving statements from his stockbroker which told him his 40 year investment had multiplied to £95,000 (ref 5). He knew the millennium pound had been depreciated by inflation and that he wasn't really 950 times richer than in 1950. But if he was the man on the Clapham omnibus, he probably thought he was more than 61 times richer.

It is therefore no wonder that the savers of the last 50 years, whatever suspicions they harboured about the investment sector to which they entrusted their savings, thought it was basically serving them well. Commentators and the government after all told them year after year how the City of London was the UK's most successful economic sector. No-one seriously questioned the charges it levied in the process of administering the public's savings.

Everyone (including in large measure the City itself) was heedless of how investment charges had grown from crumbs into boulders.

Extravagant to the point of magnificence

The following paragraphs discuss unit trust charges because their charges are more transparent than those of other subsectors. Unit trust charges are higher than those paid by pension funds, because —among other reasons—account sizes are smaller. Nevertheless, the big picture in investment charges is the same across the industry, and the trends in unit trust charges are a fair proxy for those incurred by the generality of ordinary investors.

When the UK unit trust sector got going in the 1930s, its fees were fixed by regulation to an initial charge of 3.25 per cent followed by an annual charge of half a per cent. The Board of Trade, which set these charges, was of course unaware of how investment returns would accelerate over future decades. Had the Board possessed greater foresight, it might have additionally required that the annual service charge should be deflated by a broad equity index. For instance, if the index doubled, then the annual percentage charge would be halved to a quarter of a per cent (thus generating the same fee in cash terms). After all, the progress of the index is entirely unrelated to the efforts of the investment industry, so it should gather no reward from such a trend. The concept is by no means one-sided: it would equally have protected the industry against falling markets, by doubling the percentage fee if equity indexes halved.

In a perfect world, the Board of Trade might also have recognised that the economies of scale in fund management are extravagant to the point of magnificence. It takes hardly more manpower to run a £500m fund than a £50m fund. Yet at half a per cent a year, the larger fund brings in ten times the management fee.

The illustrations of equity returns quoted above are based on returns before investment management fees. They are essentially what were available to the direct investor in equities over the periods quoted. But unit trust investors (and others who invest via institutional methods) do not receive these returns. They receive returns reduced by the management fee. Some measure of fee is obviously unavoidable, but if the investment world shared its economies of scale meaningfully with its customers, the benefits for customers would be dramatic.

This is set out in Table 2, which compares how the impact of fees on four hypothetical investors who each invest £100 and receive the market return (with dividends reinvested) for 50 years. All illustrations are in real terms—that is to say, both fees and fund growth would be escalated accordingly if inflation were taken into account.

> *Investor A invests directly in the stock market and pays no fees. If he achieved the average 8.6 per cent return from 1950 to 2000, his eventual fund was worth £6,187 (the figure quoted above).*
>
> *Investor B invests in a fund which levies an annual charge of half a per cent of his original investment. This arguably*

optimistic fee basis results in fees over the period of £25 but the final fund is £5,833, or £354 less than that of Investor A. In other words, the impact of fees over 50 years is £354. The disparity between "fees" and the "impact of fees" is due to the investor forgoing the aggregate cumulative return on the fees paid during his 50 year investment. This might seem a stingy fee basis, but it should be recognised that the investment manager (who is charging the fees) has not contributed to the growth of the fund, which is entirely due to the market return. Thus arguably (although, in the real word, admittedly—impossibly) the annual fee charged at the inception of the investment should not have grown either.

Investor C is charged one per cent of his fund each year. If the fund grows, the fee grows. This is the conventional basis of investment management fee (although typically, fees are in fact higher than one per cent). This investor pays £499 in fees. The impact of fees on his final fund is £2,291. He is 37 per cent worse off than Investor A.

Investor D is "an unhappy medium". His fee escalates, but only at five per cent per annum in real terms, based on his original investment. In other words, he pays £1.00 in year 1, £1.05 in year 2 and £1.1025 in year 3. Thus his investment manager reaps only a part of the "undeserved benefit" of the generalised rise in share values. This saves the investor £290 in total fees over 50 years, or nearly 60 per cent of the fees incurred by investor C. Nevertheless, the result of the inescapable laws of compound interest is to cost him 23 per cent of his final fund, as compared with Investor A.

Table 2 The amazing cumulative effect of investment management fees

Note 1: The effect of inflation is stripped out of all columns. The effect of including it would be to escalate all figures - both fees and funds - accordingly

Note 2 The market return for all four examples is assumed to be 8.6% pa.

	Investor A - investing directly			Investor B - paying fee fixed at 0.5% pa of original investment				Investor C - paying fee of 1% pa of growing fund				Investor D - see text			
year	fund at start of year	market return	fund at end of year	fund at start of year	market return	fee	fund at end of year	fund at start of year	market return	fee	fund at end of year	fund at start of year	market return	fee	fund at end of year
	£	£	£	£	£	£	£	£	£	£	£	£	£	£	£
0	100.0	8.6	108.6	100.0	8.6	0.5	108.1	100.0	8.6	1.0	107.6	100.0	8.6	1.0	107.6
1	108.6	9.3	117.9	108.1	9.3	0.5	116.9	107.6	9.3	1.1	115.8	107.6	9.3	1.1	115.8
2	117.9	10.1	128.1	116.9	10.1	0.5	126.4	115.8	10.0	1.2	124.6	115.8	10.0	1.1	124.7
3	128.1	11.0	139.1	126.4	10.9	0.5	136.8	124.6	10.7	1.2	134.0	124.7	10.7	1.2	134.2
4	139.1	12.0	151.1	136.8	11.8	0.5	148.1	134.0	11.5	1.3	144.2	134.2	11.5	1.2	144.6
5	151.1	13.0	164.1	148.1	12.7	0.5	160.3	144.2	12.4	1.4	155.2	144.6	12.4	1.3	155.7
6	164.1	14.1	178.2	160.3	13.8	0.5	173.6	155.2	13.3	1.6	167.0	155.7	13.4	1.3	167.8
7	178.2	15.3	193.5	173.6	14.9	0.5	188.0	167.0	14.4	1.7	179.7	167.8	14.4	1.4	180.8
8	193.5	16.6	210.1	188.0	16.2	0.5	203.7	179.7	15.5	1.8	193.3	180.8	15.5	1.5	194.8
9	210.1	18.1	228.2	203.7	17.5	0.5	220.7	193.3	16.6	1.9	208.0	194.8	16.8	1.6	210.1
10	228	20	248	221	19	0.5	239	208	18	2.1	224	210	18	1.6	226
11	248	21	269	239	21	0.5	259	224	19	2.2	241	226	19	1.7	244
12	269	23	292	259	22	0.5	281	241	21	2.4	259	244	21	1.8	263
13	292	25	317	281	24	0.5	305	259	22	2.6	279	263	23	1.9	284
14	317	27	345	305	26	0.5	330	279	24	2.8	300	284	24	2.0	307
15	345	30	374	330	28	0.5	358	300	26	3.0	323	307	26	2.1	331
16	374	32	407	358	31	0.5	389	323	28	3.2	347	331	28	2.2	357
17	407	35	442	389	33	0.5	422	347	30	3.5	374	357	31	2.3	386
18	442	38	479	422	36	0.5	457	374	32	3.7	402	386	33	2.4	416
19	479	41	521	457	39	0.5	496	402	35	4.0	433	416	36	2.5	450
20	521	45	565	496	43	0.5	538	433	37	4.3	466	450	39	2.7	486
21	565	49	614	538	46	0.5	584	466	40	4.7	501	486	42	2.8	525
22	614	53	667	584	50	0.5	634	501	43	5.0	539	525	45	2.9	567
23	667	57	724	634	55	0.5	688	539	46	5.4	580	567	49	3.1	613
24	724	62	787	688	59	0.5	747	580	50	5.8	624	613	53	3.2	662
25	787	68	854	747	64	0.5	810	624	54	6.2	672	662	57	3.4	716
26	854	73	928	810	70	0.5	880	672	58	6.7	723	716	62	3.6	774
27	928	80	1,007	880	76	0.5	955	723	62	7.2	778	774	67	3.7	837
28	1,007	87	1,094	955	82	0.5	1,036	778	67	7.8	837	837	72	3.9	905
29	1,094	94	1,188	1,036	89	0.5	1,125	837	72	8.4	900	905	78	4.1	978
30	1,188	102	1,290	1,125	97	0.5	1,221	900	77	9.0	969	978	84	4.3	1,058
31	1,290	111	1,401	1,221	105	0.5	1,326	969	83	9.7	1,042	1,058	91	4.5	1,144
32	1,401	121	1,522	1,326	114	0.5	1,439	1,042	90	10	1,122	1,144	98	4.8	1,238
33	1,522	131	1,653	1,439	124	0.5	1,562	1,122	96	11	1,207	1,238	106	5.0	1,340
34	1,653	142	1,795	1,562	134	0.5	1,696	1,207	104	12	1,298	1,340	115	5.3	1,450
35	1,795	154	1,949	1,696	146	0.5	1,842	1,298	112	13	1,397	1,450	125	5.5	1,569
36	1,949	168	2,117	1,842	158	0.5	2,000	1,397	120	14	1,503	1,569	135	5.8	1,698
37	2,117	182	2,299	2,000	172	0.5	2,171	1,503	129	15	1,618	1,698	146	6.1	1,838
38	2,299	198	2,497	2,171	187	0.5	2,357	1,618	139	16	1,741	1,838	158	6.4	1,989
39	2,497	215	2,711	2,357	203	0.5	2,560	1,741	150	17	1,873	1,989	171	6.7	2,154
40	2,711	233	2,945	2,560	220	0.5	2,779	1,873	161	19	2,015	2,154	185	7.0	2,332
41	2,945	253	3,198	2,779	239	0.5	3,018	2,015	173	20	2,168	2,332	201	7.4	2,525
42	3,198	275	3,473	3,018	260	0.5	3,277	2,168	186	22	2,333	2,525	217	7.8	2,735
43	3,473	299	3,771	3,277	282	0.5	3,558	2,333	201	23	2,510	2,735	235	8.1	2,962
44	3,771	324	4,096	3,558	306	0.5	3,864	2,510	216	25	2,701	2,962	255	8.6	3,208
45	4,096	352	4,448	3,864	332	0.5	4,195	2,701	232	27	2,906	3,208	276	9.0	3,475
46	4,448	383	4,831	4,195	361	0.5	4,556	2,906	250	29	3,127	3,475	299	9.4	3,764
47	4,831	415	5,246	4,556	392	0.5	4,947	3,127	269	31	3,365	3,764	324	9.9	4,078
48	5,246	451	5,697	4,947	425	0.5	5,372	3,365	289	34	3,621	4,078	351	10.4	4,418
49	5,697	490	6,187	5,372	462	0.5	5,833	3,621	311	36	3,896	4,418	380	10.9	4,787
total fees						25				499				209	
Compared with Investor A:															
impact of fees in £							354				2,291				1,400
impact of fees in %							-6%				-37%				-23%

In the 1930s—which was admittedly not a conspicuously prosperous decade in the City—half a per cent a year generated adequate fees to run the unit trust industry. By 1938, 98 unit trusts had been launched and had attracted a total of £98m of the public's savings. These generated annual fees for their promoters of £400,000. Rendered in current money, whilst leaving out investment growth and the flow of new savings into the industry which will be considered separately, these figures may be represented as £2.6bn of funds invested in unit trusts, and annual fees of £13m (this is based on an average inflation rate between 1939 and 2007 of 4.8 per cent).

Had the half a per cent annual charge stuck, then 70 years of advances in investment indexes would by themselves have made the unit trust industry as rich as Croesus. But it ended up much, much richer.

Imagine the unit trust industry never gathered another penny from investors, and had maintained its fees at half a per cent. Between 1938 and 2007, equity indices rose 89-fold. This would have multiplied unit trust funds from £2.6bn (in 2007 money terms), to £230 billion.

It need not have taken any more people to run £230bn as of 2007 than it took to run the £2.6bn of 1938. (One could argue that the headcount could have shrunk, because computers substituted for clerks over this period. However, those new compliance departments might have taken up the slack.) Half a per cent of £2.6bn is £130m, which is a hundred times more than the £13m (in 2007 money) of fees levied on the 1938 funds under management.

However, the charge of half a per cent with which the industry was launched did not stick. Charges rose, especially in the late 1980s when the government attempted to stamp out a few Spanish practices in the administration of unit trusts which had been used by promoters to fortify their income. Many mainstream UK equity trusts currently charge one and a half per cent, or three times the figure from 70 years ago. Perhaps this should be shaded modestly downwards to allow for the introduction of low-charge index funds, which represent five per cent of the unit trust market. Let's be generous, and assume that the average annual charge for comparable mainstream unit trusts is 1.25 per cent (or a quarter as much again as paid by Investor C in Table 2).

And then, of course, there has been the inflow of new money. According to the Investment Management Association, as of December 2007, the aggregate value of UK unit trusts stood at £440bn. 1.25 per cent of £440bn is £5.5bn. Table 3 draws these figures together.

Table 3 The UK Unit Trust sector then and now

	1938 in 2007 money	2007	increase in real terms
Funds under management	£2.6bn	£440bn	168x (1)
Comparable fee rate	0.5%	1.25%	
Aggregate annual charges	£13m	£5.5bn	422x
(2007 charge at 1938 fee rate		£2.2bn)	

(1) The greater part of this gain was due to advances in investment indices, not to profits generated by the skills of fund managers. It is surprisingly difficult to obtain long term average earnings data for the UK to compare with this table, but a 2003 review from the Office of National Statistics ("A Century of Labour Market Change: 1990 to 2000", Lindsay), suggests strongly that between 1938 and 2000 the increase in real income experienced by the ordinary man was less than tenfold.

The table shows that fees extracted from customers have grown at two and half times the rate of funds under management (422/168). Given that index gains rather than investment skill or the inflow of new money generated much the greater element of growth in funds under management, and that this industry displays very significant economies of scale, there can be absolutely no doubt that the unit trust industry has served its customers poorly.

Oligarchy served by ordinary man

Unit trusts are not an isolated island of super-prosperity within the City. Fund managers move between unit trusts, pension funds, insurance companies and hedge funds. The latter sector is a standout, and individual stars of course always command spectacular packages, but below them pay is similar across the three traditional branches of institutional investment. Thus the escalation in the charges made by—and cost of running—unit trusts has occurred equally across the whole of the City.

Moreover, other City subsectors have achieved parallel increases in prosperity. Investment bankers, accountants, CEOs, headhunters and lawyers have their own pay scales—which might be more or less generous than those of fund managers. But collectively, all these City professions comprise an oligarchy with a single macro pay structure.

The £1m a year CEO does not want to deal with a £100,000 a year lawyer or a £150,000 a year auditor. It is a natural state of affairs for these professionals to be earning broadly similar amounts to their clients. They are all employees of the same circus, with a common pay structure.

In theory, institutional investors should have kept the lid on CEO pay. But to believe this to be practical would be naive. When push comes to shove, fund managers might despatch a woeful CEO. But oligarchies do not function on the basis of their members attacking each other in the normal course of events. Moreover, the big CEO pay rises waved through in recent years by institutional investors are not paid with their own money. They are paid with their customers' money.

It's impossible to say which City subsector is the source of the rapid pay inflation of recent years in these circles. At different times, no doubt, different subsectors have driven it.

But it is clear that it is the ordinary man, who owns 70 per cent of the stock market, who is paying the high salaries and bonuses to all these players. And equally clear that he can essentially do nothing about it.

Salaries in the unit trust sector have not escalated by 422 times in real terms. Some of the extra income has been deployed into marketing campaigns, more costly premises, and the input of a plethora of extra services unknown in 1938—the price of which reflects (in what is the natural way in such circumstances) the income available to provide them. The City is all ways round an expensive place to do business. But that is not because it needs to be expensive. It is because it has found the means of extracting high fees from its customers. This has inflated the cost of everything the City does.

Wrong number!

Why are customers unable to recognise that they are paying through the nose for investment services? Tens of thousands of pages have been written about this subject over the last couple of decades (which witnessed most of the growth). Your current correspondent believes that there are three reasons:

1) 1.25 per cent is a small number. But it is the wrong number! Customers erroneously believe the charges are small because they relate them not to what they are receiving, which is the investment return, but to what they have invested. Expressed in terms of returns, investment charges typically amount to between 10 and 20 per cent. (For instance, 1.25 per cent is 14.5 per cent of 8.6 per cent—which is the figure quoted above for UK equity returns since 1950). If this formulation was in widespread use, customers would be less willing to pay the charges levied by institutional investors.

2) Customers would perhaps be able to grasp the above if the investment industry was compelled to express charges in terms of returns instead of capital invested. But they will surely never appreciate how compound interest works to make small differences in annual fees mount up over time into huge differences in long term investment outcomes. A £1,000 investment which compounds at 8.6 per cent over 50 years generates a final fund of £6,187. One that compounds at 7.6 per cent generates a final fund of £3,896, or 37 per cent less. If customers could grasp this fact they would surely beat the investment industry about the head with it. But they do not appreciate it.

3) Underlying investment returns have been so good over the last 60 years that customers have never stopped to think about whether the fees they are charged to access these returns might be unreasonable.

Times are changing

We seem to have entered a time of leaner investment returns. Even if returns are maintained, they will have to be spread more thinly. Rapidly increasing longevity, combined with the escalating cost of old age health care, will significantly reduce the disposable income of pensioners. Ordinary man is already beginning to get this message well in advance of feeling its effects. He knows that the closure of final salary pension schemes is a financial blow.

Ordinary man will be more inclined over the next 50 years than he was over the last 50 to examine and question what he is charged to invest his savings. Governments should encourage this process, because it will be a key factor in alleviating the coming pension squeeze. Here are two policy suggestions for governments:

1) Institutional investors should be required to take account of their customers' views on pay and other matters and to reflect those views in their voting. This need not be a complex process.

For instance, insurance companies, unit trusts and pension funds could be required to pose the following question to their clients and members every year.

"Please indicate the stance you would like us to take when voting the interest we hold on your behalf in respect of director pay proposals. If the average director pay in a company over the last five years has exceeded its earnings growth, and where we can identify no ameliorating circumstances, should we vote FOR or AGAINST director pay proposals which would have the effect of increasing average director pay at a faster rate than the consumer price index? Please tick either for or against".

This 85 word question will provoke mirth, but it's far simpler than a lot of the small print foisted on investors. And it contains three important and clear features.

a) It contains the principle: "vote for or against director pay". That's the essence of it. Everyone knows what that means.

b) The trackback to earnings means pay in successful companies would be unaffected

c) It contains the latitude that institutional investors need to go with their own judgement where they wish to do so.

Institutions could split their votes, routinely voting say 13 per cent of its holding in favour of the remuneration report, if that was how its clients had voted, and 87 per cent against.

2) In the retail sector, the expression of investment charges as a percentage of the funds being managed should be forbidden. Investment charges should be expressed as a percentage of average annual return over the last five years. New funds should express their charges in the same manner, using indexes as a proxy.

The investment management business harbours two characteristics which have given its operators an exceptional free ride for many decades. The first is that a huge component of its increasing income is not due to its provision of useful services, but to the increasing prosperity of the global economy. Traditionally, only monopolies stood in this position. Other sectors of the economy also benefit from growing prosperity, but only by selling more goods and services. Investment managers, however, reap a double whammy: they do sell more services, but the services they previously sold generate increases in income beyond any original expectations.

The second is that customers simply do not understand how they are charged for the services provided.

Imagine the electronics industry was charging the same price per byte now as it did 50 years ago. Therein, you have a fair parallel.

A suggestion for holiday reading

Many thanks to **Catherine Moss** for recommending "The Fear Index" by Robert Harris, who weaves the realities of the stock market and digital technology, with science fiction, into a gripping fantasy, darker than the dark net. Follow the events surrounding the reclusive mathematical genius, creator of the algorithm at the heart of a highly successful fund for the super-rich, as he wrestles with the mystery of who is trying to kill him and why.

Ethical investing and the plastics pollution plague

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

The popular BBC One television series Blue Planet II [1] typifies media coverage drawing attention to the environmental damage caused by plastic waste. This programme and others like it point out the global reach of plastic detritus, its chemical toxicity and appallingly harmful effects on wildlife and sea creatures. The WWF reported that in 2014 the UK generated 4.9 million tonnes of plastic waste, of which 67% was packaging [2]. WWF recognises that engagement across government, businesses and the public is necessary to address plastics. The UK Government has deemed the problem sufficiently severe that it has pledged to eradicate avoidable plastic waste by 2042 as part of a 25-year plan [3].

Available choices constrain individuals seeking to reduce their plastics use. Although supermarket chains appear to be making some efforts with plastic packaging, a recent ‘Which?’ report indicates that considerable work is still required [4], [5]. There has been some progress. Government has taken the lead with plastics bags charging [6], although rules have been relaxed temporarily due to the COVID19 pandemic. However, the government has banned plastic straws, stirrers, and cotton buds from April 2020 [7].

Over 120 organisations, including food and drink brands, manufacturers, retailer and plastic reprocessors have signed up to meet several targets by 2025 under the ‘UK Plastics Pact’ [5]. Ethical investing can also contribute. It can encourage change by supporting environmentally-minded companies while avoiding those that contribute to the problem [8], [9]. Wealth management firms with expertise in ethical investing can support this process. P1 Investment Management asked all its ethical fund managers to complete a survey on how they are addressing plastics, due to be published in August 2020 [10]. The results are being used to promote higher standards on this issue. Meanwhile, this has given P1 valuable insight into the ethical funds with the most robust credentials in this area.

Extremely useful

The trouble with plastics is they are so useful. Plastics are cheap, sturdy, lightweight, waterproof, chemically inert, and durable, making them ideal for many purposes, including storage and food wrapping. Consequently, even when aware of the issues, consumers struggle to avoid them [9]. By protecting food from damage, plastic wrapping helps it last longer and makes it more visually appealing for customers, thereby helping reduce food waste [5].

Recycling helps, but not all plastics can be recycled. Government initiatives, such as bag charging schemes, caused significant reductions in usage, resulting in an 83% drop in 2016/17 since 2014/15 and £66 million donated to good causes [11]. Ethical investing has a role to play in helping cut off the problem at the root. It can encourage companies to stop using or creating plastics and seek alternatives throughout the supply chain. It can also support better recycling and disposal.

Ethical investing

Key areas to examine when selecting companies to support or avoid are:

- Reduction in the use of plastics by using more sustainable materials, including for packaging.
- Reuse of plastics through the introduction of deposit schemes, such as previously used with glass bottles. It is also vital to see used plastic as a resource.
- Recycling: enhanced plastics treatments, preferential use of readily recyclable plastics, or better design so that plastics can be separated for recycling. Products that are only ‘technically recyclable’ should be avoided. It should genuinely be possible to recycle plastics near where they are used.
- Disposal, to ensure plastic waste is dealt with responsibly, so it does not enter oceans and other ecosystems, causing harm.

Indeed, the chancellor has provided an economic incentive with a new tax on plastic packaging that contains less than 30% recycled plastic announced from April 2022 [12], [13].

What to do?

Ethical portfolio managers can also engage with firms to encourage improvement. At the same time, investors (including individuals, charity, and pension fund trustees) can seek sustainable investment solutions that help address plastics. By investing ethically, they can leverage savings to support actions in their daily lives.

Advisory firms have a valuable role to play. Ethical investing is challenging, and it can be hard for investors to select fund providers with superior skills and commitment. Investors can have greater confidence their money is being used as wisely as possible by engaging with wealth management firms with specific expertise in this area.

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 [14]. The Investment Association reports £31.0 billion assets in the UK responsible funds sector in May 2020, an increase of £10.8 billion since May 2019 [15].

However, the selection of suitable ethical funds is complex. So, some investors are likely to appreciate the support of wealth managers skilled in this area. That way, they can be confident they are contributing to addressing the plague of plastic pollution as well as global warming and social and governance challenges.

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A sideways look

Here's a quote from Algy Hall's 'Tame your Brain' article on behavioural finance in Investors Chronicle:

The first thing to do when investing is have a plan. This does not have to be complex. Greg Davies of Oxford Risk suggests that for many investors it would be enough to simply follow the three rules of: *Get your money invested; Diversify; Leave it alone.*

The foundations of any plan should be based on an honest assessment of competencies, risk tolerance and the amount of time and effort available to devote to managing investments.

So, Mr Braun, if you killed all those people, where are the bodies?

Interim reflections on the Wirecard debacle

by Adrian Phillips

Editor's note: Adrian has extensive experience as a sell-side investment analyst, particularly for European markets. Now retired, he is an author specialising in British history of the abdication and immediate prewar periods.

The Wirecard saga is far from over, both in terms of what we will learn about the events and its consequences, quite possibly at a high level of German domestic politics. The former is being almost daily swelled as direct and indirect participants indulge in an orgy of self-exculpation through selective disclosure. In my career as an investment analyst covering amongst others Germany's Neuer Markt tech bubble at the turn of the century, I have never encountered an episode with so broad a range of different misbehaviours and incompetences, or one that lasted undetected quite as long. That said, Wirecard can still serve as an instructive case for the stock market outsider, appalled at such depths and curious to learn how they passed so long unexposed.

It is perhaps worth beginning with something that illustrates an ever-recurring aspect of accountancy which should never be neglected and provided the key to the final, fatal revelation of the fraud. The imaginary profits announced by the company inevitably fed through to imaginary cash flow. Here the management proved itself sloppy, greedy or unambitious according to the observer's analysis. Obedient to the basic rules of accountancy, Wirecard chose to direct this imaginary cash flow into imaginary cash balances, which the KPMG special audit revealed to be just that. Perhaps management thought that the appeal to financial markets of cash on the balance sheet was worth the risk. Perhaps a shrewder and more crooked group would have absorbed the imaginary cash flow with imaginary software development which could safely have been capitalised on the balance sheet. It is hard to imagine that appropriate invoices could not have been faked and that Wirecard's docile sell-side analysts would not have swallowed the line that the company was investing the money to secure future growth.

By the latter phases of the fraud there are signs that Wirecard's management were becoming arrogantly complacent that there was no mechanism to reveal their misdeeds and simply did not bother to build up an adequate cover story. In one of the propagandist stories to be revealed since the collapse, it emerges that management consultants McKinseys had warned the company of inadequate controls and compliance procedures for its third-party business, citing the risk of reputational damage. In reality such controls and procedures would have been an unnecessary extravagance as this business did not exist, except as the key element in the company's faked accounts.

I shall pass over the questions of auditor negligence and corporate governance, vital though they are and amply in evidence at Wirecard. The episode also vividly illustrates weaknesses in financial market mechanisms, above all sell-side equity research. The Financial Times took great delight in publishing a list of recommendations on Wirecard by sell-side analysts in March 2019. Soon after the newspaper had resumed its articles questioning the company's accounting practices, it had renewed its investigations, albeit just before it ran the story that exposed the fatal truth that practically all the company's published profits came from three obscure international subsidiaries. Of 28 analysts giving a recommendation, 21 were positive, four were neutral and only three were negative.

There are a variety of reasons – not all wholly discreditable – why sell-side analysts are biased in favour of positive recommendation. They deserve separate and detailed discussion. The Wirecard affair involved an extra dimension. Frequently analysts suspect that a company might be overstating its profitability. Without detailed access to the company's internal accounts it is practically impossible to confirm such suspicions or otherwise. The company's management can simply brandish the auditor's approval of the accounts and insist that all is well. They are operating on internal lines and the external analyst can do little.

Wirecard presented the relatively unusual case of a company whose accounting was subject to the published suspicions of a highly reputable news outlet. This is a quite different kettle of fish to targeted, once-off research pieces, written at the behest of short sellers. In practice the FT had taken over from the sell-side analysts in predicting the share price. Either the FT was correct – especially on the question of how much profits depended on the three subsidiaries – and the business was worth far, far less than the market value or even worthless, so the only possible recommendation was "sell", or the FT was wrong. Two of the analysts with sell recommendations did not have aggressively negative price targets; only one had a price target of zero, implying that the company's business was non-existent.

The trap into which most analysts fell was not just to discount the FT's story and believe that Wirecard's accounts were reliable, which would have been defensible, but to believe in the company's forecasts for profits. If you trusted their view of the past, you trusted their view of the future and the marvellous growth projections that underpinned the valuation of the share. Having swallowed this camel, there was no point in straining at the gnat of the gaps in the company's story: the absence of a coherent explanation of the business model and the barrage of buzzwords such as "artificial intelligence" which somehow never came to be expanded into concrete examples of how this was helping the business. It was a binary choice between team Wirecard and team FT.

Analysts – and perhaps investors – may have also fallen prey to the thrill of the dirty. It was widely known that Wirecard had set out processing payments for pornography and gambling sites of dubious legitimacy. This is not necessarily a disadvantage in equity market terms. Such business is often high margin. More sinister, if a company is involved in doubtful business it is all too easy for its managers to fend off probing questions by the insinuation that the questioner is straying towards some especially unspeakable area, which it would be better not to discuss. The naïve analyst can thus be shooed away by the implication that the golden-egg-laying goose might somehow be put off her work by undue exposure.

This technique is of a part with one that I have personally observed a number of German companies attempting. Once a rapport is established with the analyst, the representative of the company shares – as an act of friendship of course – a piece of insider information. Curiously, these are invariably bullish, typically a major contract that is to be announced. The compliant analyst will pass these on informally to investors to support a buy argument; sentences in a visit note such as "…the order pipeline is understood to be healthy" send a coded invitation to solicit such "disclosures". If the contract announcement or whatever involved fails to materialize, the analyst has little comeback. The company representative can anyway plead a last-minute hitch in releasing the news.

The hierarchy of lifetime financial needs

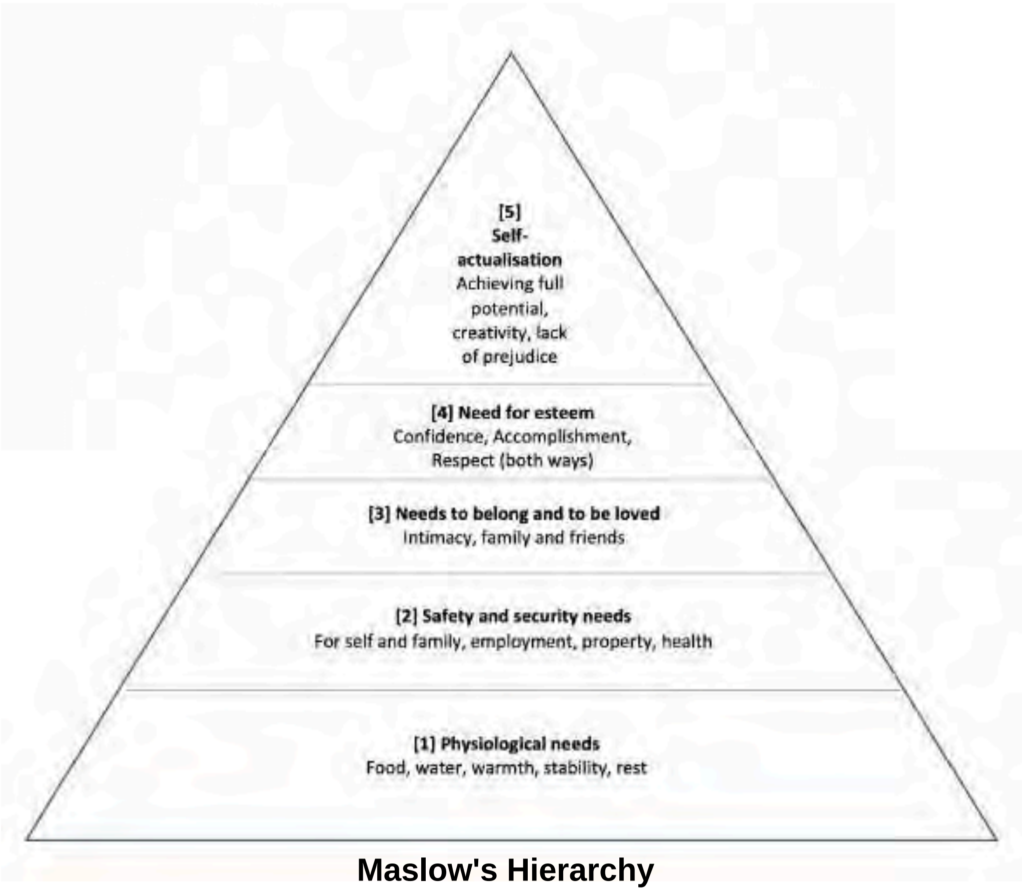
Peter Wilson reports on a thought-provoking discussion seminar led by Alan Cane

On 7 August Alan Cane, an UKSA South-West member, led a brilliant Zoom discussion meeting in which a pre-agreed 18 members participated. This was part of a series of Sharetalk Zoom meetings organised primarily for South-West and Midland members.

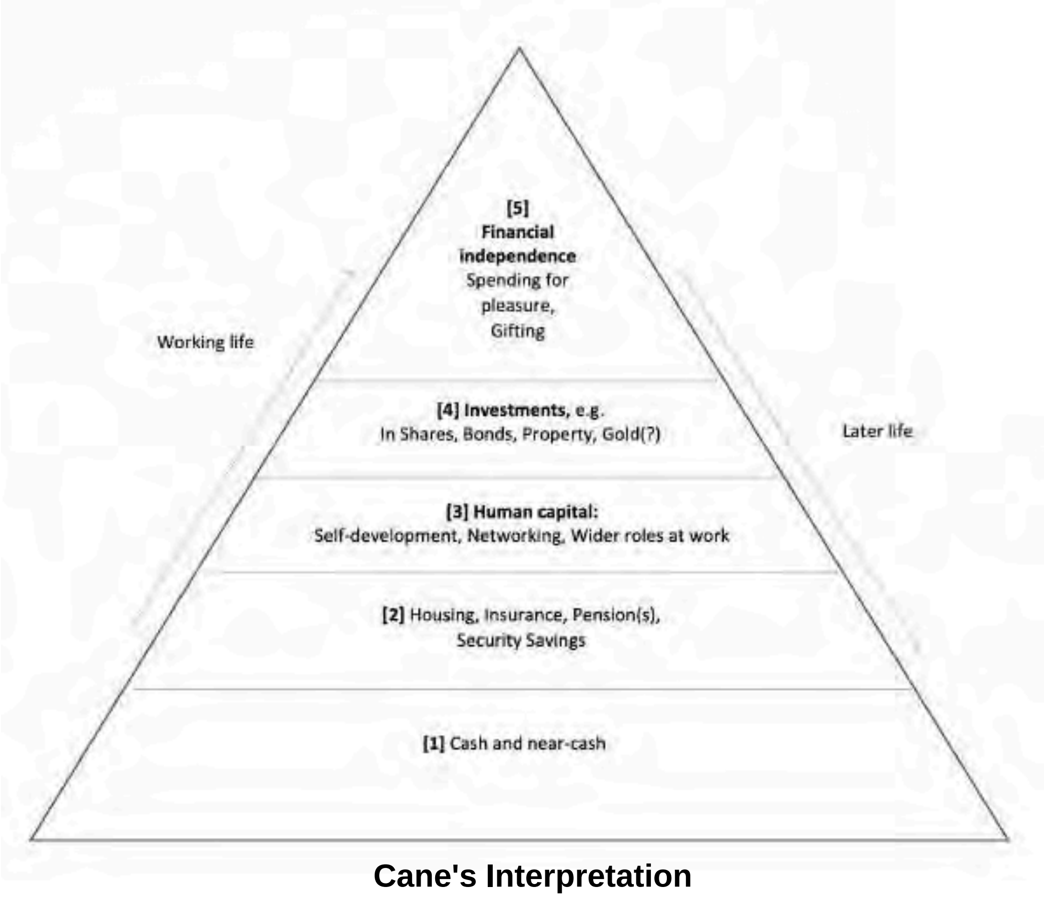
Prior to the meeting Alan had asked members about their investment strategies, particularly their approaches to diversification. He found a considerable alignment in the number of holdings (different shares or collective investments) in members' portfolios compared with those held by Fund Managers. Alan used slides to highlight his findings and then explored members' intentions over the coming years, beyond middle age for many of us. Most planned fewer holdings to reduce workload, with some shift towards collectives. The latter were particularly favoured for investment outside the UK, though we noted that some UK shares offer international reach.

Spreading investment risk, Alan found, was central to most members surveyed, though a small minority were comfortable with more concentrated holdings. The question raised was 'is it necessary to maintain a large number of holdings in order to provide sufficient diversification?' Alan's findings suggest not. He presented evidence to show that the shares of major players within a sector tend to move in unison in the medium term, and that in today's global markets even different geographies tend to behave similarly. Of course, there are short-term deviations. The key is to spread holdings across a variety of sectors. Rebalancing in present turbulent markets may be problematic.

Alan's analysis of his and his wife's joint investment policy fascinated members and led to the highlight of this seminar – the Hierarchy of Lifetime Financial Needs ©.



Maslow's Hierarchy



Cane's Interpretation

Alan explained that he had become convinced that the lessons from Maslow's Hierarchy of (Psychological) Needs have strong parallels in his own and all of our financial lives.

Following Maslow, Alan suggested five stages*:

Stage One: early in working life the focus has to be on cash to pay off possible post-educational debts and acquire the essentials such as basic household equipment, making friends and maybe searching for a partner in life. The discipline of living within one's means is emphasised. At this stage we use income to meet physiological needs.

Stage Two: investing in housing and career development which will lead to debt but also enforce savings through pension contributions. Life and property insurance buy safety nets against potential disasters. Now if not before we should establish 'security savings'. In other words we invest for life using income to secure the safety and security needs of ourselves and family.

Stage Three: We build on the base we've now established to develop family life and interests, carrying on learning, belonging to the 'family of work', making contacts, growing into a variety of roles. It's probably the most important stage in 'climbing the ladder'. The emphasis is self-development to secure 'belonging and love'.

Stage Four: With the house mortgage paid off, any children reaching the later stages of their education or becoming established in life, a greater proportion of income should be available for serious investment. In this stage, we target longer-term financial independence but the time-scale is tightening. Accumulated experience gives us more confidence in the assessment of risks, and our attitudes to risk determine much of our financial activity. Thus having achieved the earlier levels we should now enjoy not only self-esteem but also the esteem of those around us.

Stage Five: Financial security assured, there is freedom to indulge. It may be in luxury acquisitions – works of art, a superior make of car, a share in a race horse, a house with a view. It can also be searching for pleasurable experiences – travel, enjoying live opera, restoring a steam locomotive. These may have little or no residual value on death but they part of achieving self-actualisation.

We all differ as people and some may unfortunately never be able to ascend through all the levels described. Also, we'll have preferences as to exactly how the levels are achieved. But as Alan emphasised, whatever is achieved will be achieved through an asset class that is often not perceived as such: ourselves, our own chunk of 'human capital'.

As Alan bluntly pointed out, as we negotiate the later years of life, we tend to progress back down the pyramid (while retaining some pleasures of self-actualisation of course!). Pensions are spent, assets may be disbursed and we may be fortunate enough to need to concern ourselves with minimising inheritance tax. Thus at the end cash is once again king. Our executors have bills to pay.

** Others have related parts of Maslow's hierarchy to financial needs. The diagram created by Alan is copyright.*

Notes

In discussion after Alan's presentation, members were most supportive, and agreed that the Cane interpretation of the Maslow model is indeed useful in personal finance. Any further feedback through UKSA would be welcomed.

Members are asked to respect the confidentiality of the data from which conclusions have been drawn.

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