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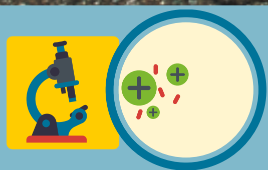
Where to invest over the next year

October 2020

Bracing your portfolio for falls



Investing after the crisis ends

The end of the road for capitalism?

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Note from the editors

Hi there!

Welcome to the first edition of 'Where to invest over the next year' from stepstoinvesting.com – an independent learning platform helping everyday people understand investing, free of complexity and jargon.

The purpose of this guide is to give you lots of tips to help you invest smarter, from selecting funds and preparing for investing, through to actionable ideas on where to invest in the short and longer term. We even hope to stimulate some conversation with a piece that looks at the dire straits capitalism is in today, and how a new, emerging model might be its saviour.

2020 has certainly been a strange year, and anyone listening to the news would have thought stock markets were all doom and gloom, but it's actually been a great time to be investing – who doesn't love a sale! We believe that if you understand investing properly and apply some simple concepts – it needn't be stressful or risky.

If you want to learn more about investing, there's plenty of buttons throughout the guide that lead you to our free, quick 7-day course, which takes you through all the basics to get started. Within our website you can also sign-up to our regular podcast for the latest tips and ideas, take a look through our YouTube channel for interesting interviews with a whole host of guests, plus we'll be updating the site all the time with new stuff to keep you coming back.

Happy reading!

Get Investing,

Simon and Marcus, Co-Founders

Before Investing
Take these four steps

By **Marcus de Silva,** Co-Founder
at **stepstoinvesting.com**

Getting your house in order

Investing involves taking risks, and can be a hair-raising experience when markets become spooked and tumble downwards. If you're to avoid any sleepless nights worrying about your investments, it's worth preparing your finances and building in some contingencies.
The Coronavirus pandemic serves as salient reminder of the sinkholes that can unexpectedly open-up and engulf our finances. By building-in buffers and obtaining the correct insurance and paperwork, you will give yourself greater financial peace of mind and reduce the possibility of having to sell your investments at inopportune moments to fund and bridge the occasional crisis.

Here's four steps to take before taking the plunge:

1 Clear any expensive debts

First and foremost, clear any expensive debts. Credit cards or other forms of fast credit will charge far more interest in a year than you could possibly hope to achieve in investment returns. Zero those first! And for the same reason, never use credit to fund investments.

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2 Create a rainy-day fund

Next, the all-important rainy-day fund. Unforeseen events WILL occur, such as a broken boiler or a roof damaged by a storm, or indeed, the next pandemic. This is where savings accounts come into their own as they will hand back a small bit of interest while offering easy access to your cash, and with very little risk (well, up to £85k – the limit of government protection). As a rule of thumb, you need between 3 – 6 months' salary, dependent on the responsibilities you're on the hook for.

Top tip before investing

If you're going for monthly investing – which we think is a great way to trickle your hard-earned pennies and pounds into the stock market – make sure you've budgeted correctly to avoid dipping into your rainy-day fund too often. Look at your spending over longer periods to ensure you've got enough slack for some of the bigger yearly outgoings, like holidays and Christmas – we know how expensive they can be!

3 Sort out insurance

One area a financial adviser will always look at is life cover, as serious illness or death could lead to a nightmarish squeeze on you or your family's finances. Life covers pay out a lump sum and are a good way to protect entire families; decreasing life insurance will also pay out a lump sum and is designed to offer protection for a repayment mortgage, falling in-line with repayments; and covers for critical illness / income protection pay out a monthly income when you get very sick or injured. There are plenty of comparison websites to help you find the best deal, but broadly, cover becomes more expensive the older and sicker you are. Make sure you check the details though – your family wouldn't want any nasty surprises!

4 Write a will

Our final bit of recommended housekeeping - making a will - is vital as this stipulates exactly what happens to your estate when you die. Failing to write one could lead to it being shared in a way you wouldn't have wanted or chosen, and could lead to higher costs in terms of inheritance tax.

The Money Advice Service offer some guidance in creating a will.

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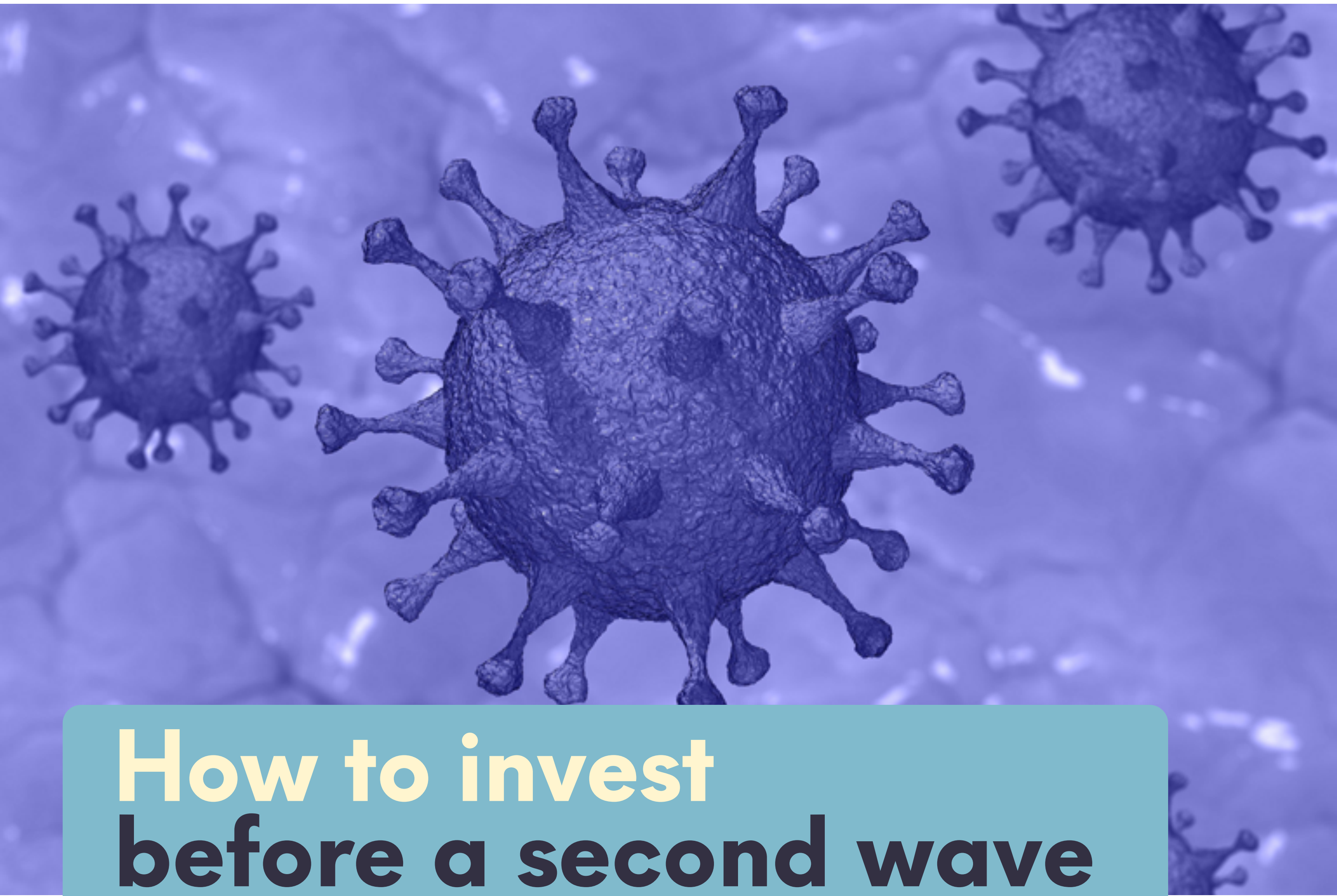
Want to find out more?

Simon answers some commonly asked questions from our investors. Find them all at stepstoinvesting.com

Video: How can I invest and retire early?

Video: Can you get rich with investing?

Video: Can I invest without a financial advisor?



How to invest before a second wave

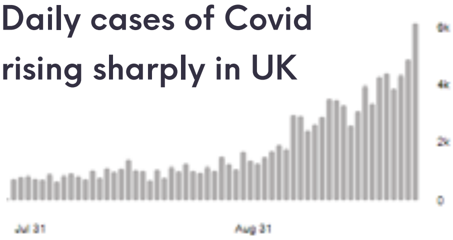
By **Marcus de Silva,** Co-Founder at **stepstoinvesting.com**

Optimism should be reserved for living and loving life; investing involves being frank about the risks involved. Markets are forward looking, and much of their present-day exuberance revolves around the belief that everything will be ok: levels of Covid infections are manageable, we've gotten to grips with how to treat its symptoms, a 'magic-bullet' vaccine is just around the corner, stimulus has carried our hobbled businesses through the worst, and a powerful economic recovery will soon take hold.

It goes some way to explain why markets have climbed so strongly from their darkest days, seeing the US's breaking through previous all-time highs. If investors were partial to rose-tinted glasses, there must have been a sale at Specsavers.

Let us now be frank. While the prime minister likens a second nationwide shutdown to the option of using a 'nuclear deterrent', tighter restrictions than the ones already announced by the PM in September aren't a ridiculous notion – it's hard to ignore the latest data on new infection rates.

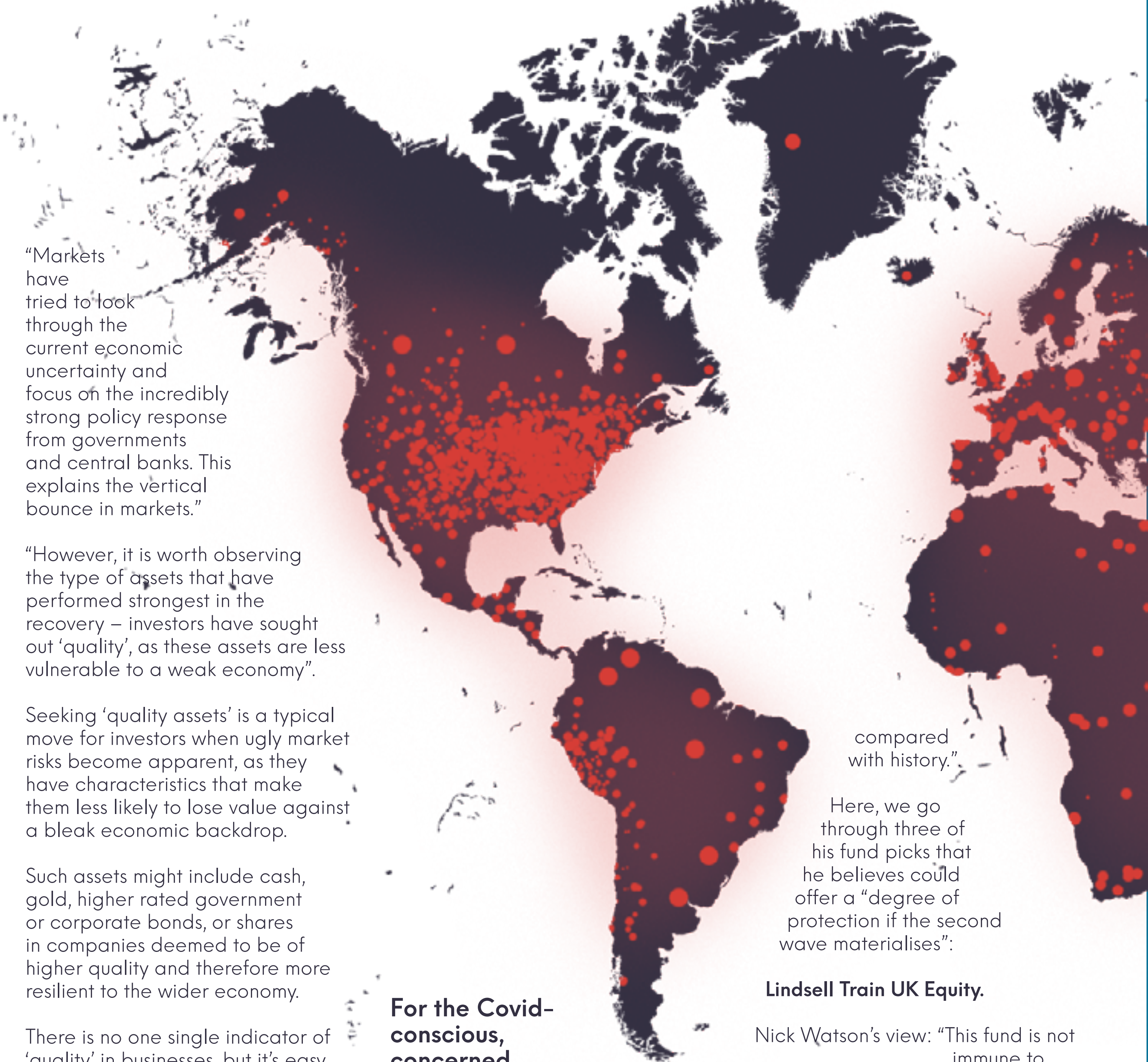
Daily cases of Covid rising sharply in UK



And then there are other risks to the zen of markets: an undoubtedly tumultuous and divisive upcoming US presidential election, ongoing US-Sino tensions, and reignited Brexit tensions and negotiations.

When the tough gets going

To the more cautious investor, these risks cannot be ignored. Nick Watson is a fund selector on the UK based multi-asset team at Janus Henderson Investors, a global investment firm managing around £273bn in assets.



"Markets have tried to look through the current economic uncertainty and focus on the incredibly strong policy response from governments and central banks. This explains the vertical bounce in markets."

"However, it is worth observing the type of assets that have performed strongest in the recovery – investors have sought out 'quality', as these assets are less vulnerable to a weak economy".

Seeking 'quality assets' is a typical move for investors when ugly market risks become apparent, as they have characteristics that make them less likely to lose value against a bleak economic backdrop.

Such assets might include cash, gold, higher rated government or corporate bonds, or shares in companies deemed to be of higher quality and therefore more resilient to the wider economy.

There is no one single indicator of 'quality' in businesses, but it's easy to imagine those that have brilliant management, conservatively run finances, low levels of debt, strong recurring revenues, and so forth: attributes that make failure less likely in the event of a protracted economic downturn when compared to more 'gung-ho' businesses with poor management and debt loaded up to the figurative eye-balls.

Nick continues: "For the more cautious investor, a continued preference for quality and defensiveness is sensible".

For the Covid-conscious, concerned investor

Ordinarily, if you are one to worry about market melt-downs, government bonds (known as 'Gilts' in the UK) have tended to be a good 'safe haven' investment, but as Nick points out: "With interest rates close to zero percent in most developed economies and bond yields close to all-time lows, the scope for government bonds to cushion portfolios in future market sell-offs is diminished when compared with history."

Here, we go through three of his fund picks that he believes could offer a "degree of protection if the second wave materialises":

Lindsell Train UK Equity.

Nick Watson's view: "This fund is not immune to market falls. However, the focused approach on quality companies with strong brands, excellent management and clear recurring revenue has been successfully stress tested."

Lindsell Train UK Equity

Sector: UK All Companies
5yrs total return 64%
Manager Nick Train
Tenure 2006
OCF 0.65%
Size (m) £6,238
Holdings 26
Main Geography UK (76%)
Main Sector Investment Banking & Brokerage
Type OEIC
Based on... ACC

Steps' view: Nick Train is one of the UK's best-known fund managers – but that doesn't necessarily offer you a sure performer when you consider the spectacular downfall of Neil Woodford, the best known UK fund manager. One important consideration here: concentration of holdings. Because he is what we call a 'high conviction' manager, he invests in a fairly short list of companies that he really believes in. This means hang-on – it could be a bumpy ride.

Allianz Strategic Bond

Nick Watson's view: "Although not the oldest bond strategy, the fund performed as a bond investment should when it had to. This is not always the case with flexible bond strategies. While protecting in one market downturn does not set a path for the future, the fund manager is clear on the approach for the fund to behave as a bond should, while offering the dynamism to navigate choppy markets."

Allianz Strat Bond

Sector:	GDP Strategic Bond
Benchmark	Bloomberg Barclays Global Aggregate GDP Hedged Return
5yrs total return	55%
Manager	Kacper Brzezniak/ Mike Riddell
Tenure	2015/2015
OCF	0.65%
Size (m)	£1,845
Holdings	364
Main Geography	US (30%)
Main Sector	Bonds
Type	OEIC
Based on...	INC

Steps' view: Dynamic or flexible bond strategies invest across the whole range of government and company bonds, and as these are lower risk than shares, it is an attractive asset when markets behave badly. A note of caution might be that cash from quantative easing (QE) programs has been piling into bonds, which means bond prices have risen considerably and are therefore more susceptible to falls if economic conditions improve. That said, the income you receive from bonds is far more reliable than income (dividends) from shares – which have seen cancellations across the globe to the tune of $108bn in the second quarter of 2020 alone, according to a study by Janus Henderson.

BH Macro Ltd

Nick Watson's view: "This investment trust gives exposure to the risk management and bond trading skill of one of the world's most successful hedge funds. It is an investment trust structure, and provides returns to investors when volatility (large price swings) spikes in the market. Given that increased volatility across all asset classes is generally associated with market falls, holding BH Macro has previously proved to be a useful holding for cautious investors."

BH Macro Ltd

Sector:	Hedge Funds
Benchmark	FTSE World Total Return GDP
5yrs total return	75%
Manager	Brevan Howard team
Tenure	2007
OCF	5.84%
Size (m)	£533
Main Geography	North America
Main Sector	Bonds
Type	Investment Trust
Only if investment trust Premium / discount	10.31
Based on...	ACC

Steps' view: NOT for the faint hearted, and a pick we would consider to be for the more adventurous investor. Hedge funds are all about leftfield, niche investment strategies – and tend to either win big, or tank terribly. But they can be fun and interesting to invest in.
The big feature to note here is performance fees, which is why the OCF figure looks so punchy. Underlying, you will pay an annual management fee of 0.5% no matter, but when the fund performs well, and rises past previous fund performance highs, it will take 20% of the gains in p-fees – ouch! Also, important to note – it's an investment trust, which we think is a great structure for specialised investment strategies such as these, but comes with added complexity.

And it's a feeder fund, which means its purpose is simply to channel investments into the Cayman Island domiciled hedge fund. This isn't dodgy and shouldn't affect performance, but for the private investor it's about as transparent as mud, which is probably why data on the fund seemed to differ enormously depending on where we were looking.

Top tip for the cautious investor

Nervous investors might be tempted to sell their funds and move into cash - but if markets shrug off worries about Covid and continue to perform well, it could be very costly on your returns. We've said it before, but now more than ever: diversifying your portfolio across assets, geographies and sectors, could be a smart move in limiting losses. With so many factors pulling markets in every which way, diversification avoids second-guessing where best to invest, especially if you drip, drip, drip your money into your investments.

Want to find out more?

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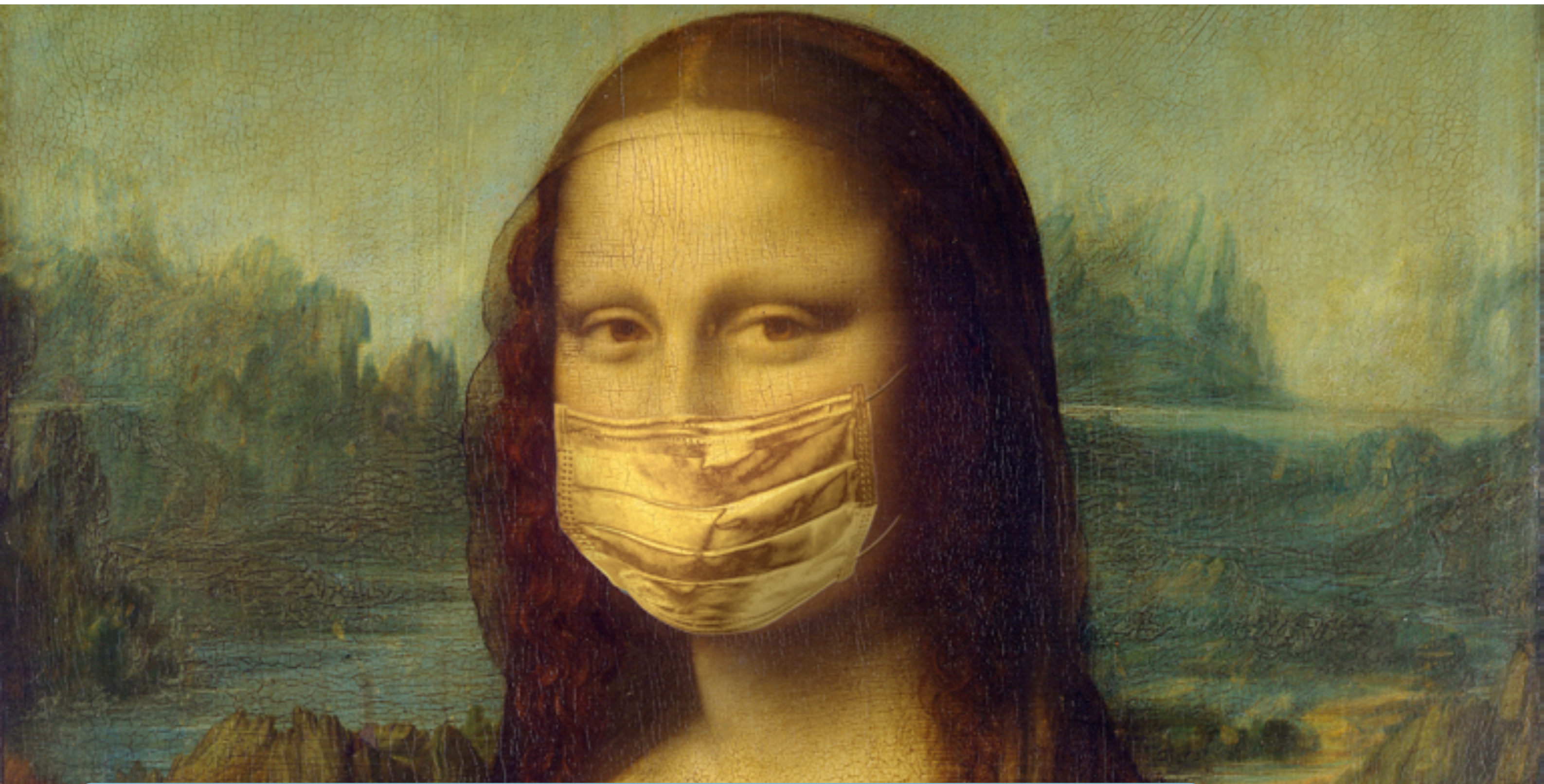

When Covid is consigned to history: three investment themes

By **Marcus de Silva,** Co-Founder at **stepstoinvesting.com**

***Marcus de Silva** looks to markets beyond the pandemic, and asks **Adrian Lowcock** what investment opportunities might surface and how private investors can go about accessing them.*

My interview with Adrian Lowcock, head of personal investing at Willis Owen, a broker, begins with the bizarre reality in which we've all become accustomed: remotely, with a stuttering phone-line and apologies for tech issues beyond our control, and of course, wandering children to thoroughly test the concentration of a speaker deep in the nuances of stock markets.

I'm speaking to him about a world beyond stifling facemasks or restaurants as silent as the lamb you're about to tuck into; where a pin-prick from a vaccine will have given us the confidence to get out and start spending again; when the wider economy will have picked-up with gusto.

Adrian Lowcock

People tend to have financial goals that stretch long into the future, be it saving to put the kids through university or retiring with a half-decent pot to play with. Time gives us benefits in investing: it offers us the opportunity to think about some of the bigger, powerful trends impacting the global economy and markets much more broadly. Trends such as these inevitably throw-up a wealth of longer-term investment opportunities – known as investment 'themes' - that can be accessed through fund managers and funds that might play on these themes.

Pressure on prices to rise

I start with what Adrian thinks the biggest influence on markets has been from the crisis:

"There are the events through the crisis: there's the lock-down itself, but then what is likely to have a bigger impact is the response to it. We've seen huge amounts of quantitative easing (QE): it's colossal – it just dwarves the [global] financial crisis (GFC)."

"This time around, it's almost four times what it was during the GFC."

QE – the printing of money by central banks – is being used to increase the slosh of money in the system and to buy government and some company debt to drive down interest rates. This encourages lending and investment, which in turn should boost the economy through its lowest ebb.

"This time around, it's almost four times what it was during the GFC."

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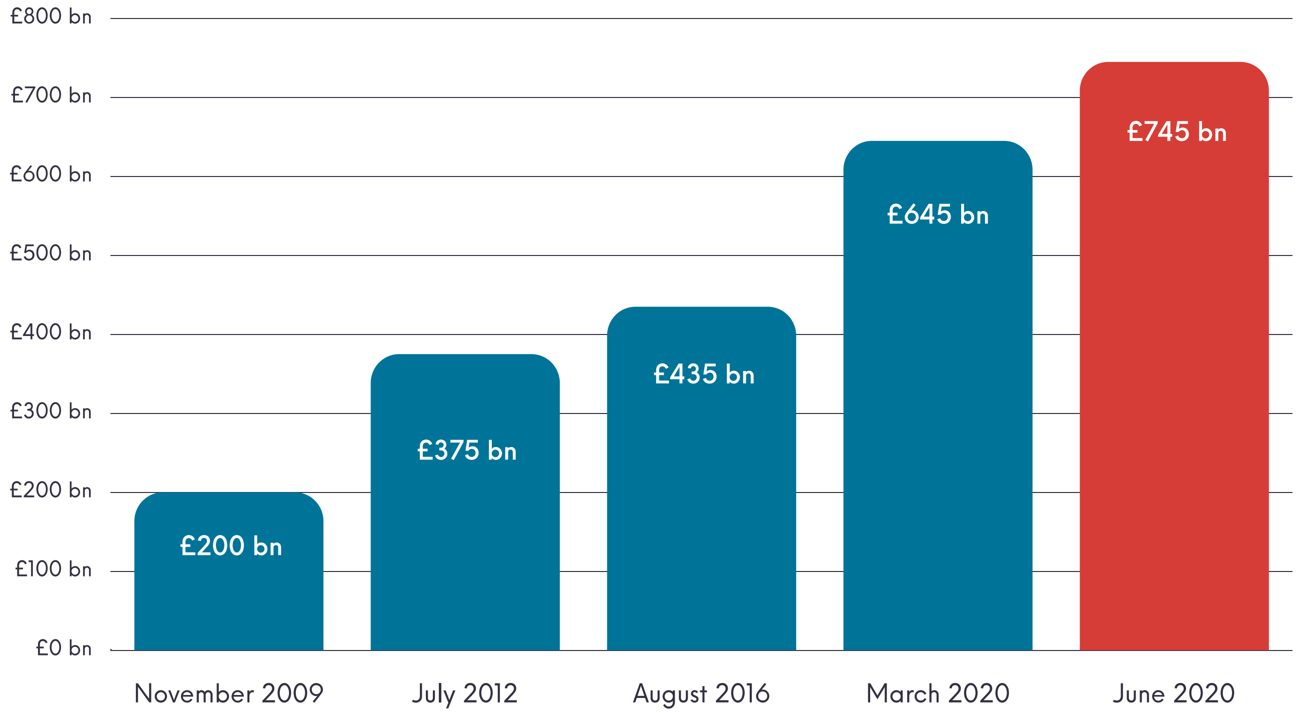
Quantative Easing balloons under Covid

Bank of England, September 2020



During the financial crisis its purpose was slightly different: to prevent the banking system from collapsing. It didn't end up in the real economy, it ended up re-filling empty bank coffers.

Lowcock continues: "Combined with the fact the banking system is working very well – there's no liquidity issues (a lack of readily available cash) like there was during the financial crisis – all this points to some form of inflation" (general price increases and fall in the purchasing value of money), adding it will likely take "18 months to 3 years to materialise, if it does".

Mark Twain once said "History doesn't repeat itself, but it often rhymes." There are indeed parallels to be drawn from history. The sharp economic hit followed by a sharp recovery reflects, to some extent, post-war economies, which have tended to be highly inflationary - although unlike returning soldiers, you won't see us all rushing back to the shops at once.

Adrian has two ideas for accessing the inflation theme:

1. "**The M&G Global Macro Bond Fund** is run by Jim Leaviss – an experienced investor who considers the economic themes and trends and then invests accordingly. The fund can invest anywhere in the bond universe, which means the manager can react to changes in expectations regarding inflation."

2. "Gold has a historical link to inflation, and it still seems to be there. **The BlackRock Gold and General Fund** invests in miners, is a large fund, but leveraged to the price of gold (small changes in the price of gold will have a dramatic impact on the performance of the fund), so will be quite volatile. Gold has also rallied strongly since March."

M&G Global Macro Bond Fund

Sector: Global Bonds
Benchmark IA Global
5yrs Total Return 46%
Manager Jim Leaviss/ Claudia Calich
Tenure 1999/1999
OCF 0.78%
Size (m) £1,924
Holdings 210
Main Geography US (48%)
Main Sector Bonds
Type OEIC
Based on... ACC

The BlackRock Gold and General Fund

Sector: Specialist
5yrs Total Return 200%
Manager Tom Holl/Evy Hambro
Tenure 2015/2009
OCF 1.93%
Size (m) £1,875
Holdings 50
Main Geography Canada (52%)
Main Sector Precious Metals & Mining
Type Unit Trust
Based on... ACC

As the world sets its sights inwards

We move onto the reversal of globalisation – the idea that companies are ditching cheap and efficient global supply chains in exchange for goods manufactured much closer to home.

Adrian thinks this is a "salient" theme: "Regional supply chains will likely become much more mainstream".

"We've arguably been seeing de-globalisation already. Japan used to manufacture everything in-house - now they get stuff made in other countries and ship it to other countries. So, they might make something in the US and ship to the US."

A few events have hobbled globalisation in recent years. First there was the global financial crisis, when trade and investment dipped after China rattled the cage by politicising rare earths – important components of electronics – and cutting off supply to Japan. Next was Trump's trade war, which began in 2016 and was designed to bring back jobs to America's blue-collar workers. The hat trick was Covid, which exposed the fragilities of supply chains amid a global bun-fight for PPE, medicines, and the very workers who plough the fields and take care of the elderly.

But Adrian contends that it will likely occur "much more so in the US where plenty of goods can be manufactured at home. In the UK, and probably true for a lot of Europe - less so, because we don't have the land-mass or the people to do it."

Adrian remarks that this is a difficult theme to play:

"De-globalisation is complex, and even more so on how it will impact markets. Technology will be behind many service companies which should benefit from the trend, but it will also help with the automation and robotics needed to support reshoring of manufacturing.
T Rowe Price Global Technology Equity has new manager Alan Tu, but he is well supported by a strong research team and has built his career analysing technology stocks. He takes a long-term view and is conscious of valuations (determining whether a stock is expensive or cheap)."

T Row Price Global Technology Equity

Sector: Technology & Telecoms	**Tenure** 2019
Benchmark MSCI All Country World Information Technology Net Index	**OCF** 1.02%
3yrs Total Return 82%	**Size (m)** £429
Manager Alan Tu	**Holdings** 51
	Main Geography US (77%)
	Main Sector Software & Computer Services
	Type OEIC
	Based on... ACC

Video: What are bonds?

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Sign-up for our quick 7-day course

Investors to buck a decade long trend

We move onto Adrian's final theme:

A switch in investor interest from investing in growth companies to value companies, which are two important differences in the way investors look at stock market investing.

Growth stocks are companies ahead of the pack - usually doing something pretty unique with their business, in markets that are exciting and growing fast. It means their earnings are growing at a higher rate in comparison to the wider economy or other companies. Technology is a strong sector for growth companies.

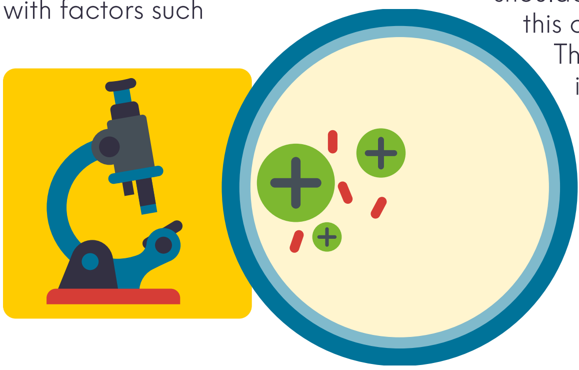
Value stocks are much like the bargain basement: by numerous accounting metrics they appear 'cheap'. These companies tend to be much more linked to the ebbs and flows of the economic cycle, and therefore associated with factors such as rising interest rates. Some good sectors for value stocks are financials or energy.

Since the Global Financial Crisis, with paltry economic growth and interest rates wedged on the bottom rung, investors have opted to invest in growth companies, as they are prepared to pay – sometimes a lot – for earnings growth that cannot be found elsewhere. In addition, since the onset of the pandemic, growth companies have continued to be attractive to investors as they tend to have skills and technologies that offer an element of protection from a bleak economy.

Adrian explains that investors are likely being a bit short-sighted here:

"[The performance of] growth compared to value is head-and-shoulders above, but this could snap back. This is because, if interest rates rise, suddenly banks and other value stocks become much more attractive. It seems, at the moment, the market is focused on winners from the crisis, not winners from the recovery." He adds that the opportunity could lie in these unloved stocks as investors are focusing on "the recession, not whether these companies will be profitable and around following the recession".

"For value I would look to **Man GLG Undervalued Assets.** Henry Dixon manages this very actively managed fund. He looks for companies which he believes the market has either undervalued the business or underestimated its potential", says Lowcock.



Man GLG Undervalued Assets

Sector: UK All Companies
Benchmark FTSE All Share Total Return GDP
5yrs Total Return 3%
Manager Henry Dixon
Tenure 2013
OCF 0.90%
Size (m) £1,002
Holdings 72
Main Geography UK (86%)
Main Sector Household Goods & Home Construction
Type ICVC
Based on... ACC

How to choose a fund

By **Faith Archer,** personal finance journalist & money blogger at Much More With Less

Anyone new to investing faces a bewildering choice of thousands of funds, all served up with a side helping of jargon.

You may even have decided how to divvy up your money, between different parts of the world and types of investment, whether the shares in companies that drive growth ('equities'), steadier loans to companies and governments ('bonds' and 'gilts'), property and commodities. This is known as 'asset allocation'.

However, choosing specific funds can still seem a daunting prospect. Here's how to nail down the right funds for you.

Start with the sector

Funds are handily grouped into 'sectors', which tell you where they invest. This might be based on the investment approach, aiming for income or capital growth, and then geographically (eg global, UK, emerging markets), by asset type (eg equities, bonds, a mix of assets), by size of company (large cap, smaller companies) or by specific industry (eg healthcare, technology, property).

Selecting a combination of funds, rather than sticking with a single sector, can help keep your overall balance on an even keel.

Active vs passive

Within sectors, your choice depends on whether you want an actively-managed fund, which tries to beat a benchmark and charges according, or a passive fund, which typically charges lower fees to mirror or 'track' a benchmark. You'll also see passive funds called index funds or trackers. Fees can dip below 0.1% a year for passive funds, heading up to well over 1% a year for active funds.

If you fancy passive funds

Choosing a straightforward tracker fund is relatively easy, once you have selected the index you'd like to follow, such as the FTSE100 index of Britain's biggest companies or the global reach of the MSCI World Index.

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The main areas to compare are the costs, and the 'tracking error', which shows how far the fund's performance differs from the index it is trying to track. Basically, the lower the tracking error, the better, although there will always be some difference due to the fees charged

If you fancy active funds

The whole point of an active fund is to beat the market, by picking the best investments and avoiding the worst, so the manager generates enough returns to beat both its benchmark and fees charged. Sounds great – but beating the market consistently, year after year, is notoriously hard to do.

What to consider when choosing an active fund

Once you've settled on a sector, here are some key issues to consider:

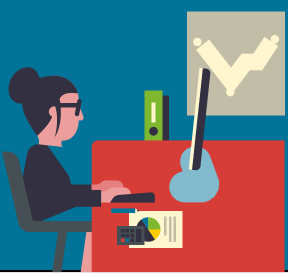
1 Performance

As the caveat always says, 'past performance is no guarantee of future returns'. However, you can at least see which funds have done well previously, and which have been dead as a dodo.

Focus on longer term performance, over five or ideally 10 years, rather than any lucky breaks over the last few months. Look at how the fund has performed compared to its 'benchmark', which is the index it's trying to beat, and compared to other funds in the same sector.

If you want to get down and dirty with the data, check out indicators such as the fund's 'alpha' and 'Sharpe ratio'.

Alpha measures the extra performance, above and beyond the fund's benchmark. Let's face it, if you just want a fund that follows a benchmark, you could pay less for a tracker fund. In contrast, a high alpha number indicates a fund has done better than its benchmark.



Meanwhile the Sharpe ratio compares the returns a fund has generated to the risks it has taken. The higher a fund's Sharpe ratio, the better its returns have been, relative to the investment risk taken.

2 Fund manager

Who manages the fund and how long for? A manager with a long track record has had the chance to survive and thrive during different market conditions. If the manager changed recently, performance in future might change too.

3 Fees

Lower fees will eat up a smaller portion of your returns, so when comparing funds, look out for cheaper options. Compare the 'ongoing charge figure' (OCF). This includes both the annual management charge (AMC), and additional costs for running the fund.

4 Size of fund

A large, established fund from a well-known asset management company can bring the peace of mind that it's not about to disappear.

5 Investment approach

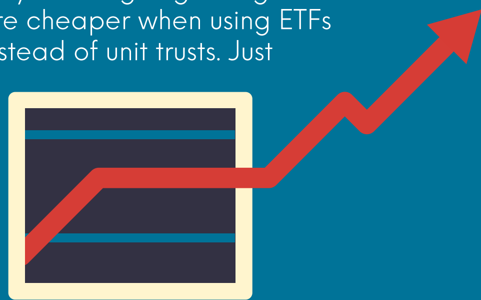
Funds vary in the ways they try to make money – whether focusing on future growth, looking for value in unloved companies, generating income, backing high tech bets or sticking with the safety of well-established big brands.

6 Type of fund

Often, the type of fund used doesn't make a major difference, whether a unit trust, open-ended investment company (OEIC), investment trust or exchange-traded fund (ETF). However, some fund types can be better suited to particular situations.

For example, the structure of investment trusts helps when seeking reliable income or when investing in assets that are harder to sell, such as property and companies that aren't listed on a stock market.

Similarly, fans of passive funds may find ongoing charges are cheaper when using ETFs instead of unit trusts. Just

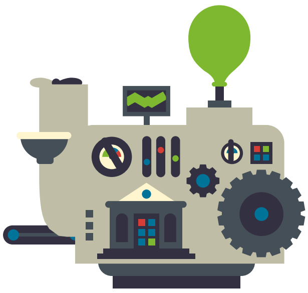


weigh up dealing fees before diving in, which can make buying investment trusts and ETFs more expensive than buying unit trusts and will be more of an issue when investing smaller amounts.

Easy life

Remember, you don't have to choose your own funds if you don't want to.

You could opt for a 'robo adviser'. These online wealth managers suggest portfolios based on your answers to a few questions, and then manage your money for you. Examples include Nutmeg, Wealthify and evestor.



Alternatively, if you don't want to choose a combination of funds for different assets, you could go for a 'multi asset' fund, which bundles shares, bonds and potentially other assets such as properties and commodities into a single investment. Check out the percentage of equities – the higher the percentage, the higher the potential returns, but also the higher chance that your balance will bounce around all over the place. For a less heart-stopping approach, or a shorter time frame, opt for a lower percentage.

Hints and tips when choosing funds

- Look out for terms such as 'cautious', 'balanced' and 'aggressive'. These terms are not scientific, but provide a steer on whether a fund might suit your preferences.
- Use fund facts sheets to see loads of useful info in one place, from investment objectives, fund size, manager and when they started to past performance, biggest investments, dividend yield and fees.
- Bemused by the mysterious abbreviations 'inc' and 'acc' at the end of fund names? These just indicate whether a fund pays out income ('inc'), to invest or spend as you choose, or whether any income is automatically reinvested in the fund ('acc').
- Check out Citywire fund manager ratings for the 25% of managers who generate positive, risk adjusted performance (return relative to the given level of risk taken in a particular investment) over the last three years, averaged over all the funds they run. Statisticians Morningstar also provide star ratings, reflecting a fund's past performance, and analyst ratings, based on its views for the future.
- Review fund shortlists put together by investment platforms for starting points when building a portfolio, such as Interactive Investor's Super 60, Hargreaves Lansdown's Wealth Shortlist and Fidelity's Select 50.
- When adding funds, compare their biggest investments and asset allocation with your existing portfolio, so you don't end up duplicating areas and investments you already hold.

Whatever you choose

However you choose your funds, don't get too hung up on your selection. There is no such thing as the 'perfect' fund choice.

Instead, there will be multiple combinations that suit your goals, time frame and attitude to risk.

Better to start with some sensible choices, benefit from time in the market and learn more, than let analysis paralysis stop you from investing at all!

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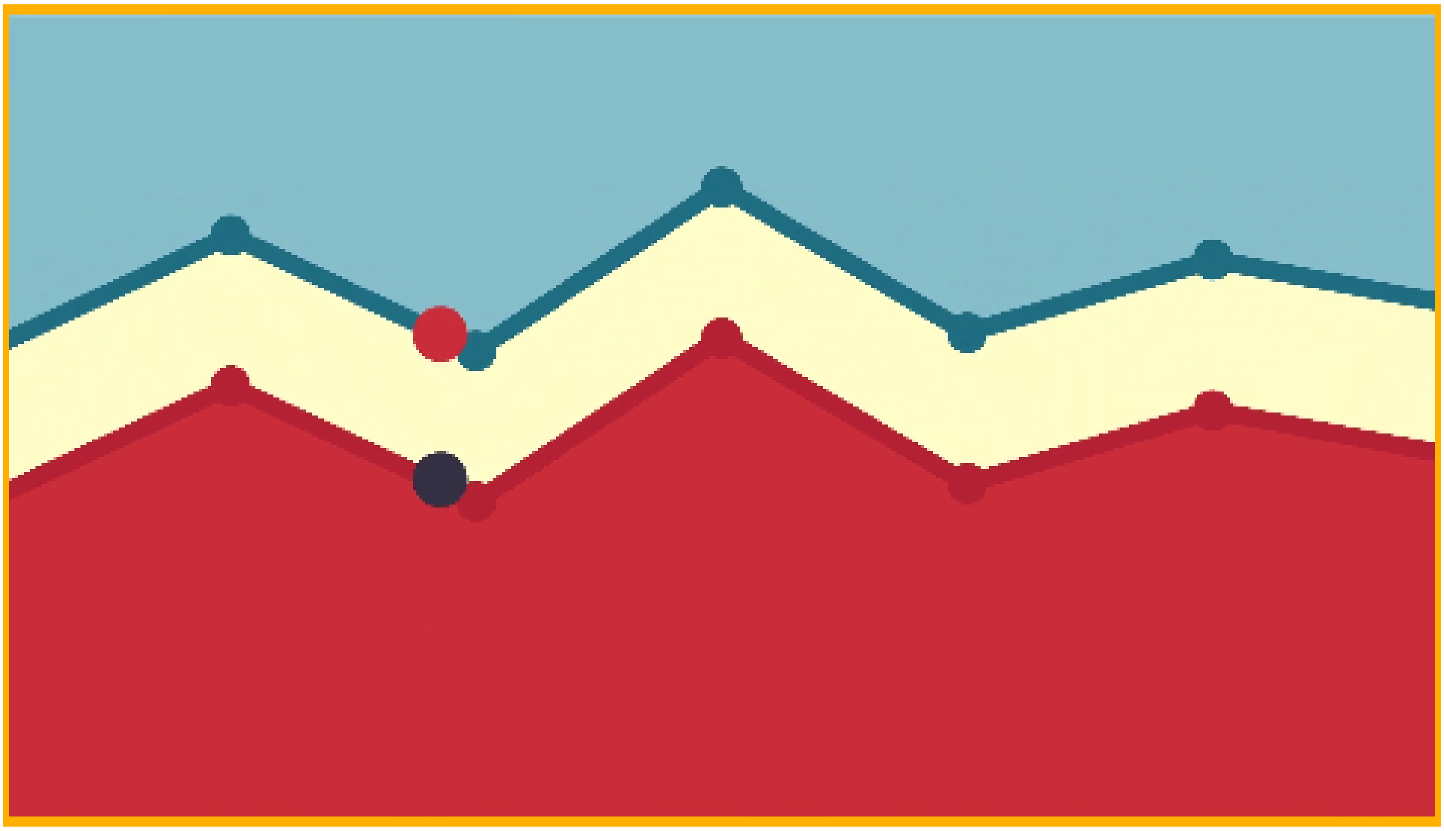
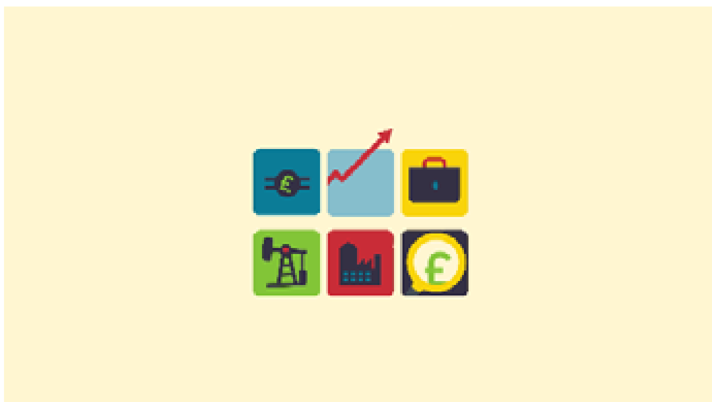
Video: What are funds and investment trusts?



Video: Fees and what they include



Video: What are asset classes?

The future of capitalism

By **Marcus de Silva,** Co-Founder
at **stepstoinvesting.com**

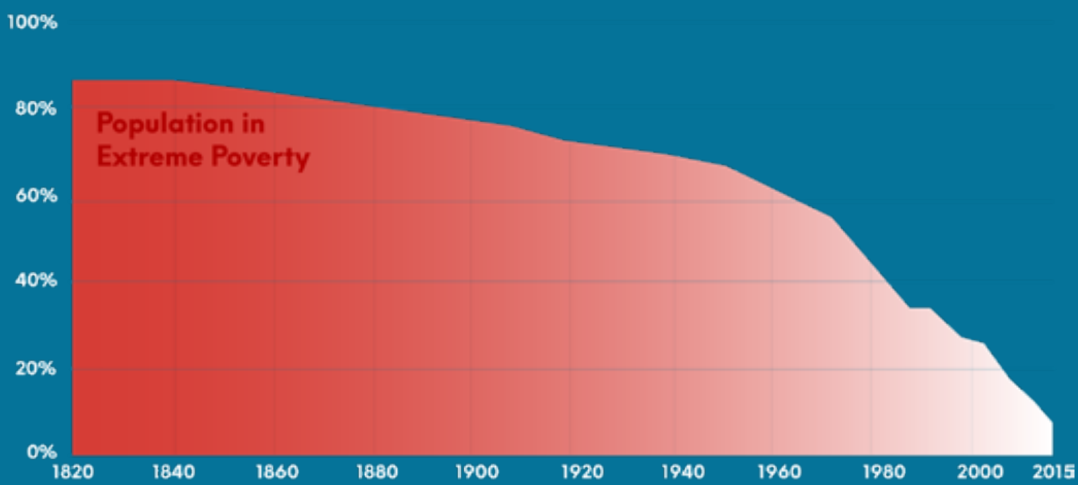
***Marcus de Silva** looks at the birth of a new breed of capitalism, and talks to **Ben Constable Maxwell** about investors' role in its adoption*

As Rutger Bregman, a Dutch historian, notes in his book 'Utopia For Realists': "for roughly 99% of the world's history, 99% of humanity was poor, hungry, dirty, afraid, stupid, sick, and ugly".

What history shows us it that capitalism has proved to be a mighty system for allocating resources – raising productivity, societies and living standards enormously through ingenuity and innovation.

But unfortunately, today, frustrations with the system are rife: investment and wages have slumped, its activity has wreaked havoc on the environment, a sea of debt and a cavernous wealth gap has

In the 17th century, capitalism began to change things. According to Our World in Data – a Bill Gates funded, not for profit organisation – by 1820, roughly 89% of the world lived in extreme poverty; by 1929, it was 66%; and by 2015? A smidge under 10%.



emerged - all in lockstep with an increasingly polarised political discourse that's rankling society. History tells us of similar flashpoints, with dire consequences: rampant inequality from the Great Depression in the 1930s led eventually to rather nasty autocracies and global wars in the 1940s.

Cowed under its failures, capitalism is having a re-think. The theme at this year's World Economic Forum in Davos – a power outing of the world's business and political top-dogs – was 'stakeholder capitalism', with speakers referring to a sea change that was "long overdue". Is this the answer to our woes?

Where did it all go wrong?

In the 1970s an economist from Chicago, Milton Friedman, wrote a paper entitled: "The social responsibility of business is to increase its profits". Boardrooms across the globe latched onto this doctrine with fervour. It put profits and shareholders at the centre of business: governance, incentives, stock options, compensation committees and independent boards were all focused in this unified endeavour. If the 70s picked up this ball, the 80s – in a heady era of 'Reaganomics' - took it and ran with it.

Ben Constable-Maxwell, head of sustainable and impact investing at M&G, a large UK-based asset manager, remarks that contrary to popular opinion, Friedman was actually misunderstood:

"There's a view that Friedman espoused an amoral position – that the social purpose of the business was just to deliver value to shareholders - at the expense of everyone else. This was an over-simplification of what he was saying."

"He thought the focus on shareholder value would end up taking into account other stakeholders – because you need to take those into account as part of a business' activity."

"The problematic thing was that the headline of the essay – published just over 50 years ago on September 13th – was really the only thing that got picked-up by business management...it was a nice headline to hang corporate strategy off."

"It had an enormous impact."

With the pursuit of profit in mind, ethics were swallowed and market share aggressively built - ballooning corporate power, which became concentrated and unchecked. As executives focused on creating value for their shareholders (and let's face it – themselves), a disconnect grew between business, the real economy and society. Regulators were toothless to stop the bad behaviour, and when they did and fined offenders, it was just absorbed as a cost of doing business.

Then, the Global Financial Crisis hit, and the inexorable rise of the Friedman approach was about to come to a juddering halt.

Out of the flashpoint

Ben continues: "The Global Financial Crisis proved to be an absolutely seminal moment. It was a clear indication that elements of capitalism were completely out of control – incentives had been skewed towards short-term casino capitalist mentality."

"It was a massive shock for the real economy, real people and communities – lots of people lost their jobs and homes. It prompted austerity, which hit people on the bottom-rung the hardest. It cut lots of social welfare and public services, which was helping the people that really needed it, through an increasingly difficult period."

Boardrooms needed to restore the trust they had broken. Pressure for change was now building from above and below: from society, from workers, from climate activists, from politicians, from regulators, and from investors - increasingly taking notice of the investment risks associated with bad behaviour.

What transpired was the ignition of a generational shift in strategic corporate thinking, from the short-termism of shareholder centricity towards a longer-term lens that considered all stakeholders in the chain: customers, employees, suppliers, communities, and shareholders. 'Shared value creation' would be the new mantra, combining 'softer' environmental, social, and governance (ESG) goals with more traditional financial metrics.

To evaluate emerging stakeholder interests, increasing numbers of investors started to adopt the ESG framework promoted by the UN-backed Principles of Responsible Investment (PRI), launched in 2006.

Becoming a mainstream idea

The ESG framework helps investors understand the investment implications of environmental (E) factors such as carbon pollution or water usage, social (S) factors such as the treatment of employees or ethics involved in the supply chain, and governance (G) factors such as transparency with shareholders or the independence of the board.

Ben explains: "ESG is a framework for thinking about all the risks and opportunities a business has. But away from the balance sheet – it's not the financials. It's risks around reputation, or societal contribution, or regulatory fines. Is it properly governed? Is it increasing diversity to improve decision-making? Is it reducing its emissions to be more efficient? All of these considerations are contributors to business success".

Being a truly sustainable company, Ben believes, goes far deeper than ESG scores and ticking the right boxes to satisfy investors: "The idea of corporate purpose is really central and powerful: a company must set-out why it exists, what it's here to do."

Ben concedes that purpose can be difficult to measure: "Having a high-level purpose can dissolve very easily into greenwashing (creating a false impression of sustainability), it's about walking the talk: how is the management, strategy, communications, workforce all aligned with the purpose."

"Purpose is much stronger if it encapsulates all of its stakeholders: we want to inspire our employees to work for this company because they're helping to solve a global problem; we want to work with local communities because we need to build a relationship with them to be successful in the long run; we want to support a governance agenda in a sustainability area because that helps us with regulation."

Capital with a powerful voice

With the winds of change behind it, this approach has spawned a worldwide 'sustainable investment' industry with assets under management of around $30.7trn, according to 2018 figures. 90 of the world's top 100 asset managers are now signatories of the PRI, including the largest, BlackRock, with assets under management of $7.43trn.

According a study from last year by the Morgan Stanley Institute for Sustainable Investing, interest in sustainability among private investors keeps on growing, with 85% of them switched on to ESG issues, up 10% from two-years previously.

What is more, it has become the darling of millennial investors, who are particularly engaged in issues such as climate risk, social injustice, poverty, and access to healthcare. The same study found that 95% of millennials were interested sustainable investing, up 9% from 2017.

It has also spawned a much more razor-focused subset: impact investing. Rather than consider how ESG factors affect the business, impact companies are in existence to solve the "real-world problems" of sustainability issues.

Ben describes the difference: "If ESG businesses are outwards-in - and think about how external factors such as climate change, pollution or labour relations affect the firm; 'impact' businesses are inwards-out – and designed to improve or affect a sustainability issue."

In for the long haul

There are some encouraging signs that the stakeholder approach will take hold as the dominant future model of capitalism.

In 2019, the Business Roundtable – an influential lobby group of top US CEOs – changed a decades old declaration that "corporations exist principally to serve their shareholders" to "While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders: customers, employees, suppliers, communities and – (last in the list) - shareholders.

And Covid only seems to be accelerating the trend. According to a recent survey by McKinsey – the world's pre-eminent management consultancy – 9 out of 10 Americans think the pandemic is the opportunity to hit "reset" and consider the views of stakeholders under the "rapidly shifting expectations around the role of business in society".

M&G Positive Impact Fund

Sector: Global
Benchmark MSCI All Country World Index Growth GBP
1yr total return 11%
Manager John Olsen / Thembeka Stemala
Tenure 2018 / 2019
OCF 0.85%
Size (m) £141
Holdings 38
Main Geography US (42%)
Main Sector Healthcare
Type OEIC
Based on... INC

Video: Are millennials investing?

Ben agrees it's here to stay:

"There's no turning back in terms of responsible business practice. Using transparency as a stick to encourage better behaviour - regulation is going to protect against that. Consumer preferences are going to demand it. And investors are almost universally engaged on fulfilling their responsibilities by pushing for better standards on ESG."

"In the sustainable and impact sectors, companies will increasingly recognise there's money to be made and new business models to be embraced in societally beneficial areas such as the circular economy, or regeneration, or sustainable agriculture".

Ultimately: "Businesses are being pushed by investors, and investors are being pushed by their clients and their own regulators to be responsible".

It seems there's hope for capitalism just yet. As Ray Dalio – the world's most successful hedge fund manager – recently commented:

"Productivity and opportunity go hand-in-hand with a good society and a good outcome for the whole – the costs of not having that, are so very great."

***Ben Constable Maxwell** advises on the impact strategy for the M&G Positive Impact Fund*

Want to find out more?

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