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WEALTH MANAGEMENT

SOCIAL MEDIA

Impact of activists on the investment industry

Suddenly investors on social media and tweets from celebrity entrepreneurs are impacting the valuation of company shares. What does this mean for the industry?

Marianne Curphey

The GameStop debacle was a watershed moment for the investment industry. Suddenly the valuation of shares in a listed company was being decided by a co-ordinated group of investors on social media seemingly gaming the system.

Elsewhere, Tesla and SpaceX boss Elon Musk's tweets about why people should invest in cryptocurrency and the gamification of investment is changing the way the industry views profit and loss, with some investors posting evidence of huge losses to forums to gain online notoriety.

> The debacle at Robinhood was really about how private investors were at the mercy of a system few of them really understood

GameStop reached mainstream media and caught the imagination of many people well beyond trading. So-called "activist investors" used Robinhood, the trading app, to co-ordinate a buying frenzy and teach hedge funds a lesson. It was hailed as a turning point where small investors began to reclaim control from institutional investors.

Could it signal the beginning of finance becoming more meritocratic? Many retail investors feel they are disadvantaged in the market and that larger institutions should be held more accountable for their actions.

On the other hand, there are those who believe there will always be a two-tier system that benefits institutional investors and brokers, and retail investors are still denied real influence or sway.

"The activity earlier this year around GameStop, AMC and Nokia was an unprecedented time for the markets and definitely one of the more dramatic examples of the power of retail investors," says Matthew Leibowitz, chief executive of Stake, a platform that allows traders to invest directly in the US market.

He argues that the rise of the retail investor had been happening well before the GameStop situation. For the past few years, retail investors have had greater access to the markets than ever before and are contributing significantly more trade volume to the global stock market, says Leibowitz.

The GameStop episode illustrated the power of a band of retail investors who were out to prove a point, as opposed to focusing solely on turning a profit, says Michael Kamerman, chief executive of online trading venue Skilling.

"When there is a motivation beyond profit, particularly in the arena of a David versus Goliath narrative, investors need to pay attention as incentive gathers momentum," he says. "This new breed of market participants is savvier and aware of the high risks they are taking. The Reddit-fuelled revolt that we continue to witness as retail traders and investors take on Wall Street is substantial. That momentum continues apace as retail traders continue to seek greater access, centralisation and control."

Kamerman argues that the scale of collective action taking place is a showcase for why retail traders deserve a seat at the table. The coronavirus pandemic has triggered a renaissance of retail trading and the trend will continue to be driven by better access to platforms that enable faster execution and provide competitive prices.

With interest in investing and trading set to continue, retail traders will come to make up a significant percentage of the equities market and begin to hold greater influence.

"It has become distinctly clearer that a better dialogue is needed about why larger institutions should secure one deal while retail investors may only get a slice of the pie," he says.

Ben Hobson, markets editor of Stockopedia, says GameStop illustrated that a large group of smaller, individual investors joining together could cause a lot of pain for short sellers, who had to cover their positions.

"In one sense, Robinhood's business model of selling its order flow – the execution of trades that private investors make through the app – to big brokers is a reminder of the saying that 'if you're not paying for the product, you are the product'," he says.

"There is no doubt that fees and commissions are a headache when you are trading frequently. But the debacle at Robinhood was really about how private investors were at the mercy of a system that few of them really understood."

While retail power has been rising steadily over the past decade, the real accelerating factor has been the pandemic. Job losses, furlough, more free time and a need for cash or a willingness to spend furlough money have all been driving this forward. This has skewed normal perceptions of risk and reward, say Mark Gorzykci and Mahesh Kashyap, creators of new stock data analytics tool OVTLYR.

"Under normal circumstances, when assessing risk, people will prioritise preventing loss over a potential gain. When the pandemic and resulting economic shutdown hit, many were put in a position where taking a financial risk feels like a necessity," says Kashyap.

"The coronavirus-induced market gamification was largely catalysed by many people's loss-aversion curves being briefly inverted," adds Gorzykci.

"If you don't have the money to prevent your family from being evicted from your home, the difference between a thousand-dollar loss and a million-dollar loss is negligible. On the flipside, a thousand-dollar profit feels like a million dollars when that's what you need to keep a roof over your head."

Rick Eling, investment director at Quilter, says long-term investors should ignore the frenzied excitement spewing out of social media platforms and online forums.

"It's just noise. Focus instead on your own long-term objectives and on maintaining exposure to a broadly diversified multi-asset portfolio with a clear level of risk," he says. "These GameStop-style market players are not investors in the true sense and are more akin to short-term traders."

Azamat Sultanov, co-chief executive of Fortu Wealth, a London-based fintech, argues that technology is a key influence in democratising access to financial markets.

"Whereas historically an individual investor would need access to a broker, along with any additional requirements that they may have, the rise of digital brokers such as Robinhood, Trading 212 and eToro have reduced the barriers to entry to a smartphone and bank account," he says.

Instead of closing off access, he calls for better education for investors to enable more people to benefit from engaging in the markets, while preventing risky trading.

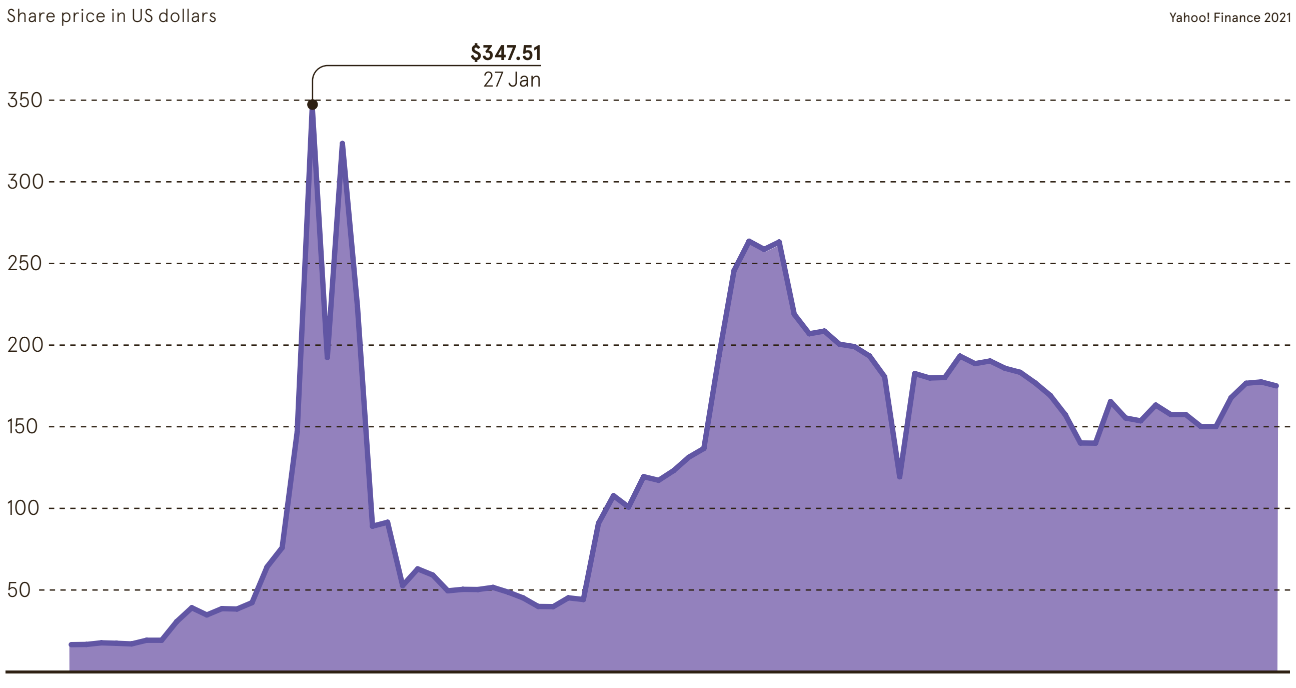
"The combination of instant social media information with these digital brokerships can and has led to swathes of first-time investors jumping on a bandwagon that is propped up by unverified information, with many of these investors overlooking due diligence in the hope of quick gains," says Sultanov.

So will social media and group discussions on company shares have to be more tightly regulated?

"The role of social platforms in building and fostering communities, be they investing or other aspects of life, is undeniable and a positive thing," says Leibowitz at Stake. "I've no doubt they will continue to play a powerful role. How regulators will approach those channels as the rise of the retail investor continues remains to be seen." ●

ACTIVIST INVESTORS CAUSED GAMESTOP'S SHARE PRICE TO SOAR

Share price in US dollars



Yahoo! Finance 2021

THE SHARE PRICE HIGH FOR VARIOUS COMPANIES AFTER ACTIVIST INVESTOR ACTIVITY

$9.7 Nokia

$28.8 Blackberry

$20.4 AMC

Yahoo! Finance 2021

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Commercial feature

Q&A

How digitalisation is driving the democratisation of wealth management

Martin Greweldinger, co-chief executive of Avaloq, discusses how a generational shift in the make-up of new clients is causing wealth managers to accelerate digital transformation and the barriers in their way

Q What role does digitalisation play in the ongoing transformation of the wealth management industry?

A Over the next five years, there will be a huge generational shift in global wealth management. Many large portfolios are being transferred from the baby boomers to the younger generations, whose needs are fundamentally different. Wealth management is generally a service that is exclusively reserved for the wealthy, however for future growth, financial institutions must target other groups as well. Avaloq's mission is to democratise wealth management. Automating processes to increase efficiencies, as well as enhance the digital customer experience, will be fundamental to achieving this aim. Technology can enable wealth management products to be offered in a more scalable manner, which ultimately will benefit less wealthy customers, helping a larger portion of the population to reach their financial goals. Meanwhile, financial institutions are able to tap into new markets. This includes the lucrative Asia-Pacific market, in which there is currently huge potential in the emerging middle class. Increasing automation means we can finally eliminate the perception that wealth mangers are only for the super rich, and all the while wealth managers can better cope with technological and generational changes.

Q How has the wealth management sector's approach to technology evolved in recent years?

A The importance of technology in wealth management is growing rapidly. Sales and client enablement are increasingly operating via digital channels. COVID-19 has been a catalyst for digitalisation in wealth management and it is going to accelerate this development even further. As a result, digital channels with real-time straight-through processing, or STP, are becoming increasingly important for customer engagement and management. A high degree of automation and clean data storage are essential, enabling wealth managers to implement processes in real time and generate actionable insights from them. Also artificial intelligence is being used to advise end-customers, as well as for client relationship management or client engagement. However, there are numerous challenges involved as wealth managers require agile and intelligent platforms to orchestrate all these processes.

Q Can you expand on the specific challenges wealth managers are facing?

A Wealth managers should be able to concentrate on their core business, adding value for their customers. All other processes, such as the back office, should be automated as much as possible to maximise efficiency. Wealth management will become a service that is integrated transparently into many process chains, but the greatest challenge to achieving this is the proper storage, management, verification and consistency of data. There are still too many data silos, which wealth managers will have to abandon, especially in light of ongoing digitalisation. Nothing works without perfectly prepared data. The pandemic has exacerbated the challenge because in many regions employees can't manage clients from home without violating regulation. That means, for example, client-identifying data must be separated from non-client-identifying data. Intelligent automation supports wealth managers not only on the operations side, but also in advisory. It helps enormously if advisers can see all relevant information directly when exchanging information with clients.

> **There are very few providers that can automate the entire process chain end to end**

Q How do younger customers want to interact with their wealth managers?

A When it comes to engagement, it is important for clients to be able to contact their advisers through their preferred digital channels and not through some separate new app. Clients want to communicate via platforms they also use privately in their everyday lives and on which they feel comfortable, such as WhatsApp. COVID has accelerated progress in this area and ultimately it will lead to more homogeneity in the wealth management industry. At the same time, the use of cloud-based services is increasing. There is still a great deal of heterogeneity in the wealth management environment; each wealth manager has a different infrastructure. Avaloq is committed to facilitating collaboration between wealth managers. That means we develop the same code for many wealth managers with the relevant requirements of the individual firms. We do the same thing with the various systems. The move to the cloud allows us to bring about a degree of standardisation of systems that has not been possible before.

Q How is the rise of fintechs altering the wealth management landscape?

A Wealth management is moving towards greater co-operation, especially between wealth managers and fintechs. In the past, many wealth managers took a DIY approach to developing their businesses, however fintechs have shown they can innovate with more agility than legacy incumbents. It is important that co-operation takes place via a standardised, open platform. We see huge growth potential over the next few years in open banking and the resulting ecosystems in wealth management, which means co-operating with one another and agreeing on interfaces. It's about developing truly integrated solutions and moving away from the old concept of best of breed. We are already well positioned in this area with our ecosystem, which we will continue to expand. There will also be some exciting use-cases in crypto and blockchain technology, such as crypto asset life cycles. We are firm believers in digital investments and already offer an integrated crypto assets solution.

Q How is Avaloq helping wealth management companies to digitally transform?

A There are very few providers that can automate the entire process chain from end-customer to adviser, all the way to core settlement. We do that and power digital transformation in the wealth management sector through fully integrated software. We have recently introduced three new platforms to enable companies to meet the fast-changing needs of clients and what they demand of their wealth manager. Avaloq Engage, an artificial intelligence-based omni-channel engagement platform, automates customer support and interaction. By integrating all the wealth management functions, including advice, portfolio, trading, news and sales channels, Engage acts as a smart digital assistant for relationship managers, understanding messages and suggesting products or information to offer the customer. The Avaloq Wealth platform helps wealth managers meet the hyper-personalised expectations of younger customers who want to manage their financials in real time and invest with an individualised risk profile, while Avaloq Insight is a federated learning system for data preparation. It does this through a machine-learning algorithm that processes data across all participating clients. Such innovative solutions are designed to boost digitalisation and to pave the way for the democratisation of wealth management.

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TECHNOLOGY

Bringing investing to the masses

The past 12 months have seen a surge in people investing for the first time with robo-advisers, platforms and digital disruptors all vying for their business. But do they work for the ordinary investor?

Stephanie Hawthorne

Wealth management has traditionally been the preserve of the ultra-rich, but technological innovation is opening up the market. From robo-advisers to trading apps, there are a myriad of solutions promising to democratise investing, but can they provide the same, or better, outcomes than traditional wealth managers?

Dozens of new names have sprung up in this market, many of them minnows compared to the traditional players. Even Nutmeg, which claims to be the largest digital wealth manager, has just 100,000 customers; compare that to the 4 billion logins to Lloyds Bank's digital banking services in 2019.

Digital wealth management platforms in particular have done a lot of work to democratise investing. Where once the market was hugely complicated, usually required advice and needed a large capital sum to start, investors can get going online in only a few minutes and with as little as £25 a month. Combined with the coronavirus pandemic and associated lockdowns, this has led to a spike in activity.

Indeed, some argue it is all too easy to "plug and play". Many stock market novices who began investing last year in lockdown simply googled "trading apps". Such a search brings up dozens of options, including some unregulated firms with products more akin to gambling than investing such as cryptocurrencies using blockchain; it's the Wild West of investing.

The Financial Conduct Authority (FCA) has fears for the new breed of self-directed investors encouraged by the accessibility of investment apps. The FCA says: "Those investing in high-risk, high-return types tend to have a high degree of confidence and claimed knowledge. However, the reality of their behaviours and beliefs around investing indicate that this can be misplaced."

For people who lack the confidence in self-directed investment, robo-advisers such as Wealthify, which is backed by Aviva, suggest a model portfolio based on whether the investor describes him or herself as cautious, tentative, confident, ambitious or adventurous. It will then provide ongoing management. The minimum investment is just £1. But do such products work for the ordinary investor? There is increasing evidence they do.

The financial website Boring Money invested £500 with 15 platforms and robo-advisers in their "medium-risk" portfolios or own-brand multi-asset funds with portfolios that had closest to 60 per cent in equities in the first quarter of 2018. In January 2021, Moneyfarm, Vanguard and Nutmeg were the top performing portfolios net of charges. After fees, the average balance across all robo accounts was £552, an increase of 11 per cent over a three-year period. By comparison, over the same period, the FTSE 100 was down 14 per cent.

"Over the past three years, my £500 investment has made me £86 more with one provider than another. This sort of difference is material and currently largely impossible to see if you are a retail customer shopping around for a ready-made solution."

For investors looking for a more traditional wealth manager, the digital Brewin Portfolio Service allows consumers to access model portfolio solutions from £500.

Others prefer to go it alone: for them the more established players in the self-directed market, such as Hargreaves Lansdown, Interactive Investor and AJ Bell, may provide comfort. At Bristol-based Hargreaves Lansdown, website logins were up 60 per cent and app logins increased more than 150 per cent over the past year, indicative of the lockdown investing mania.

At Interactive Investor, around 80 per cent of trades were made on its app using a desktop computer or laptop last year compared with around 20 per cent using mobile phones.

In the savings market, there has also been something of a revolution in the past couple of years. Moneyhub has developed open-banking technology to enable consumers to receive an overview of their finances on their device. Disruptors like Raisin and Akoni Hub have made it easier to manage cash savings across a range of banks and building societies.

These cash-management platforms enable savers to access an array of savings accounts, swap accounts to get a better interest rate, change the terms of their access, secure full Financial Services Compensation Scheme protection of £85,000 by spreading money across different banks and accounts, without the hassle of form filling and supplying ID every time a change is made.

Once the application process is done, this enables the platform to search for new terms for the saver who simply decides how much access or notice they want to give; the platform does the rest.

> **My £500 investment made £86 more with one provider than another. This is material but impossible for retail customers to see**

Kay Ingram, director of public policy at retirement adviser LEBC, explains: "These tools are relatively new but have the power, once widely adopted, to reduce orphan assets which currently account for £15 billion of savings, according to the Treasury, and £20 billion of pension funds, estimated by the Association of British Insurers."

Personal money management apps like LEBC's Hummingbird use open-banking technology to give the user an overview of their income and spending, investments, savings and borrowing. This includes current and savings accounts, ISAs, pensions and investments, overdrafts, credit cards and mortgages with more than 80 institutions, but have yet to be widely adopted.

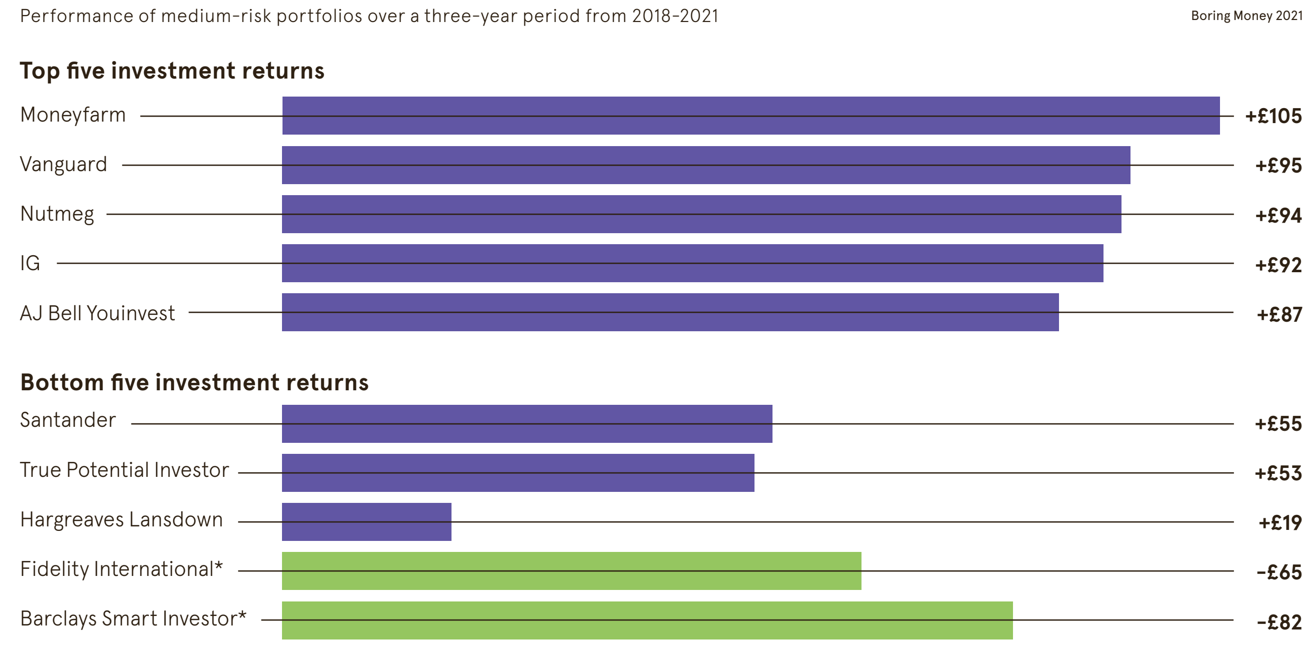
Tech has also made its mark at the large insurers. Royal London claims its acquisition of Wealth Wizards, a digital financial advice platform that can automate key parts of the advice process, should ultimately mean advice is more widely available.

While some investors, especially those with big wallets, still prefer the experience and emotional intelligence of a human adviser, technology is proving it can compete and help widen access to money management whether through investing or saving. But as always, doing the research and picking the right service or tool is critical.

HOW DIFFERENT PLATFORMS AND ROBO ADVISORS PERFORMED AFTER A £500 INVESTMENT

Performance of medium-risk portfolios over a three-year period from 2018-2021

Boring Money 2021



*Fidelity and Barclays include a fixed fee element that impacts net performance on smaller accounts

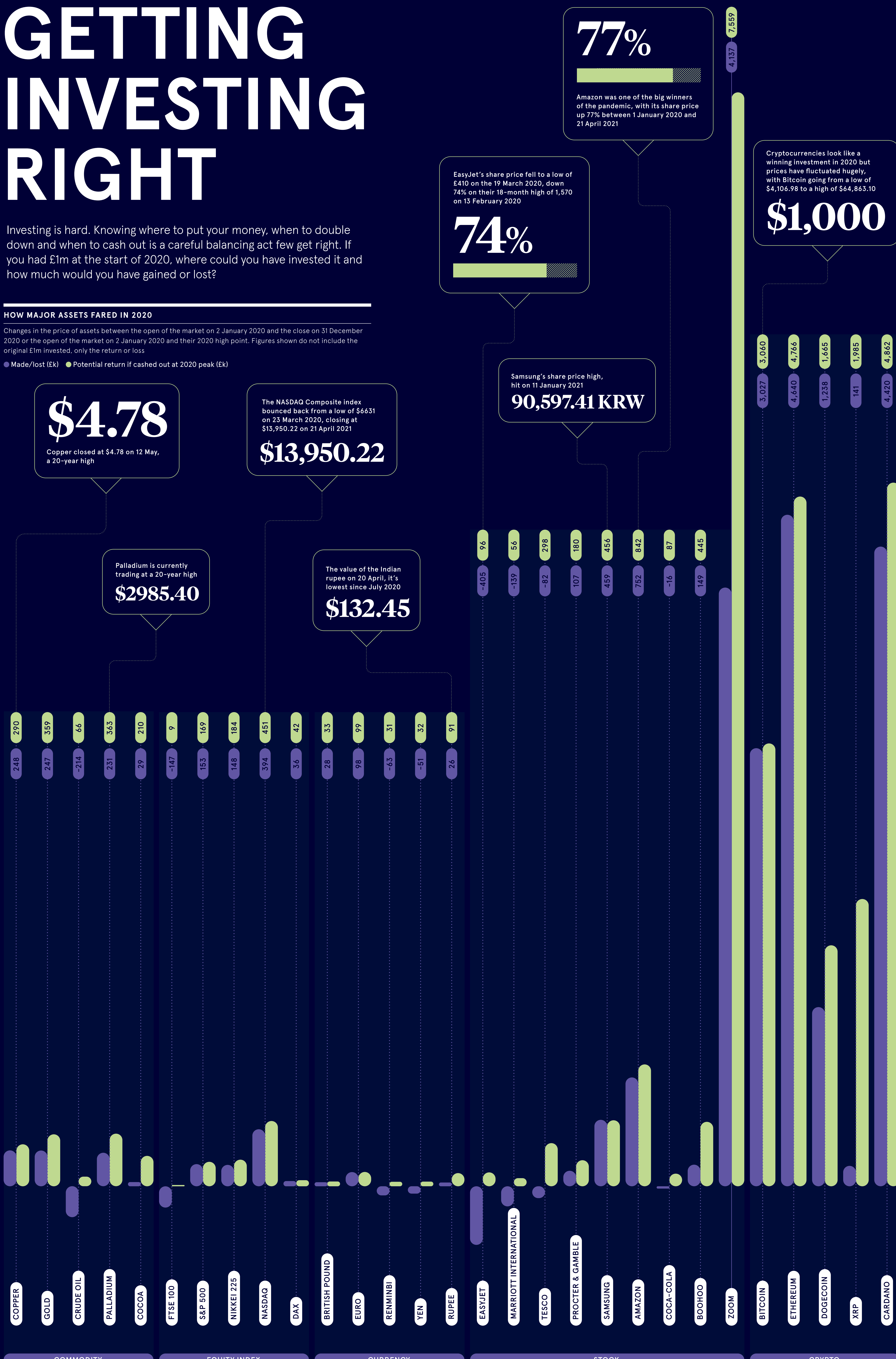
GETTING INVESTING RIGHT

Investing is hard. Knowing where to put your money, when to double down and when to cash out is a careful balancing act few get right. If you had £1m at the start of 2020, where could you have invested it and how much would you have gained or lost?

HOW MAJOR ASSETS FARED IN 2020

Changes in the price of assets between the open of the market on 2 January 2020 and the close on 31 December 2020 or the open of the market on 2 January 2020 and their 2020 high point. Figures shown do not include the original £1m invested, only the return or loss

● Made/lost (£k) ● Potential return if cashed out at 2020 peak (£k)



Commercial feature

Why responsible investing is good for people and the planet

Investment managers are increasing their focus on environmental, social and governance issues and playing a critical role in the transition to a low-carbon future

As the focus on environmental, social and governance (ESG) standards becomes increasingly important for investors around the world, the case for sustainable investing has never been stronger.

What once simply meant investing in entities that were sustainable over the long term and could grow their earnings has developed to encompass a much broader definition of sustainability in that business models must be able to continue without incurring disruptions from ESG issues, says Chris Iggo, chief investment officer at AXA Investment Managers.

"A good example is a business that is a heavy carbon emitter; increasingly it will be penalised for those carbon emissions either through taxation or regulation to the point where it will become less profitable and therefore the business will be unsustainable," he explains.

While there are a number of ESG risks investors need to think about, it is also creating opportunities for investors to support companies that are contributing to a sustainable future. "An example would be a renewable energy company, which is helping shift the economy to a low-carbon world," says Iggo.

While some institutional investors, such as endowment, charitable and pension funds, have long incorporated non-financial considerations into their investment policies, responsible investing is now becoming far more mainstream.

"There are two things driving this," says Iggo. "People do want to invest in assets that are good for people and the planet, but there is also a sense the world is moving this way and therefore some companies are going to be rewarded for doing the right thing. And there are other companies that are going to be punished for not doing the right thing, which will increase their cost of capital and make it harder to generate a good economic return."

While ESG concerns are wide-ranging, the issue that is drawing the most attention is climate change and the potential cost of not reducing carbon emissions. A number of countries have committed to achieve net-zero carbon emissions by 2050 and those government commitments mean they are likely to pressure businesses to reduce carbon emissions while implementing policies to transition to a low-carbon economy.

"Not only do governments have the power to impose regulations and taxes to help achieve that, they also have the fiscal power to subsidise new technologies and encourage the energy transition," says Iggo.

"It's also very measurable. We can look at a company and measure its carbon footprint today and we can assess how that's going to look going forward based on the plans that company has to transform itself. The UK, US and Chinese governments all have target dates when they want to achieve net-zero economies, so there's huge pressure on companies to be compliant towards those universal targets."

Against this backdrop, investment managers can also play a critical role in helping the world transition to a low-carbon future. For starters, fund managers can measure the carbon intensity of their investment portfolios by measuring the carbon footprint of all the companies a particular fund invests in, enabling managers to adjust their portfolios' carbon footprints accordingly.

> **People do want to invest in assets that are good for people and the planet**

For example, AXA Investment Managers has committed to exit all its coal investments in Organisation for Economic Co-operation and Development countries by the end of this decade and in the rest of the world by 2040.

"That's a big source of capital that coal companies can no longer tap, which means they can't fund their businesses as easily as they did in the past. But equally asset managers can also play a more venture-capital role by investing in companies that are developing new technologies such as electronic vehicle batteries," says Iggo.

In addition, investors have a role to play in engaging with businesses and marshalling them in the right direction on sustainability issues, no matter if they are investing in equities or bonds. AXA Investment Managers' stewardship and engagement strategy, for instance, seeks to protect client investments by holding businesses to account on issues that could significantly impact the value of that business, and therefore investor returns, over the longer term.

Growth in sustainable investment also means asset managers have to weigh ESG considerations, including climate, inequality and biodiversity, alongside more traditional investment metrics, such as a company's financial statement and balance sheet.

"Incorporating that information into the investment decision is already happening and it's becoming embedded into the traditional investment process even for funds that don't class themselves as ESG," says Iggo.

"It's a necessary process to go through to establish the value of a corporate asset, because if you ignore all this then suddenly that asset could get devalued through some kind of fine or increased tax burden or whatever it might be and, if you're not aware of those risks through a detailed study of the business, then as an investor you're going to underperform."

Any concerns investors might have that they are forfeiting potential returns in favour of more sustainable but less profitable investments is also being contradicted by an increasing body of research showing incorporation of ESG factors can lead to better investment performance.

"That trade-off just doesn't exist," says Iggo. "Think about the auto sector. Some car companies are much further advanced in developing new electronic vehicles, for example, so you can still have the same allocation to autos but within that you can pick the best-in-class companies. They're likely to be the ones that have done more in terms of changing their business model and this means they're more profitable and the return to investors will be better as a result."

AXA Investment Managers is already leading by example on sustainability. It has pledged to reduce its carbon exposure to net zero by 2030 across all its investment portfolios. And 90 per cent of its assets under management meet the criteria set out under articles 8 and 9 of the European Union's new Sustainable Finance Disclosure Regulation.[1]

"Our culture has undergone a massive change to put sustainability at the heart of everything we do, from research to our entire investment process," says Iggo. "As a responsible asset manager, we actively invest for the long term to help our clients prosper and to secure a thriving future for people and the planet."

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[1]As of 31 December 2020, assets under management within Equities, Fixed Income and Multi-Asset stand at €587 billion out of which €460 billion are applicable under the SFDR

For more information please visit axa-im.co.uk/climate

2030

net-zero carbon-exposure pledge across all investment portfolios

90%

of assets under management meet the criteria set out under articles 8 and 9 of the EU Sustainable Finance Disclosure Regulation

CHINA

The risks and rewards of investing in China

China represents a red-hot ticket for investors after weathering the coronavirus storm better than many economies, yet questions remain and not just over whether it can sustain growth

Nick Easen

The one thing investment professionals around the world are good at is following the money. It's why all eyes continue to focus on China. When foreign direct investment in the world's second-largest economy surged recently, at its fastest rate in over a decade, it peaked interest among wealth and asset managers. That's because China has navigated the coronavirus pandemic well and is now seeing a strong recovery.

This is likely to be highlighted by its leaders when China's Communist Party turns 100 this year; ironically their celebrations may well tout the success of capitalism. The country's financial markets have deepened, diversified and matured of late, their size and liquidity are now more enticing to global investors, just in time to make the most of record annual growth. Output has leapt 18 per cent year on year in the first three months, the fastest rate since records began in the early-1990s.

"In the last few years, China has made great progress in reforming its equity and bond markets, while enhancing access for foreign investors," says Arne Staal, chief executive of FTSE Russell. "Reform of China's domestic capital markets has also paved the way for greater foreign ownership of mainland Chinese companies."

The investment case is strong partly because many global investors are hugely underweight when it comes to China and their participation is surprisingly low. This is true for both global equity and fixed-income markets; the numbers are stark.

The Chinese economy makes up 16 per cent of the world's GDP. Its share of global manufacturing is close to 30 per cent, the same as the combined shares of America, Japan and Germany. China also accounts for 14 per cent of all global exports, yet it only makes up 5 per cent of the world's equity markets.

"Right now, as an investor you cannot afford not to have exposure to China," says Ronald Chan, chief investment officer at Chartwell Capital. "Managers must look beyond the Western media headlines about the country and apply perspective, as well as logic, to investing."

Already, cool-headed institutional investors have been increasing their exposure. Chinese markets are being added to some of the major global equity and bond indices. "It feels like investors are jumping on a bandwagon right now," says Mark Williams, chief Asia economist at Capital Economics.

The country's inclusion in the FTSE Russell, MSCI, Bloomberg Barclays Global Aggregate and J.P. Morgan GBI-EM Global Diversified indices, to name a few, should not be ignored. This is expected to drive hundreds of billions of dollars of inflows.

Let's also not forget that China was the only major economy to expand in 2020, albeit by a little more than 2 per cent, driven by a surge in industrial production rather than consumer spending, during a year that was fraught with economic paralysis elsewhere and global lockdowns.

At the same time, China has refused to rely on "helicopter money", unlike the United States and others. This Asian behemoth has not resorted to a demand-side stimulus either, which has been deployed by some developed economies. Its orthodox monetary policy is in contrast to what investors are observing in many industrialised nations.

"COVID-19 has seen global central banks and governments engage in a synchronous monetary and fiscal easing that has exacerbated the scarcity of safe, decorrelating yield," says Alan Siow, portfolio manager at Ninety One.

Many industries in China have also been exhibiting high and sustainable growth over a long period. The Chinese ecosystem of industrial sectors is increasingly deep and sophisticated, from solar panels to COVID testing kits, representing growth opportunities not widely available in many other markets. The country has also set a growth target of at least 6 per cent this year.

"The investment case for China is strong. There is tremendous potential for investing in this Asian giant as part of a well-constructed total portfolio," says Nikesh Patel, head of investment strategy at Kempen.

Turning to the \$16-trillion bond market, a ten-year Chinese government bond offers yields of more than 3 per cent. A US equivalent will generate close to half as much. When interest rates are rock bottom around the globe, it is not surprising overseas investors are piling into China.

"Northbound trading volumes between Hong Kong and mainland China are also good indicators of foreign capital flows and have increased tenfold since 2017," Chan at Chartwell Capital points out.

> **The West needs to cast off its stereotype of China as an unsophisticated work horse and simply the world's factory. The country is diverse**

"The West needs to cast off its stereotype of China as an unsophisticated work horse and simply the world's factory. The country is diverse and like Europe there is abject poverty in rural provinces, yet sophistication and dynamism across hundreds of Chinese cities. Shenzhen now rivals Silicon Valley as an innovation hub, with energy driving new products and solutions, as well as creating new markets. In terms of patent applications, China had over four times more than the United States in 2019."

The Year of the Ox, the Chinese zodiac sign that is known to be strong and tenacious, inspire confidence, yet hates to be challenged, is a good analogy for China in 2021. To date, the country's bank-financed economic model has been reliant on strong exports and capital investment. This is unsustainable in the long term, yet China has shown stubbornness in its shift to a more consumption-led economy.

"There are also a whole range of additional risks with China, even more so and magnified when compared to other emerging markets," says Patel.

From the persecution of ethnic minorities in Xinjiang province to civil liberties violations in Hong Kong or sabre rattling over Taiwan, China is feeling the pressure. A wave of sanctions imposed by the UK, European Union and Canada has ripple effects.

"You now have hyper-specific issues like forced labour and human rights abuses of the Uighur Muslim population. This isn't just contained to Chinese equity and fixed-income markets, there are large global companies that have questions to answer here," Patel adds.

"ESG – environmental, social and corporate governance – reporting is not mandatory in China. Engagement efforts are often neglected by companies. There's also a very high degree of state interference in ESG matters of policy and a huge discrepancy between the interest of the Chinese government and both shareholder and stakeholder interests."

This is why a group of socially conscious and religious investors, as well as other funds, have recently ramped up pressure on Western companies such as Zara owner Inditex, H&M and Hugo Boss that source from China. They want transparency and accountability on whether supply chains deploy forced labour or lead to human rights abuses.

At the same time China denies all accusations of abuse. There are also concerns to do with legal standards and the stability of the country's property market. For many managers, the country can still be opaque.

"Investors need to separate the differences between politics, economy and the company. These three things don't correlate with each other all the time," says Colin Liang, head of China at RWC Partners.

"Investors find it hard to fully understand how China works under a one-party system, both politically and economically. Investors are often confused with China's policies domestically and abroad. Many private companies, as opposed to state-owned enterprises, are also very much immune to changes in GDP growth, money liquidity or any US-China conflict."

China also faces long-term issues. There's a high debt burden with growing corporate bankruptcies, poor productivity, the support of flagging state-owned enterprises and its ageing population. Beijing's apparatchiks can also change the rules on a whim. Investors looked on wide-eyed when Chinese regulators took a swipe at Alibaba with a \$2.8-billion fine for violating antitrust laws, a company that in the past has received extensive government favour and support.

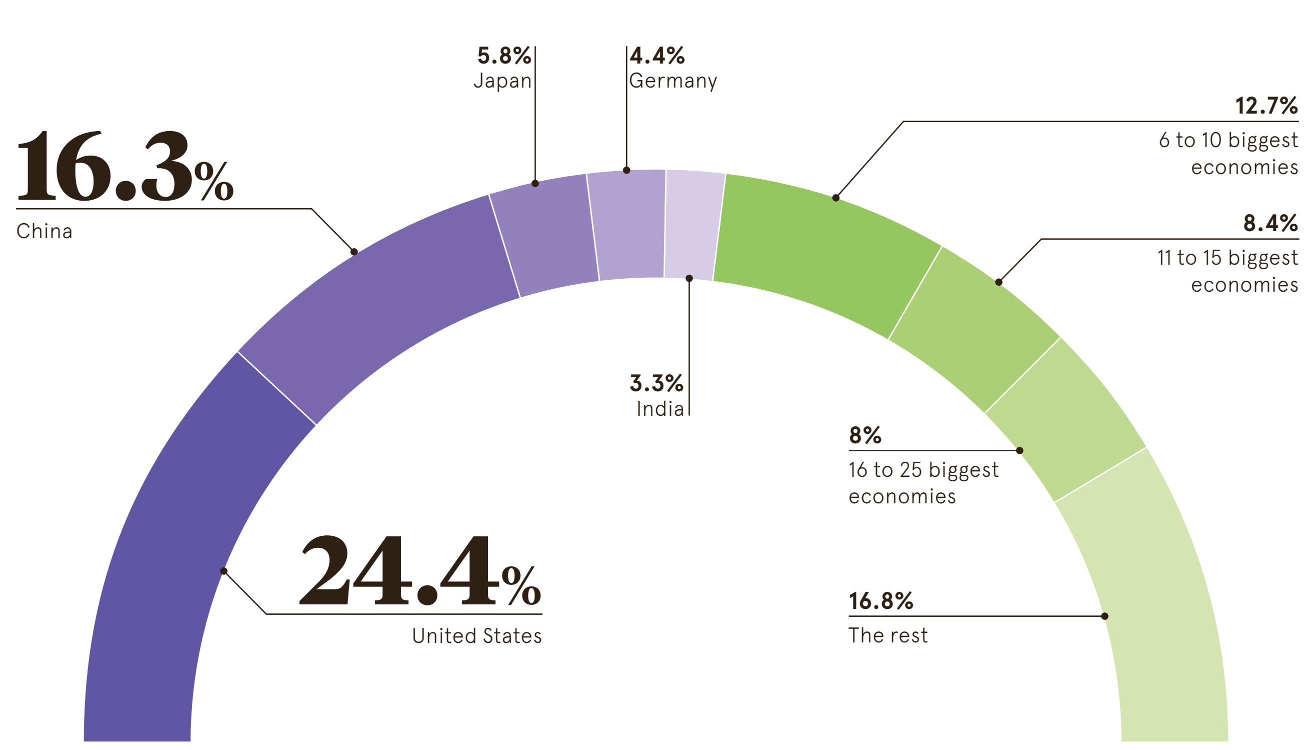
"Investors should be aware that China's markets don't operate to the same rules as major markets elsewhere. Regulators have aligned some rules as part of a push to join global benchmark indices. But it's the unspoken rules that catch foreign investors out. Many firms aren't run for the benefit of shareholders or with a purpose of maximising profit," explains Williams from Capital Economics.

"Some of the biggest listed firms are state controlled and explicitly used as policy tools. But private firms also have to do the state's bidding. It doesn't matter how big or successful. In fact, the bigger a firm is, the more it has to follow the leadership's bidding. Just look at what has happened to

CHINA'S ECONOMY IS NOW THE SECOND LARGEST IN THE WORLD

Share of the global economy

World Bank 2020



crystal51 via Shutterstock

Ant Financial, Alibaba and its chief executive Jack Ma."

There is certainly a lack of understanding among global investors beyond large and commonly owned stocks. Yet cutting through the opaqueness of information can play to an investor's advantage. "There is an undisputed need for local knowledge. Investing blindly through an index or tracker will give you exposure to volatility and the full suite of highs and lows that China offers," says Chan.

The key piece of advice is to do significant homework and really understand the risks associated with onshore or mainland China investments. This involves using an investment process that combines both a top-down comprehension of the macroeconomic and political themes and trends with a bottom-up knowledge of the company, sector and wider marketplace.

"However, I don't think the Chinese market will be sufficiently open and welcoming to Western standards of institutional due diligence to make it mainstream in the coming years; I don't think onshore China will become mainstream until the 2030s," says Kempen's Patel.

Besides monitoring diktats from President Xi Jinping or macroeconomic trends, ESG factors are a significant concern for global investors in the lead up to COP26, the United Nations climate summit in Glasgow.

China is improving, albeit from a low basis and disclosure is getting better. Many internal policies in Chinese are now laid out in English. Regulators in Beijing are also pushing better practices, if only to clear the smog-laden skies that consume many cities. The country has also committed to peak carbon by 2030.

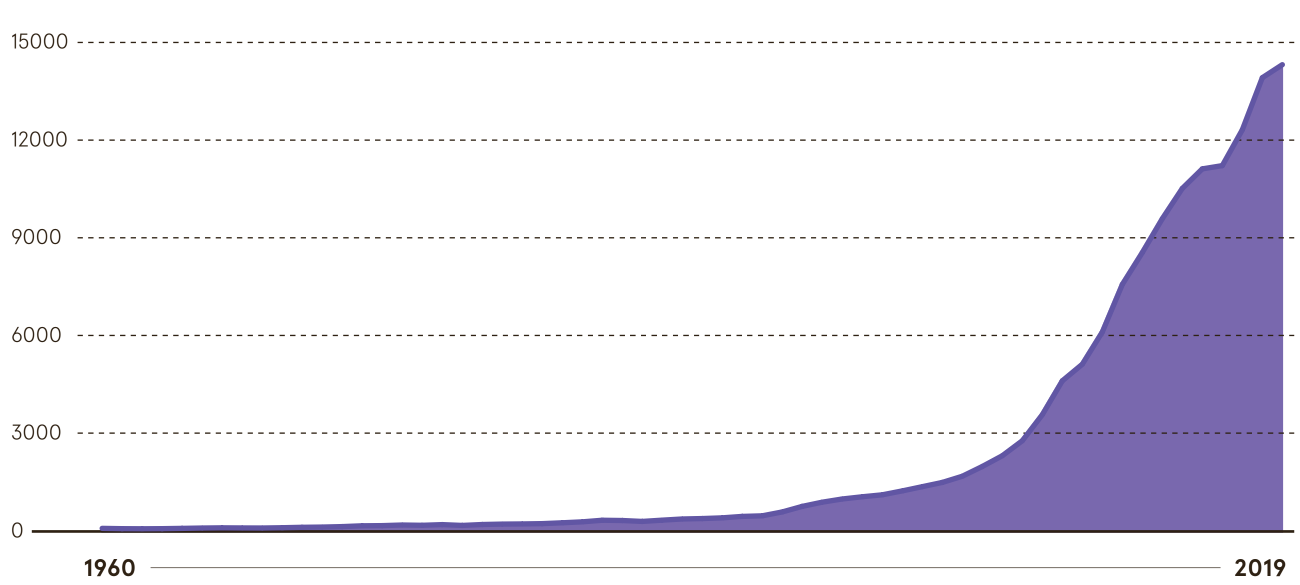
"ESG is a growing pain. Headlines and horror stories persist in the global media on China's environmental record, however China is cleaning up its act. The one key difference that Chinese policymakers have over their Western counterparts is control of more levers. When China says it is going to do something, it usually can and will," says Chan.

"It's pledged to be carbon neutral by 2060 and is currently investing dramatically in core industries to support this. China is the largest market for renewable energy, so you will see a tsunami of investment in this sector. Coal contributes to 65 per cent of China's energy generation, but it is expected that solar, hydro and wind power will quickly take over in the coming decades."

CHINA'S GDP HAS SOARED OVER THE PAST 40 YEARS

Annual GDP in current US dollars, billions

WorldBank 2020



> **Investors should be aware that China's markets don't operate to the same rules as major markets elsewhere**

Looking to the future, wealth and asset managers should focus on the megatrends. Urbanisation, domestic consumption and the explosion of the Chinese middle class will continue to be in focus. The population with more than $10,000 annual disposable income is expected to grow from 280 million to 680 million by 2030. Chinese millennials and Generation Z are also becoming more discerning consumers.

President Xi's dual-circulation strategy is part of this story. This involves China still being part of international circulation, which involves competitive global exports and trade, however there is a move to improve domestic circulation. This involves building a vibrant home-grown economy with less dependence on imports. Investors hope this will bode well, at least for local demand.

CHINA'S STOCK EXCHANGES ARE SMALLER THAN THOSE IN THE US

Market capitalisation

NYSE	$29tn
NASDAQ	$10tn
Shanghai	$4.7tn
Shenzen	$3.5tn
Hong Kong	$4.5tn

Investopia 2020

"China's consumption market is expected to double in size and reach a scale similar to the United States. Chinese brands are already capitalising on this opportunity, with strong national brands such as Midea and Haier emerging in China," says Wenchang Ma, portfolio manager at Ninety One.

Shifts in demographics don't lie either. China is set to report its first population decline since 1949. A significant moment when you consider that its workforce could drop by 0.5 per cent each year to 2030, with a higher burden for elderly care. Education and technological progress may not compensate for this slump and shift in population. This is likely to temper any gear change for China to overtake America as the world's largest economy.

"Let's also not forget China has been climbing the technology curve, trying to capture higher value in the industrial supply chain. China won't succeed in every segment, but leaders in certain fields will be able to do that. R&D spending has also been increasing across the board. Cloud-based solutions, high-end manufacturing and specialty materials are examples where China has excelled," says Liang at RWC Partners.

"China is also never slow to adopt new innovations, either new products such as electric vehicles or new business models in ecommerce. We expect rampant business innovation will continue and champions will continue to emerge from new areas."

That's the thing. China never fails to surprise. For good or bad, wealth and asset managers should be ready.

CRYPTO

Are advisers ready to embrace cryptocurrencies?

Long viewed as off limits by many, rising demand from retail investors is driving some financial advisers to reassess the validity of cryptocurrencies as an alternative asset class

Finbarr Toesland

Monitors display Coinbase signage during the company's initial public offering (IPO) at the Nasdaq MarketSite in New York, U.S., on Wednesday, April 14, 2021.

Michael Nagle/Bloomberg via Getty Images

Once the preserve of hardcore early adopters, cryptocurrencies are breaking into the financial mainstream and attracting the interest of investment giants in the process.

Morgan Stanley recently became the first major US investment bank to offer clients with at least $2 million in assets access to bitcoin funds. Soon after Morgan Stanley's entry into bitcoin, rival Goldman Sachs announced it would shortly provide ways for clients of their private wealth management division to invest in a range of cryptocurrencies.

A handful of financial institutions may be slowly warming to digital currencies, but the challenges for professional advisers in offering clients access to, and advising on, cryptocurrencies are considerable. From difficulties in valuing cryptocurrencies to custody concerns and a lack of understanding of digital currencies, many financial advisers are finding it hard to embrace these currencies.

Robert MacDonald, financial planner at Succession Wealth, an independent wealth management and financial planning business with £8 billion of assets under management, believes the main issue with cryptocurrencies is their unregulated nature.

"The Financial Conduct Authority is unlikely to get involved in this asset class due to the lack of tracking ability, potential prospects of theft, fraud and violence surrounding the coins," says MacDonald.

"In essence, cryptocurrencies are just 'bets' and not incoming-producing assets. As such, wealth managers are likely to avoid putting cryptocurrencies in front of their clients as an option."

Many wealth managers and financial advisers may view cryptocurrencies as uninvestable, but interest from UK investors in digital currencies is reaching fever pitch. Sixty-three per cent of investors in the UK are planning to purchase bitcoin for the first time or increase their holding during 2021, according to a survey by UK financial markets platform Investing.com.

It's not difficult to see the attraction of a cryptocurrency like bitcoin that has a history of rapid price growth to investors with an outsized risk tolerance, with a single bitcoin increasing its value from under £3,000 at the start of 2019 to highs of more than £43,000 this year. Yet, as Richard Jones, senior partner at Oundle Wealth Management, points out, the volatility of cryptocurrencies is well documented.

"While some people have made tremendous returns from bitcoin and other cryptocurrencies, there is nothing to guide us as to what future returns may look like," says Jones.

When he speaks to clients about cryptocurrencies, the primary driver for considering these investments is the fear of missing out. "Typically these tend to be clients who are otherwise not high risk takers and have simply heard stories of others getting rich quickly," says Jones, whose firm is a partner practice of St. James's Place Wealth Management, which manages client funds of more than £129 billion.

Although not wanting to miss the chance to take part in a seemingly booming investment can be a powerful reason for some ambitious investors to try out cryptocurrencies, fear of missing out is not exactly a new concept. "I often point clients towards the example of tulips in 17th-century Holland to remind them of how markets can overreact," Jones adds.

The number of advisers allocating to crypto in client portfolios increased by 49 per cent in 2020, growing from 6.3 to 9.4 per cent, according to a recent survey of financial advisers by Bitwise/ETF. Advisers that responded to the survey reported rising client demand, inflation hedging and high potential returns as key reasons for adding crypto exposure to client portfolios.

As one of the small but growing number of advisers who have embraced crypto, James Vermillion believes cryptocurrencies will play a central role in the future of finance.

"I view crypto as the first totally new asset class in my lifetime and we're likely in the infancy of how these technologies will impact the world. Like any new technology, time, a maturing market and education will widen the appeal to advisers and wealth managers," says Vermillion, founder of independent financial planning and investment management firm Vermillion Private Wealth.

Softening anti-crypto rhetoric from some institutions and well-known business leaders, as well as a number of companies adding bitcoin to their balance sheets, are a few of the factors Vermillion attributes to prompting some advisers to welcome bitcoin and other cryptocurrencies.

Despite the growing mainstream acceptance of cryptocurrencies and associated technologies, he is acutely aware of the barriers stopping these innovations from reaching widespread usage by advisers.

"One of the challenges at the moment is the unclear regulatory environment and limited platforms for advisers to implement holding cryptocurrencies in client portfolios. This will surely change as crypto matures as an asset class and regulators adapt. In the meantime, there are other ways to get crypto exposure, but none of them are a replacement for holding the assets and come with various other risks," says Vermillion.

Every adviser has their own motivations for backing cryptocurrencies. Some view this as an early opportunity to invest in innovative technology, akin to the opportunities found in the dot com era, according to Dan Eyre, chief executive of Blockchange, a digital asset investing platform for professional wealth managers.

"Others see it as an opportunity to diversify into an asset class that appears to be eating portfolio allocations across gold, cash and fixed income," he adds.

A perhaps surprising benefit advisers can gain from advising on cryptocurrencies is the ability to attract hard-to-reach millennial clients, as younger investors are driving the increase in bitcoin adoption. Only 1 per cent of over-65s own bitcoin, compared to 18 per cent of 18 to 34 year olds, according to a Blockchain Capital survey.

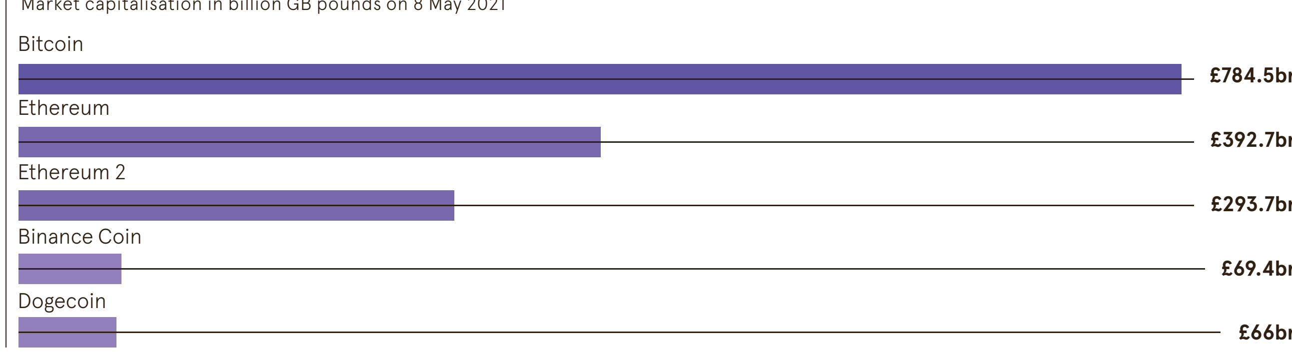
> **While some have made tremendous returns from cryptos, there is nothing to guide us on what the future may look like**

Eyre concludes: "Nearly all firms that engage with this asset class understand by participating they're sending a clear message to the market they're paying attention and are willing to adapt to the desires of a shifting demographic during the largest generational wealth transfer in history." ●

THE VALUE OF CRYPTOCURRENCIES HAS BEEN RISING THIS YEAR

Coinbase 2021

Market capitalisation in billion GB pounds on 8 May 2021



OPINION

'We want to build a robust advice industry that is fit for the future and accessible across society'

In the past two decades, the UK has experienced significant social and demographic changes that mean people are faced with more moments when they have to make important financial decisions.

Previously, the biggest financial decisions typically revolved around getting married, buying a home or having a family. But the impact of an ageing population, changes to government policy and new working patterns means many of the old certainties have disappeared.

This is why it is vital that as many people as possible can access professional advice. A wealth of research shows people who have engaged with the advice sector are significantly better off in retirement than those who have not.

People who receive advice feel more confident about their finances overall and have increased financial and mental wellbeing. Research by Open Money shows the vast majority (86 per cent) of those who have taken professional advice had a positive experience.

Despite this, most people do not engage with professional advice. Open Money's research also found just 10 per cent of respondents had taken paid-for advice, while 79 per cent of those who had not, had no intention of doing so. For many, the cost of advice is a barrier, but it is not the only one. The lack of uptake is also the result of poor awareness of the benefits and a lack of trust.

Advice can be expensive, in part because costs to the industry have risen over the past 20 years. Regulations designed to professionalise the industry and protect consumers, while beneficial, have had the unforeseen consequence of creating an "advice gap".

Meanwhile, scandals have contributed to a general lack of trust and technology has led many people to take financial decisions without necessarily being fully aware of the risks, or in the worst cases enabled criminals to defraud unsuspecting victims.

Here at the Personal Investment Management and Financial Advice Association (PIMFA), we believe that everyone who wants to receive professional advice should be able to do so.

We know from research by Royal London that those least likely to access advice due to the cost are the people most likely to benefit from it. This is why we are working with regulator the Financial Conduct Authority (FCA), and others, on the creation of a simplified low-cost advice model that would make advice more accessible to more people.

We want the FCA to work with us to remove, permanently, those bad actors that rely on the rest of the industry to compensate the clients they have failed through the Financial Services Compensation Scheme. Doing so would reduce the burden on the scheme and, therefore, reduce the single biggest cost pressure our industry faces.

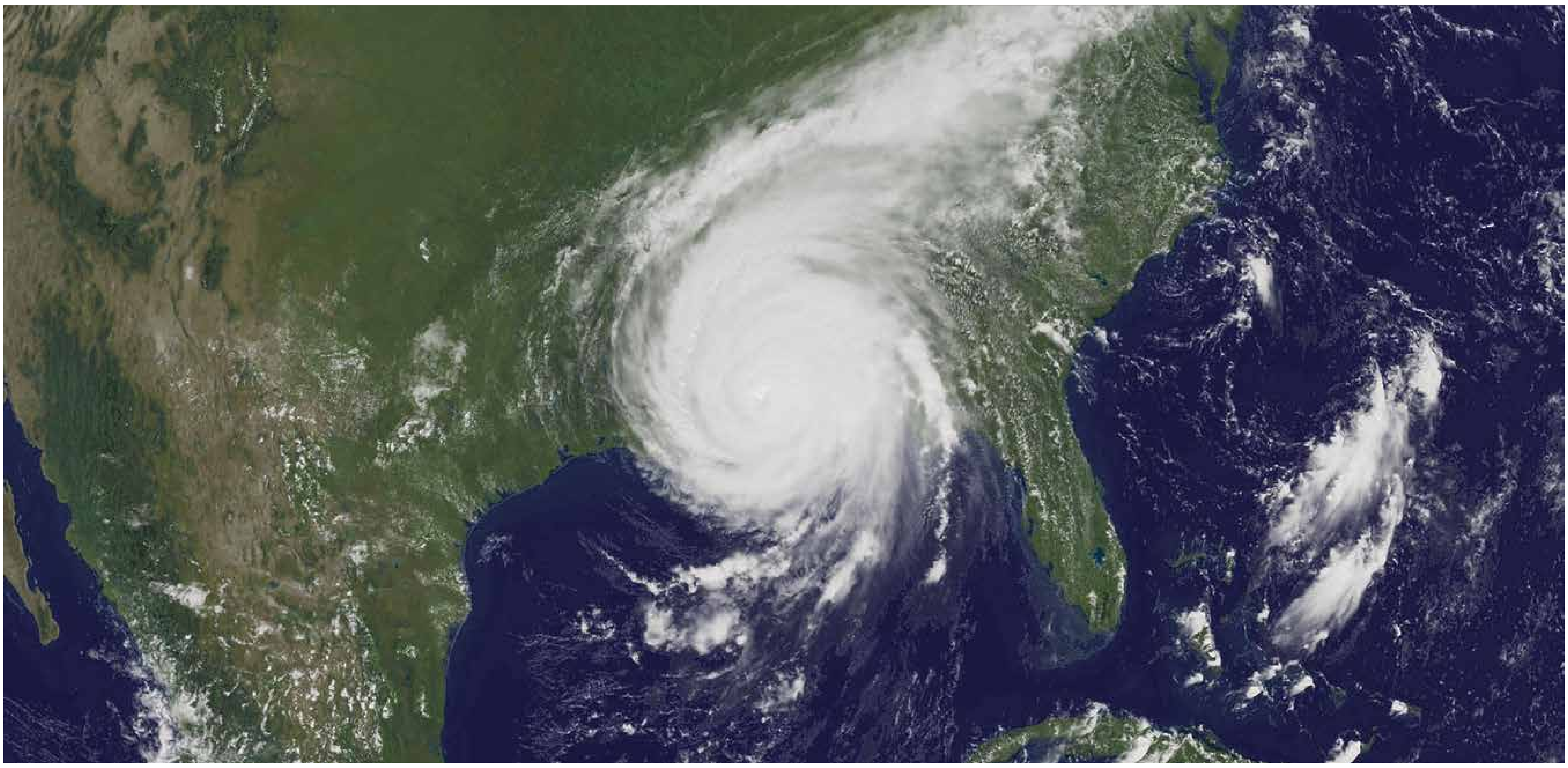
In addition, we want people to feel safe from fraudsters online, which is why we are campaigning for financial harm to be included in the government's Online Safety Bill.

PIMFA also wants to resolve how advice is defined and charged. Currently, the definition of advice is derived from European legislation, but now we have left the European Union there is an opportunity to provide a clearer definition that works for the UK advice industry and a rulebook that enables flexible advice models using technology. Redefining advice would also allow for the creation of a model where charges are tiered based on the complexity of the advice offered.

Moreover, we need the government to work with us to improve financial literacy in the UK and encourage a savings and investment culture. This can only be achieved by teaching younger generations how to manage their finances, by encouraging people to invest for the long term at an earlier age and by promoting the value of advice.

PIMFA and our members want to build a robust advice industry that is fit for the future and accessible across society: a market that allows advisers to thrive, develop and innovate, and provides consumers with professional and affordable advice. Ultimately, this will be a market that works well for the UK economy, not only by increasing levels of savings and investments, but by improving the nation's financial and mental wellbeing too. ●

Liz Field
Chief executive,
Personal Investment Management and Financial Advice Association



Insurance-linked securities help investors ride out the storm

Building an investment portfolio with several truly uncorrelated assets is difficult to achieve, but insurance-linked securities (ILS) is one asset class which provides real diversification benefits

Investors will always remember the moment capital markets acknowledged the impending doom posed by the coronavirus crisis, causing unprecedented turmoil in their portfolios. It wasn't long before the age-old lessons on diversification were being recirculated in investor forums and publications, though when most traditional asset classes are affected, it's easier said than done.

Decorrelation is one of few ways investors can seek protection in times of turbulence, but various market events have shown traditional asset classes are more correlated than many people think. The benefits of diversification only work properly when the portfolio's assets are truly uncorrelated. No amount of diversification can guarantee immunity to losses, of course, but achieving real decorrelation in an investment portfolio will reduce risk and volatility.

Among the rare, genuinely diversifying asset classes is insurance-linked securities (ILS). Though not mainstream, the size of the investable ILS market is approximately $100 billion. Comprising a suite of instruments, of which the catastrophe bond is the best known, ILS enables insurance and reinsurance companies to transfer insurance event risk from their balance sheet to capital market investors.

ILS reduces volatility for insurance and reinsurance companies by sharing the burden of insurance claims after a natural catastrophe while offering investors the ability to access long-term, attractive, risk-adjusted returns, which are uncorrelated to most traditional asset classes; a stock market crash does not make a hurricane or earthquake any more or less likely to happen. By isolating the insurance claim component, investors are immune to the impact broader financial market turmoil may have on the asset bases of those insurance and reinsurance companies.

"ILS has been the most successful attempt in converging the insurance industry with the capital markets," says Vegard Nilsen, chief executive of Securis Investment Partners LLP, an asset management company specialising in ILS. "With interest rates at record low levels, investment returns across traditional asset classes are not only expected to be lower, but also more correlated and volatile.

"In a wounded economy, which has seen a spectacular level of monetary intervention, the fiscal toolbox is empty and this should be a concern. Uncorrelated investment strategies and fixed-income alternatives are more relevant than ever. Our value proposition is to provide investors with the ability to access investable insurance risk in its purest form,and to eliminate exposure to the issuer in a structure where the collateral – the investments made – is entirely ring-fenced and protected."

Born in the mid-1990s, when the first catastrophe bond was issued amid a shortage of insurance cover following Hurricane Andrew, the ILS market has evolved significantly since, driven by the fundamental goal of securitising insurance event risk. Today there are several mechanisms available to transfer insurance risk to investors.

$100bn

the size of the investable ILS market is approximately $100bn today

76%

A significant gap between insured and overall economic losses which is set to continue growing (AIR's latest report on global catastrophe losses suggest that 76% of average annual economic losses globally are uninsured)

The insurance and reinsurance events investors are exposed to relate mostly to natural catastrophes, but also include life and health-related risks. Securis invests exclusively in ILS, via a range of different funds, for an investor base predominantly made up of large pension funds and institutional investors. Securis manage approximately $4.5bn of assets on behalf of its investors.

A catastrophe bond is similar to a fixed-interest bond, but rather than being exposed to the default or bankruptcy of a corporation, it may be exposed to contingent event risk arising from low-frequency, high-severity insurance events, such as the occurrence of a large hurricane or earthquake. When certain conditions are met, the bond defaults. The investor collects a regular coupon for the duration of the bond and, in the absence of that event, the capital invested is returned upon its maturity.

The global financial crisis in 2008 was the first real test and proof of concept for ILS and it lived up to expectations. Securis posted performance that year in line with what it had modelled and expected, uncorrelated to the capital markets and more traditional and well-known assets. ILS had its own challenges during 2017 and 2018 when there were an unusually high number of natural catastrophes around the world. This demonstrated how both the ILS and capital markets are cyclical in nature, only amplifying the value of a diversified investment portfolio with proper decorrelation.

"ILS can be very helpful for investors who have the governance capability to properly implement and manage an ILS allocation within a diversified investment programme," says Weston Tompkins, head of investor relations for Securis in North America. "Investors should treat it like any other strategic asset class: do your due diligence, educate yourself and get to know the investment manager. ILS does act unlike anything else in their portfolio and for all the right reasons.

"The incidence of hurricanes or earthquakes isn't related to global GDP or any of the capital markets, so ILS is an unquestionably diversifying asset class. It's really easy to understand: if the wind doesn't blow and the ground doesn't shake, you should typically make money. There should be a positive return premium for underwriting potentially large global property catastrophe losses and historically that has been the case. Implementation can be incredibly complex, but that is why Securis exists."

> **ILS has been the most successful attempt in converging the insurance industry with the capital markets**

For professional investors looking to embrace the diversification opportunity that ILS presents, Espen Nordhus, Founder and Executive Chairman, recommends a strategic long-term allocation, with at least a five-year perspective.

"Take a long-term view and be prepared to adjust your committed capital over time," Nordhus adds. "If ILS outperforms the rest of your portfolio, reduce your position. If it underperforms or there is a meaningful market dislocation, add to ILS despite the preceding returns. This is the most critical point for a long-term successful ILS experience, as it means you're reducing your allocation when expected returns are declining and increasing allocation when return expectations are increasing."

For more information please visit securisinvestments.com

SECURIS INVESTMENT PARTNERS

Q&A

Leading the evolution of ILS

Vegard Nilsen, chief executive of Securis Investment Partners, reveals how the company has helped shape the evolution of insurance-linked securities over the last 15 years and continues to lead the charge

Q What role has Securis played in the development of this burgeoning asset class?

A When Securis was established in 2005, very few investment managers were deploying investors' capital to provide protection to insurance and reinsurance companies via a fund product. There was a significant amount of innovation and invention prevalent in those early days. Asset managers were in many ways spurred on by the large reinsurance companies seeking avenues to pass on risk. Fifteen years on, it's clear we were a disruptive force and now actually compete with the reinsurance companies. The universe of insurance risks is very broad and Securis has always been at the forefront of extending the part of it that is accessible to ILS investments. This has not meant to branch out into areas where insurance risk is combined with market risk or credit risk, but rather to find new markets for insurance risk participation and genuinely diversifying risks for our investors, increasing risk-adjusted returns.

Q What approach do you take to ensure you can continue to innovate in this space?

A As an example, we created an Insurance Solutions Group last year to focus entirely on pursuing new strategic ideas. We see a number of opportunities to deploy life financing technologies to the non-life space, where the combination of taking on insurance risk together with financing can be a powerful combination to enhance returns, particularly in the areas of insurance premium financing, commission financing and speciality risk financing. Securis also has one of the longest track records in the Life ILS space, a highly specialised proposition which involves risks including mortality, life expectancy, lapse (when a policy is cancelled or modified) and morbidity. The success of a Life ILS transaction should be down to highly predictable actuarial risks that can be analysed, not the risk of a counterparty failing to pay us or any general market risks like equity shocks or interest rate rises. "This is why particular focus is paid to putting in place appropriate collateral ring-fencing structures for most of our life transactions. This, in turn, allows us to produce a highly diversified, return maximising portfolio for our investors, with minimised exposure to traditional market risks" Andrea Cavalleri, CIO (Life) adds.

Q How will the continued effects of climate change impact the ILS market and asset class?

A Climate change has the potential to impact all asset classes. The climate is changing, for example average sea surface temperatures have risen approximately 1.1 degrees Celsius since the late 19th century and sea levels have risen 20cm in the same period. And although it has a negative impact on our planet, that doesn't automatically make it negative for ILS as an investable asset class. If the assumption is that climate change creates a more volatile climate, you should also assume the need for insurance will increase, the market will grow and the additional risk will drive insurance premiums up, which will ultimately benefit our investors. It's also important to note that natural catastrophe risk is not just a function of the hazard or climate, but rather the exposure to the hazard. Hurricane Katrina cost the insurance industry $39 billion when it flooded New Orleans in 2005. That's $63 billion in present-day values, however contemporary analysis suggests the damage would have been 60 per cent less had the levee systems been at current standards, following reconstruction and improvements which have reduced the city's vulnerability to storm surge. Our modelling estimates that a repeat of Katrina, with present day exposures and protections in place, could in fact cost the insurance industry less than $25 billion.

Q How do you evaluate risk in a complicated climate environment?

A Securis employs around 70 people with a unique mix of capital markets and insurance experience in addition to a number of technical experts, actuaries and mathematicians. We apply a robust and sophisticated approach to the risk models and tools we use to evaluate catastrophe risks. However, the concept of evaluating catastrophe risk using models adjusted to represent the current climate, rather than just the full available historical record, has been around in the catastrophe modelling community for a long time. Climate change is one of several risk factors that must be considered, quantified and priced accordingly. We are very familiar with the tools and approaches, have adapted them based on our own analysis and continue to use the philosophy of non-stationary distribution of risk when pricing risk. Many aspects of climate change are gradual, it may take decades, even centuries, for trends of changes to be observed – while ILS can adapt quickly. Herbie Lloyd, CIO (Non-Life) adds, "We are very well positioned to model, analyse and price risk to reflect changes in exposure, construction vulnerability and the insurance-related impacts of the changing climate. The short-term nature of insurance policies allows for annual repricing when policies are renewed and renegotiated, so new science, better data and updated views of natural catastrophe risk are readily adopted into our investment decision making framework."

Q What is your own company stance on the environment as well as other ESG components?

A We believe ILS has inherent ESG-friendly characteristics as through insurance, investors in ILS support rebuilding following natural catastrophe events for non-life, and after illness or death on the life side, i.e. within, an element of social return for investors. Longer-term, insurance promotes resilience and incentivises good risk management. As a signatory of the United Nations Principles for Responsible Investment, we are firmly committed to the environmental, social and governance (ESG) agenda. At a corporate level, we are developing a more sustainable working approach, which will result in both environmental and social benefits with reduced reliance on physical infrastructure, minimising waste and extracting efficiencies through utilising cloud technologies. Our most valuable resource is our team. Our culture is built around an inclusive, ambitious and dynamic environment that encourages transparency, integrity, collaboration and creative thinking. We encourage staff to embrace the concept of corporate citizenship, and we're dedicated to making a positive impact in our local communities and globally, through the Securis Foundation, our Charity. We also recognise corporate governance and ethical conduct as essential drivers of long-term success. Embedding proper, transparent practices in our organisation is core to Securis's risk management framework and operations in a globally regulated environment.

How ESG is challenging wealth managers

Meeting the needs of ethically aware investors requires a rethink, says **Bruce Hobson**, chief executive of corfinancial®

The wealth management industry is undergoing a period of seismic change associated with environmental, social and governance (ESG) factors and the interests of investors.

The biggest transferral of asset ownership in history is underway, with wealth moving to a younger generation of digital-native investors. The numbers are immense: Washington-based investment manager United Income reckons $36 trillion will be transferred by baby boomers to their children in America alone by mid-century. Cerulli Associates puts the number at $68 trillion over the next 25 years.

This new breed of investor is demanding far more input to the decision-making process and greater access to data than ever before. Generation Y investors (those born between 1981 and 1995) seek more than just risk-return data, they also want to understand the impact of their investments on the world in which they live.

Meanwhile, sustainable business operations, in the context of a firm being able to continue its operations by adapting to environmental changes or social challenges, such as diversity, continue to be a focal point. The strength of a company's sustainable strategies has been shown to correlate positively with long-term performance.

New breed of investor

The emergence of digitally empowered investors and the rise of self-directed investing means investment performance is no longer enough. Wealth managers must demonstrate a risk-managed culture through control, transparency and absolute rigour, but at the same time provide an engagement model for their clients that suits the individual desires of the whole spectrum of investors.

In a recent 2021 EY *Global Wealth Research Report: Where will wealth take clients next?*, we see some interesting trends as shown in the infographic.

The research shows that ESG is personal to each individual: some care more about certain environmental issues, others more about social issues. This will make it even more challenging in the future for wealth managers to understand every client's unique needs and to deliver against them.

ESG and sustainability of a company

Our view is that sustainability, with a capital "S", focusing on a positive environmental impact, has rapidly advanced. For many investors, and in particular the younger Generation Y group, the sustainability of a company including ESG issues naturally becomes a greater imperative.

Fidelity International compared the performance of more than 2,600 companies based on Fidelity's own ESG ratings (from A to E), for a study of the period February 19 to March 26, 2020, as the economic and social impact of the pandemic became evermore apparent. According to the research, A-rated companies performed on average 3.8 percentage points better, while E-rated companies performed on average 7.4 percentage points worse than the S&P 500 during the period examined.

This analysis demonstrates a positive relationship between high sustainability scores and relative return in a short-term correction. Many other studies have provided arguments for the same over the longer term.

Building ESG into portfolios

Wealth managers and advisers need to capture client preferences for sustainable investing, from a simple "green" preference to specific ESG factors and impact statements, all within one flexible framework addressing business and regulatory requirements.

All this means the way investors look at ESG investing has transformed. It is no longer regarded as a nice to have; it's now indispensable, not in terms of whether an investor has a high "E", "S" or "G" score in their portfolio, but in terms of understanding the factors, exposures and risks of those to individual companies and assets.

It is our belief that the integration of ESG into private client portfolios should appeal to all investors, if articulated correctly. Once a wealth management firm has established its policy on how ESG is to be incorporated in investing, it can build thematic models and client-specific portfolios. Advisers and managers can apply tilts for ESG-mandated portfolios that are very specific, such as focusing on the highest-ranking environmental companies.

Of course, this kind of analysis involves a huge amount of data. The key for the adviser or manager is to be able to present this complex data in a simple fashion that the investor can readily understand, through the effective use of technology.

ESG and importance of monitoring

As wealth management firms grow, merge or acquire other businesses, the operational structures they have in place with which to monitor client portfolios often begin to feel the strain. Our view is wealth firms need to highlight these painpoints and rapidly identify whether they present a risk to client portfolios.

This will become even more critical with the incorporation of ESG preferences in suitability. To combat this threat, wealth management firms should have the technological infrastructure to deliver daily insights and analytics across the portfolio and entire business, including ESG factors.

> **Wealth managers must meet the expectations of the most sophisticated clients, and software lies at the heart of this mission**

How corfinancial can help

To meet these requirements corfinancial offers advanced wealth management software. Our BITA Risk® ESG Manager combines complex ESG data and client preferences in portfolio management and reporting. It analyses a portfolio through ESG-focused portfolio screening, tilts, exposures, modelling and reporting in the context of a client mandate and ESG preferences using a preferred ESG vendor's data.

The platform makes it easy for wealth managers to record client preferences for sustainable investing. Portfolios can be reviewed, for example to identify ESG conflicts between client preferences. Reports are quickly generated to share data with clients. It's a powerful tool to cover the most demanding ESG investing.

In summary, ESG is now mainstream. Wealth managers must meet the expectations of all investors including the most sophisticated clients, and software lies at the heart of this mission. As clients take more interest in how their capital performs, investor demands are only going to grow. We at corfinancial can help your organisation excel in this radical new world.

bitarisk.

For more information please visit www.BITARisk.com

78%

of wealth clients now have goals related to sustainability in their lives

46%

In the last 12 months, climate change has not only climbed the agenda for 24% of the mass affluent population but also among 46% of ultra-high-net-worth clients

76%

A major reallocation of investments is clearly on the cards, with 76% of clients believing it is important to integrate ESG parameters into their portfolios

61%

Diversity and Inclusion (D&I) has attracted increased interest from 61% of clients over the past year

2021 EY *Global Wealth Research Report: Where will wealth take clients next?*

PROPERTY

The value of investing in commercial real estate

Many investors are exposed to the commercial property market, which has been hit hard by the coronavirus pandemic, but the sector has shown its adaptability

Celia Jones

We interact with commercial property every day. From local coffee shops to logistics warehouses packed full of Amazon parcels, commercial real estate forms an integral part of the UK's economy and is regarded as the oldest asset class.

Perhaps surprisingly, many people are exposed to commercial property investment through funds, insurance companies and pensions. "As soon as you tick the real estate option on an ISA or pension, you're a property owner," explains Adam Coffer, managing director of real estate investment firm EPF Group. "It's not just the realms of cigar-chomping barons."

As coronavirus swept through the UK, shops dropped their shutters, offices closed and hospitality venues struggled to stay afloat. Almost overnight, reliable income streams provided by rent subsided.

Many landlords are now facing the prospect of empty properties and long periods without rent payments. It's led some investors to consider whether the impact is temporary or if it signals a greater shift in confidence in the sector.

Retail was profoundly affected by COVID-19 as non-essential vendors closed on and off over the last year. Dr Andrew Baum, professor of practice at Oxford University's Future of Real Estate Initiative, says: "Retail property was in deep trouble years before COVID."

The sector had been damaged by the 2008 global financial crisis and the creep of online shopping. However, Baum is confident there is a long-term space for bricks-and-mortar retail, but cautions: "There is almost certainly too much of it."

He points to the significant changes in high streets during the last decade and the pivot towards service provision, such as nail bars and yoga studios. "Retail generally adapts quite well to changes in demand and clearly there's going to be continued demand for the sort of things you cannot buy over the internet," he says.

Still, creative solutions are required to repurpose some retail property. This was supported by a relaxation of the planning laws in July 2020, which simplified conversion of retail to restaurant, office or residential use. The hope is many vacant high street shops will be converted to much-needed new homes. Government estimates suggest 345,000 are needed a year in England alone, which could breathe new life into once-loved retail and commercial hubs.

However, not all retail property lends itself to alternative use. "Purpose-built shopping centres are not easy to repurpose," says Baum. This is unfortunate given that data from MSCI, which tracks the value of commercial real estate owned by financial institutions, shows shopping centres were hit particularly hard in the past year, forcing its largest operator, Intu, into administration.

If retail's decline was well underway pre-pandemic, leisure was performing adequately, albeit with mixed fortunes. Amy Wood, property economist at Capital Economics, says: "While the leisure sector was benefiting from the trend towards spending on experiences, certain types of leisure, such as food and beverage, were struggling."

But there is confidence that leisure businesses able to weather the COVID-19 storm could trade buoyantly once allowed. Wood says: "There are already early signs that households are willing to go back to pubs and restaurants. And as the remaining virus restrictions are removed, there is plenty of scope for spending to pick up again."

Pubs and restaurants able to reopen safely have witnessed strong demand. In England, CGA Insights compared like-for-like sales in sites that reopened on April 12 to that of the equivalent day in 2019 and they were up 58.6 per cent. Meanwhile, PureGym logged 1 million workouts across its 240 sites in the first week of April's reopening.

An optimistic outlook is shared by EPF Group's Coffer. "You simply cannot replicate the physical experience and environment online," he says. "In attractive locations, such as affluent market towns, suburbs with a strong residential catchment, major city centres and tourist destinations, where consumers have a compelling reason to leave their home, we continue to see leisure property as a growth area going forward."

Data shows suburbs have been more resilient than city centres to COVID changes; what some call the doughnut effect, as centres were hollowed out by office closures and the impact on surrounding retail and leisure. As workplaces offer more flexible working arrangements and evaluate the importance of the office to their business, non-central locations may continue to benefit.

Changing consumer habits in response to the pandemic meant logistics was one the few areas of commercial property that performed well over the last year. Jennet Siebrits, head of research at CBRE UK, says: "Logistics benefited from the massive increase in ecommerce."

Between 2011 and 2019 the value of ecommerce trade mushroomed from £23 billion to £58 billion, but this trend accelerated during 2020 with an eye-watering increase to £84 billion. "This shift in consumer behaviours has a knock-on effect to real estate with an increase in need for logistics warehouses and hubs," Siebrits adds.

Property firm Knight Frank predicts the expansion of ecommerce could drive demand for 92 million square feet of further warehouse space in the next three years. In a sign of the times, etailer Boohoo recently leased a warehouse previously operated by former Topshop owner Arcadia to support its expansion. Meanwhile, Topshop's flagship shop on Oxford Street is currently empty.

> **Tick the real estate option on an ISA or pension, and you're a property owner. It's not just the realm of cigar-chomping barons**

The long-term challenge is the permanence of this boom, which remains to be seen. Dr Steven Devaney, associate professor in real estate and planning, University of Reading, says: "Whether demand for logistics assets grows post-pandemic depends on how the economy rebounds and to what extent shoppers switch back to physical stores."

While the pandemic expedited some anticipated changes to commercial real estate, it has also shown the opportunities and adaptability of the sector in response to such a huge challenge. Alongside the growth of distribution centres to support online deliveries, public reaction to easements tentatively suggests a pent-up demand for experiences that can't be delivered to a doorstep within 24 hours.

As the country prepares for the next stage of lockdown lifting, investors will monitor whether COVID-forged consumer behaviour is here to stay.

PROPERTY FUNDS EXPERIENCED AN OUTFLOW OF MONEY IN 2020

Investment levels in the UK

Open-ended property funds

£291m

outflow

Equities

£10,410m

inflow

Fixed income funds

£7,963m

inflow

Money market product

£3,002m

inflow

Investment Association 2021

ALTERNATIVE INVESTMENTS

Where the rich are putting their money

Collectible, and sometimes unexpected, items are becoming increasingly popular among wealthy individuals looking for new ways to invest their money

Bondarchuk Fight via Shutterstock

Alex Wright

Luxury handbags, fine wines and even trainers, first edition comics and Pokemon cards have become the must-have collectibles for high-net-worth individuals (HNWIs).

Rocked by the coronavirus crisis, which has wiped billions off the value of global economies and financial markets, wealthy investors are now looking to protect their assets and diversify their portfolios.

As a result, HNWIs are increasingly turning to tangible investments such as Bordeaux wines and Hermès Birkin bags, enabled by technological advances such as online auctions giving them greater access to a wider range of asset classes, as well as growing interest from a younger audience.

Designer jewellery and watches have been another much sought-after line, with exclusive timepieces garnering a ten-year waiting list and a market value double that of the retail price from day one.

"In a time when investors are seeking to expand their investments, art, wine and designer items present an opportunity where not only does it promise a possible high return, but it combines with their personal passion," says Kareem Rathore, partner at Hoxton Capital Management. "Exclusive supplies of one-of-a-kind collectibles and rare opportunities all add to the allure of this audience."

Yet, at the same time, more traditional investments like rare whisky have receded in popularity.

> There has been a dramatic increase in interest in the market for luxury handbags and contemporary streetwear

So what is driving this change in investment behaviour and strategy? Which investments hold their value best and what kind of returns can be achieved?

Much of the change in investment behaviour is being driven by social media influencers. Investors see a product they like trending or being promoted by a celebrity on Twitter or Instagram and buy it.

"There is this increasing search for tangible assets going back to the financial crisis of 2007-8 when equities went down and investors switched their focus to fine art, classic cars and the like," says Andrew Shirley, editor of Knight Frank's The Wealth Report. "Added to that was the liquidity provided by quantitative easing, which has enabled them to make many of these purchases."

Designer handbags, particularly limited editions, were by far the most popular investments over the last year, with Hermès bag returns rising 17 per cent, according to Knight Frank. Fuelled by an appetite for relatively affordable luxury pick-me-ups during the pandemic, particularly from collectors in Asia, investors have flocked to buy these essential status symbols.

Handbags hold their value too, with the 2018 Hermès 35 Birkin bag, which sold for \$11,900 retail, now fetching between \$20,000 and \$21,000 at resale. That's a 75 per cent capital appreciation over three years.

Trainers have also soared in popularity, with an autographed pair of Michael Jordan's basketball shoes fetching \$560,000 at auction last year. The market has the potential to reach \$30 billion in value by 2030, Cowen Equity Research estimates.

"There has been a dramatic increase in interest in the market for luxury handbags and contemporary streetwear," says Rachel Koffsky, Christie's international senior specialist, handbags and accessories. "That along with the rise of resale sites, social media and famous collectors, as well as dedicated handbag and fashion museums and exhibitions across the globe, has helped drive this market."

Fine wine is another asset class that enjoyed strong growth in 2020, up 13 per cent, as reflected in the Fine Wine Icons Index. Remaining stable throughout the pandemic, the wine market has drawn in investors as prices have held firm.

A recession-proof investment, fine wine has consistently outperformed the S&P 500 Index in recent decades. Because of its low correlation to the global stock market, its value is unaffected by volatility, instead being dictated by supply and demand.

"Fine wine is inherently scarce, which allows for greater price appreciation than many other assets," says Anthony Zhang, chief executive of fine wine investing platform Vinovest. "It also offers tax-efficient diversification, as investors generally don't have to pay taxes unless they take personal delivery of the wine."

The biggest single cost in looking after fine wine is storage. Sufficient cellar space and climate-controlled environments are required to maintain the wine's flavour and value, and ensure it doesn't mature too early.

Another area experiencing a renaissance is classic cars, which climbed 6 per cent, with Ferraris among the most sought-after models. Over a ten-year period, classic cars as a category has leapt 193 per cent, offering a strong risk-reward for investors.

£267k

The record auction price for a bag, achieved by a Hermès Birkin in Hong Kong in 2017

Christie's 2017

By contrast, the top end of the fine art market has waned in popularity with physical auctions shutting down due to the COVID crisis and no painting selling for more than \$100 million for the first time in years. As a whole, the AMR All-Art Index was down 11 per cent in 2020.

"The volume of all sales that were publicly auctioned at Sotheby's and Christie's was down 26 and 46 per cent on 2019, respectively," says AMR's Sebastian Duthy. "The problem was compounded by the slowing of the supply of quality works as consigners who could afford to wait preferred to sit it out at home."

Whisky's 3.5 per cent decline was mainly due to the volatility of ultra-rare top-end whisky as an investment. That said, a hand-painted bottle of The Macallan stored for six decades in an ex-sherry oak cask recently sold for an auction record of £1.2 million.

The biggest issue with protecting alternative investments such as these is the security costs associated. Then there is the specialist insurance coverage, which can run to the tens or even hundreds of thousands.

"Depending on where your investment is located, you have to factor in protection against natural catastrophes, such as wildfires, earthquakes and hurricanes, transit and humidity controls," says Ginny Hunter, senior vice president at Marsh McLennan Agency Private Client Services. "You also have to partner with a specialist broker and insurer who really understand the asset class and can provide broad and flexible coverage."

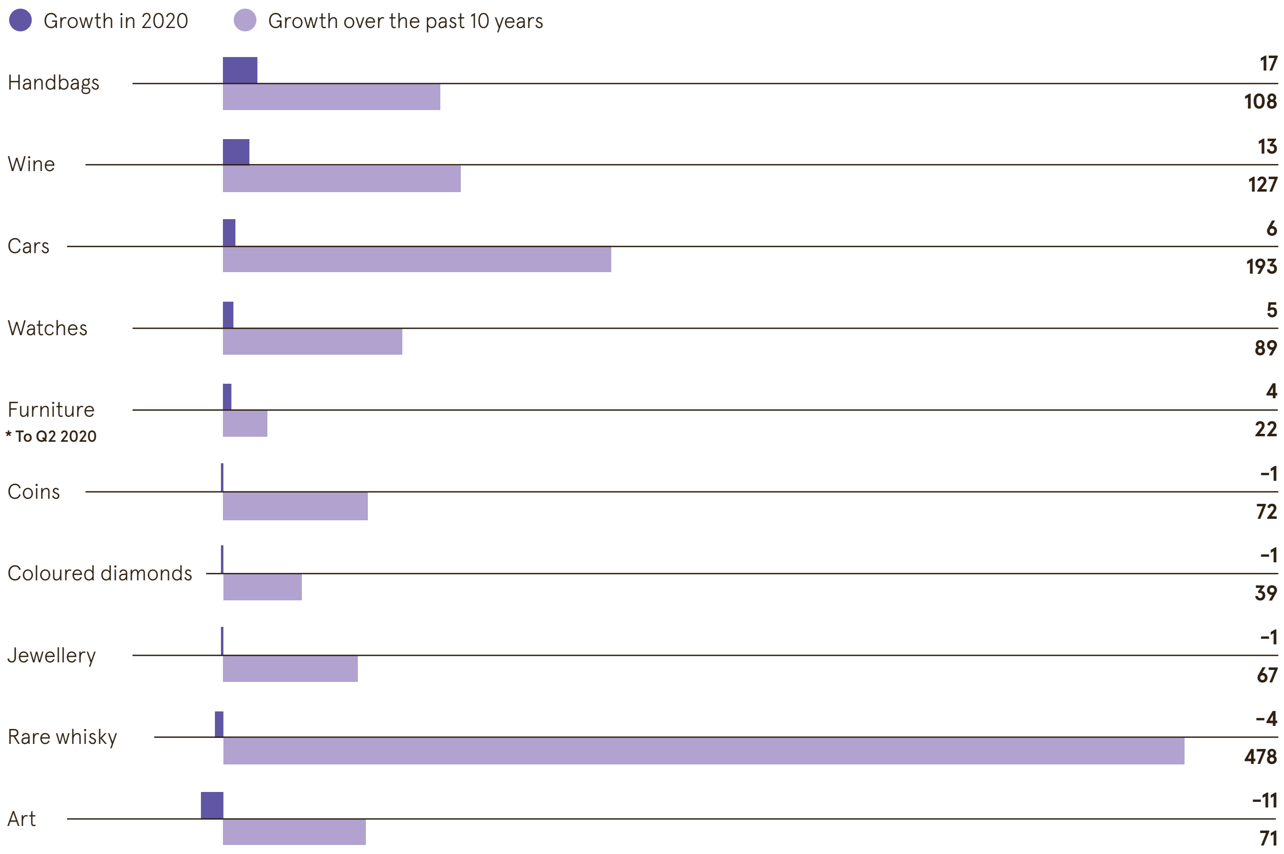
Among investments to watch for in the future is jewellery, notably diamonds. A dwindling natural resource, they are a highly valued asset.

"No new diamond mines have been found for decades," says diamond expert Henry Pruwer. "And with laboratory-grown diamonds increasing in circulation, certified natural diamonds have a special appeal to purists and investors alike."

THE VALUE OF LUXURY ITEMS HELD UP IN 2020

% change in value to Q4 2020

Knight Frank 2021



Commercial feature

Wealth management in times of change

Wealth management firms are accelerating digitalisation in response to historic trends and events

Even before coronavirus disruption, radical changes had been afoot in the private wealth sector for some time. Recovery from the global financial crisis of 2008 was made more challenging by new regulations aimed at preventing a repeat and all the while new upstarts from a burgeoning fintech sector were able to respond to consumers' digital expectations faster. The pandemic then amplified the need for digitalisation in the private wealth sector.

Wealth, in itself, has taken on new meaning, driven by the rise of mass affluent segments in developed economies and a growing middle class in emerging markets. Traditional wealth, as defined by high or ultra high net worth, has also seen major changes through a generational transfer of trillions to millennial and post-millennial generations, who are not only digitally native, but also have different views on money than their predecessors.

Deeper understanding of digital

Digital transformation, albeit much hyped, was previously misunderstood and incomplete. The adoption of "point solutions", which focused primarily on the user experience and at the frontend, did little for integrated, enterprise-wide digital workflows and operational fabric.

True and comprehensive digital transformation affects the highest-level strategy, process design, operations and business models. It radically changes the role of people in front-to-back operations and the way they use technology.

Improving user interfaces or back-office operational efficiency leaves the institutions partly digitalised, but unable to benefit due to disconnects between functions and business units in their levels of digital adoption. Only full, cross-functional, end-to-end digitalisation can ensure return on investment and positive outcomes.

Gaining tangible value from digital change starts by building a reliable, open and consistent digital business data layer, which empowers clients to access their investment information and provides advisers with relevant, real-time and actionable insights to act on.

Secondly, it requires a digital customer experience delivered through the optimal channel mix, enhancing timely and personalised interactions anytime and anywhere. Finally, digital must be a new standard, completing the "open wealth" architecture with digital native business processes.

Digital transformation is a journey, not a destination. There is no end state to the required technological and cultural changes; it is a continuous process of evolving capabilities to meet evolving needs and markets. This makes long-term planning a critical priority, road-mapping phased adoptions and transitions, and optimising resource allocation for maximum outcomes.

Tech vendors must play a valuable collaborative role in this process and Objectway, a digital wealth and asset management technology and services provider, has a track record of assisting wealth managers' strategic digitalisation plans.

All about the customer

The wealth management sector is rediscovering the imperatives of customer centricity. Traditionally providing tailored experiences in a relationship-based business, firms are now adapting to new client expectations in the digital world.

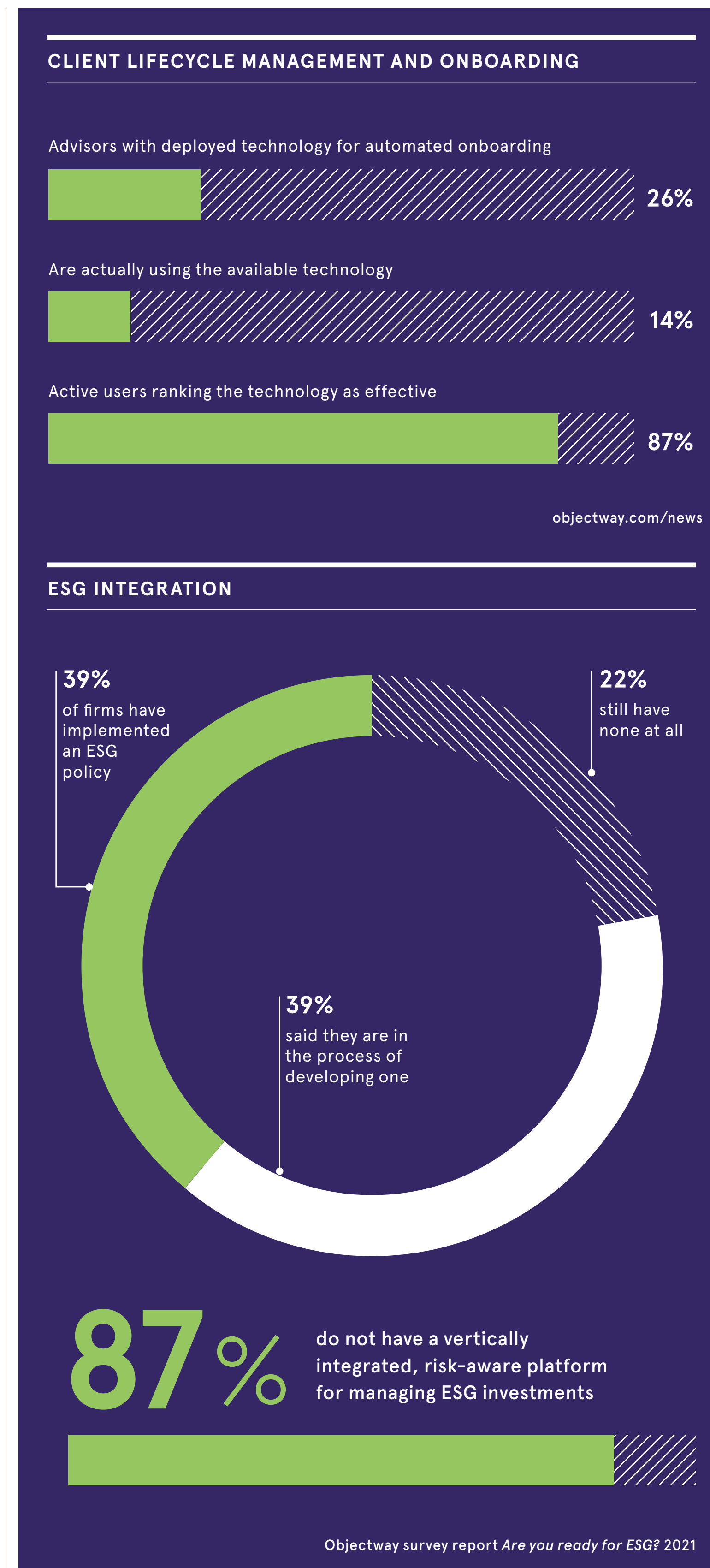
The early months of the pandemic were a wake-up call that excellent in-person service is no longer enough and even a well-designed website does not meet diverse interaction requirements. This realisation triggered a catch-up rush to innovate customer engagement with digital tools and solutions.

Onboarding new customers is a critical life-cycle event that remains a challenge for most firms and a weakness for many. In a recent news release, Objectway reported a Gartner study in which only 26 per cent of advisers said automated client onboarding was available at their firm and just 14 per cent were actually utilising it.

Despite the low adoption, 87 per cent of advisers using the technology ranked it as effective. Best-practice solutions include process-oriented client life-cycle management with advanced digital onboarding, combined with opti-channel and omni-device portals and native apps for superior user experiences.

Managing wealth remains at the core

While the fundamental objectives of wealth management are unchanged – wealth preservation and growth – the requirements are shifting and increasingly complex. Diminishing returns from traditional investments have increased interest in new and alternative asset classes: from real estate and private equity to cryptocurrencies and tokenised assets.



> A modern Investment Management solution must leverage a total portfolio approach to generate alpha in terms of stronger returns and higher quality of investments
>
> Alberto Cuccu, CEO international, Objectway

Sustainability, meanwhile, is no longer a fringe concept. Client interest has placed environmental, social and governance (ESG) investing centre stage, though wealth managers are yet to fully embrace it.

A recent Objectway survey found that only 39 per cent of firms have implemented an ESG policy, another 39 per cent are developing one and 22 per cent have none at all. Nearly 90 per cent of firms said they do not have a risk-aware, vertically integrated platform to manage ESG investments.

A complete solution requires ex-ante analysis of risk and sustainability, validated by ex-post monitoring and relied-on processes that take into account the risk tolerance and characteristics of the end-customer while respecting the sustainability criteria.

Objectway helps wealth managers to achieve higher returns from ESG integration through its end-to-end, risk-aware investment management solution RiskTech.

Wealth and investment management firms are also seeking to move away from decoupled and independent IT systems, and towards a fully integrated wealth ecosystem that handles all business operations.

Such a platform must leverage a total portfolio approach to generate alpha in terms of stronger returns and higher quality of investments. That would typically require a front-to-back open and modular suite providing a digital integrated experience to both wealth management professionals and customers, with a client experience portal, client life-cycle management, artificial intelligence-based portfolio and risk management, and securities accounting.

Objectway's WealthTech Suite won the XCelent award for Breadth of Functionality and for Client Base. Research and consulting firm Celent also commended Objectway's portfolio management and advisory solution, adviser and investor portal and mobile apps, as well as its client life-cycle management and onboarding solutions, saying they are "rich with capabilities that ultimately augment adviser-client interaction, drilled-down automated reporting, adviser efficiency and comprehensive key performance indicators".

Living and operating in ecosystems

Today's interconnected world is made up of fully integrated technology ecosystems and architectures with flexible modular structure and advanced, broad application programming interface (API) capabilities, which enable and enhance operating models like software as a service and business process as a service. The cloud, public, private or hybrid, is the ultimate ecosystem, with Objectway already supporting more than 100 clients with over €1 trillion of assets under management.

On the business side, partner and other stakeholder ecosystems enable collaborative engagement with other solution providers to maximise the value to client firms and their customers. Tech vendors can act as trusted partners of their clients in digital transformation and the delivery of evolving capabilities. This is one Objectway philosophy and strategy, tested in long-term relationships with some of the most successful players in the industry.

For more information please visit objectway.com

FAMILY OFFICES

Private wealth comes under the spotlight

Discreet and private, private offices manage the wealth of some of the world's richest people, but now a scandal has thrust them into the open

Simon Brooke

Even by the standards of high-end wealth management, family offices are discreet and publicity shy. Providing a bespoke, holistic financial service for small groups of ultra-high-net-worth individuals (UHNWIs) who are very often, as the name suggests, members of one family, they had little reason to shout about their dealings.

But now, following the collapse of Archegos Capital, the family office run by Korean-born New York-based investor Bill Hwang, the spotlight has been turned on a sector that had combined assets under management of some $5.9 trillion in 2019, according to a report by INSEAD, the business school. This compares to $3.6 trillion for the entire hedge fund industry. They are growing rapidly too as there are now more than 7,000 family offices, INSEAD calculates, an increase of 38 per cent between 2017 and 2019.

Needless to say, the industry is keen to put the Archegos case into context. "Archegos is far from a typical family office," says Michael Oliver, co-founder of the Global Partnership Family Offices.

"At the end of the 2010s, the United States saw an increase in hedge funds restructuring under the guise of 'family offices' which saw them running similar strategies, but without external capital. This was done to adjust their regulatory burden as family offices have a reduced regulatory requirement because they have no clients to protect from malfeasance.

"To ask whether family offices should be more regulated is the wrong way to look at this; it is impossible to properly define what a family office is and they operate in a wide range of sectors."

Family offices' emphasis on managing intergenerational wealth sets them aside from most other financial institutions in terms of regulation, according to Dr Miruna Radu-Lefebvre, professor of family entrepreneurship and society at Audencia Business School in Nantes, France.

"In the UK, family offices require an authorisation from the Financial Conduct Authority, as they manage investments or investment funds, deal as principal in relation to investments, and provide financial and business advice," she says.

Some in the sector argue because family offices are managing their own money, not that of outside investors, and know the risks they're taking, greater external regulation isn't necessarily relevant. Instead, they should focus on their own corporate governance structures and, with growing competition among multi-family offices, this could be a key selling point.

Christophe Reech, chairman and chief executive of Reech Corporations Group, an investment company that focuses on technology-based solutions, says: "As the scale of family offices has grown over the past few years, so has the business environment, not least rapid technological advancement, regulatory change and greater focus on the external 'purpose' of financial institutions.

"As a result, more have started to look at themselves as businesses, bringing in professionals who can help them manage elements such as data security, compliance, risk management and human resources so internal operations are watertight."

Demand for family office services has not escaped the attention of other financial services firms. "Larger banks are now offering more family office services to cater for this increase, which has led to a debate over whether this creates a truly family office environment or whether it is just an extension of the traditional investment management offering," says Emily Mailer, consultant at law firm Howard Kennedy.

Growth of multi-family offices and their increased geographical spread has implications for governance and regulation. Mailer adds: "We're now a borderless society with money spread across the globe; the family office has to take into account monetary regulations this entails with no single pot of money and standard jurisdiction."

It's not just discretion that makes family offices attractive to UHNWIs. They also appreciate the extra element of control, according to Rami Cassis, founder and chief executive of Parabellum Investments, an international investor and entrepreneur, who operates a family office.

"By setting up this type of business, UHNW investors can have their fortunes managed by a trusted group of financial and legal professionals, who can potentially be briefed to follow specific social or environmental goals as investors look to boost their legacy as well as their bottom line."

The environmental, social and governance, or ESG, agenda is of growing importance to family offices, a trend driven by their changing demographics. Once concerned with old money and inheritance, they're increasingly managing wealth from those who have made their fortunes earlier on in their careers, often in sectors such as technology.

> Rather than just putting money in different asset classes, the new family offices are behaving more like venture capitalists

"As the next generation come to a position of control over their family's wealth, these principles are much more to the fore, with a greater concern over the environmental and social impact of their investments; this is something the family office space has had to adjust to," says Daniel Dickinson, chief executive of AHR Private Wealth.

This new generation is also challenging the traditional family office approach to wealth management. "More entrepreneurs are creating family offices and transforming the sector," says David Newns, who founded his family office after launching and selling two companies to FTSE 100 corporations for around £158 million.

"These are people who successfully built businesses and had a wealth-creation event, such as selling their business. They set up a family office to manage that wealth themselves. And they're bringing an entrepreneurial mindset and skillset that's different to the traditional approach," he says.

"Rather than just putting money in different asset classes or funds, and analysing the financial performance, the new family offices are behaving more like venture capitalists. Deals are increasingly hard to come by, so they're talking directly with specific companies that need capital.

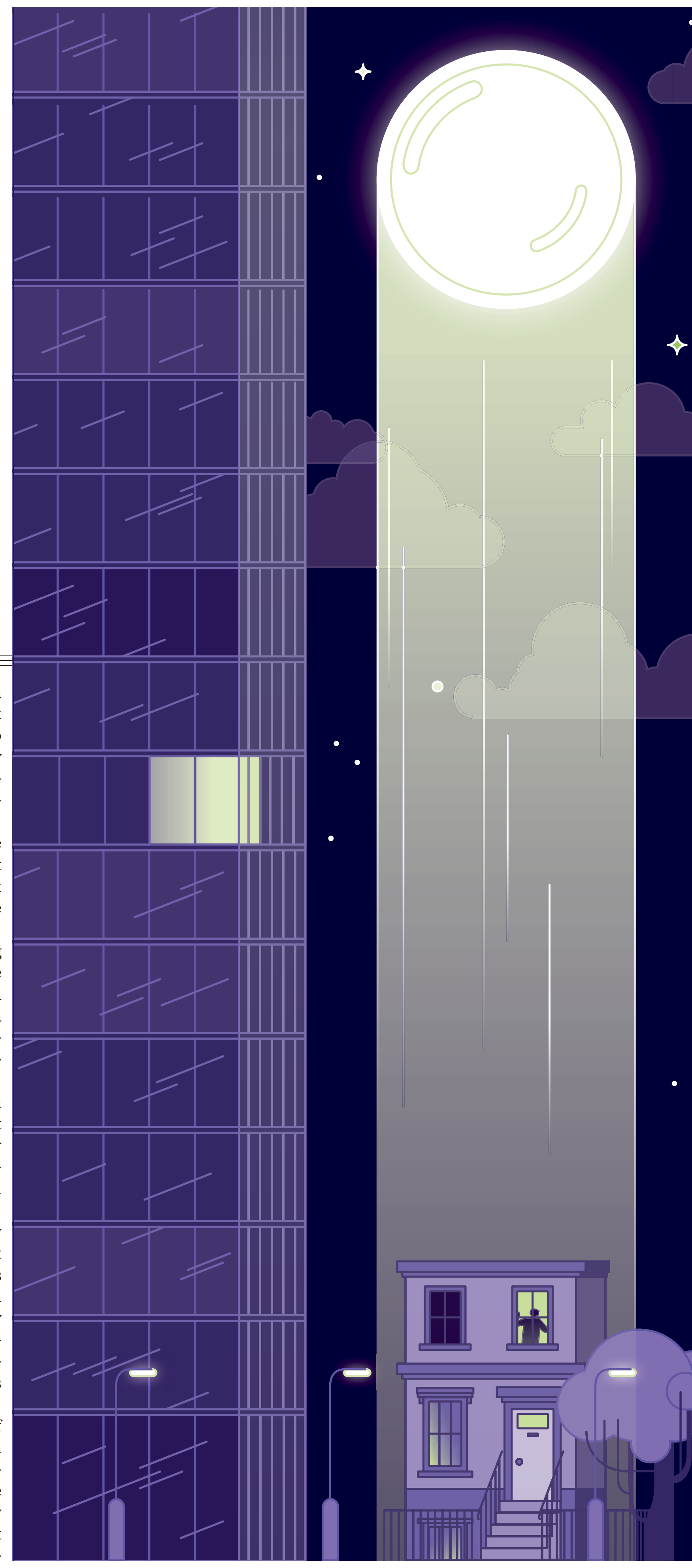
"There'll be a merging of venture capital and the family office. The latter will play a more active and prominent role than ever in the ecosystem of funding."

What kind of lasting effect the Archegos case has on family offices remains to be seen. However, one thing is clear: this highly discreet, exclusive subset of the financial services sector is embracing innovation with remarkable enthusiasm.

$5.5bn

The amount Credit Suisse forecasts it will lose due to to the collapse of Archegos Capital Management

Credit Suisse 2021



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fizkes via Shutterstock

SUSTAINABILITY

Passive versus active: the ESG debate

Can passive funds be truly compliant with environmental, social and governance concerns, and if not does this open up opportunities for a more active way of investing?

Simon Brooke

Two of the strongest trends in investing over the past few years have been the move from active fund management towards passive funds and growth of interest in environmental, social and governance (ESG) issues.

But there are questions over whether the two can be compatible or whether increasing demand for ESG investing represents an opportunity for discretionary or active managers to attract customers.

One of the reasons why ESG investing is only possible with actively managed funds, many wealth managers argue, is because of the absence of well-established, easily verifiable ESG indices.

"This is partly because these issues are complex and there are no concrete definitions," says Tim Cockerill, investment director at Rowan Dartington, an active manager and an early adopter of ESG. "For example, do you exclude BP because of its focus on fossil fuels or include it because it's a major developer of renewable energy technology?"

There are other challenges, as Marc Naidoo, partner at solicitors McGuireWoods London, points out. "An ESG fund might raise cash for ESG projects, but this is commingled with the rest of the firm's accounts. If an investor wants to know their money has been invested into green projects, the fund manager can't be sure exactly how much, if any, has gone to which project," he says.

Another issue with sustainable investing is the broad scope of the term. "Some of these assets might be very small and even if a few thousand of them are securitised into a passive investment fund the interest they pay will diverge considerably," says Naidoo. "It's therefore very difficult to calculate standard rates of return for investors."

Although there are some passive exchange-traded funds (ETFs) in the ESG space, an active investment strategy is crucial to assessing portfolio suitability over the long term, according to Jonathan Hives, managing director of financial planners Arlo Group UK & Arlo International.

"Fund managers need to continually ensure the underlying stocks continue to fit with ESG criteria and this is not something that is usually part of a passive strategy," he says. "In this instance, fund managers would be relying solely on the companies themselves, which can be a much riskier approach."

Active management enables investors to have more detailed conversations with companies about key ESG issues and to explore their records, activities and policies. Many passive strategies are retrospective and only reviewed annually. Active managers can also switch investments more easily.

"ESG-related concerns may warrant divestment from certain companies with significant controversies, or where engagements are unsuccessful, whereas passive funds do not have this advantage," says Ken McAtamney, head of the global equity team and portfolio manager at William Blair.

A lack of dialogue and close scrutiny with companies means passive ESG investors could be missing out on opportunities to invest in companies that don't shout their sustainability credentials, says Melissa Scaramellini, ESG fund research lead at investment manager Quilter Cheviot. She believes that there are increasing opportunities for those interested in the ESG agenda who want to use passive funds.

"Some passive approaches are well thought through and can be appealing as low-cost investment strategies," says Scaramellini. "There are also some interesting passive approaches being launched, for example strategies that align to the European Union climate transition benchmark where a specific reduction in the portfolio's carbon footprint is targeted as well as further year-on-year reductions."

Certainly, passive ESG funds seem to be attracting investors, albeit slowly. According to Morningstar, as of the end of last year, the share of passive strategies in the European sustainable funds market increased from 18 to 22.5 per cent over three years.

There are also opportunities to tackle the challenge of creating well-established ESG indices, thanks to better ESG company data disclosures, according to Maryia Semianchova, director and global manager of research at RBC Wealth Management.

"This enables the creation of more robust ESG methodologies and indices by financial information firms, such as MSCI, FTSE and Sustainalytics, and fuels development of increasingly credible passive ESG options that go beyond simple exclusion screens employed by early versions of green-labelled ETFs," she says.

ESG ETFs have seen a steady but strong growth over the past five years with a notable uptick in the past 12 months. More than half of all new inflows to ETFs at the start of the year were ESG focused, according to Charles Sincock, managing principal at Capco, a technology consultancy with a financial focus.

"This shift, coupled with an increasingly widely held view that ESG is no longer a niche differentiator or asset class, but rather a fundamental investment strategy, and hence should not be overpriced, has driven the popularity around ESG ETFs," he says.

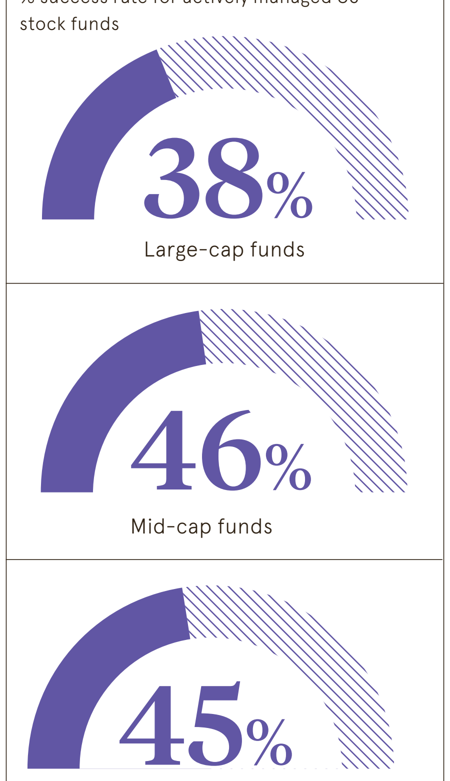
Manuela Sperandeo, BlackRock's Europe, Middle East and Africa head of sustainable indexing, says: "An index-based approach to ESG investing enables investors to implement their sustainability preferences in an explicit and consistent way across their entire portfolio. Index investing is often conflated with a perceived dormancy or lack of flexibility that does not truly reflect the wide variety of ways investors use ETFs and index funds to take control of their investment outcomes."

The company's newly launched iShares S&P 500 Paris Aligned UCITS ETF and iShares MSCI World Paris Aligned UCITS ETF are designed to mitigate exposure to capture opportunities arising from the transition to a lower-carbon economy.

It may be that over the next few years, as ESG investing becomes the norm and sustainability indices continue to improve, investors will be unwilling to pay a premium for sustainability. This will placenew demands on both active and passive funds, but also offer them new opportunities.

THE ONE-YEAR SUCCESS RATE OF ACTIVE FUNDS SLIPPED IN 2020

% success rate for actively managed US stock funds

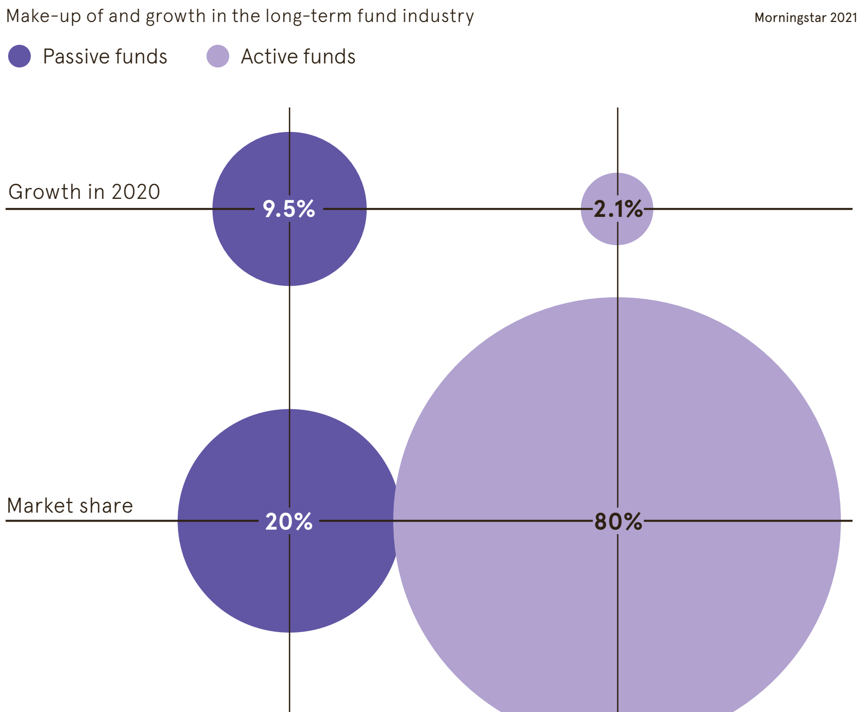


Morningstar 2021

PASSIVE FUNDS' SHARE OF EUROPEAN INVESTMENT HAS JUMPED

Make-up of and growth in the long-term fund industry

Morningstar 2021



Changing face of financial advice

A deep, unique global crisis and ensuing financial turmoil have raised the profile and virtues of proper financial planning, as well as the need for accessible technology to serve a broadening demographic seeking advice

The coronavirus pandemic has accelerated transformation of the financial advice landscape. While many have struggled financially, others are better off and the demographic variation is clear. Young people have been twice as likely to lose their jobs during the crisis, according to research from the London School of Economics, while a Financial Conduct Authority (FCA) study found 14 per cent of adults, mainly in older groups, have seen an improvement in their financial situation, due to low activity and spending through the lockdowns.

The drastic difference in experiences is reshaping the provision of financial advice. Historically the preserve of older, wealthier individuals, a recent report by Prudential discovered the need for financial advice is now felt strongest among younger generations, with 74 per cent of millennials saying they had or were going to see an adviser. That's not to say demand from more mature generations has diminished. For many, the pandemic has brought mortality into focus, leaving them wondering if they can retire earlier or what they need to do to ensure their family are supported.

"We have seen an increase in the number of first-time investors, particularly in the over-50 age group, with more disposable income or savings," says Ian Balgarnie, commercial director at Ascot Lloyd, one of the UK's leading national firms of independent financial advisers. "We have found that the older generation, who've already accumulated wealth, now have more options as a result of reduced spending during the pandemic. However, demands from family may have increased and others are reconsidering their future as a result of what's happened.

"As millennials are increasingly aware of the importance of their savings and being introduced to investing, it is no longer just the mature individual we need to serve. The pandemic has seen people's attitudes and behaviours change and wealth distribution between generations shift, more rapidly than was anticipated. Advisers that are adapting their client approach and innovating their service are succeeding in building stronger, more robust businesses that give clients assurance and continuity."

The demographic shift, along with the necessity of continuing to serve clients during the pandemic, has accelerated the use of technology in the financial advice industry. As a profession built on developing strong interpersonal relationships via face-to-face meetings, often in people's homes, advisers quickly needed to find other ways to speak to clients while maintaining trust. Older generations, both on the client and adviser side, have been propelled into using video platforms like Zoom and Microsoft Teams, which have been crucial to continuing communication during a stressful period.

Short-term market volatility raised concern for many investors, who sought advice and guidance from experts. Often just reassurance was needed and given that doing nothing when markets were plunging was the safest option. While its independent financial advisers (IFAs) have engaged regularly with clients via phone, video and email, Ascot Lloyd has also shared additional insights and expertise through regular e-news bulletins, video blogs, podcasts and webinars. High levels of digital client engagement have shown this is very much the new normal.

"The feedback we've had is that meetings have been more succinct and focused, which has allowed advisers to do more of them," says Balgarnie. "Technology won't replace IFAs, but it will replace IFAs who don't engage with technology. This can only be a good thing, enabling us to adapt and improve the client experience as consumer demands continue to evolve. A trusted adviser relationship with clients is crucial and this won't change; it's just that technology is becoming more of an enabler.

"It's not only about video conferencing, either. When a lot of people look for a financial adviser now, they want to see if you can do valuations and cashflow modelling online and if they can look at their portfolio on their mobile device. They do their research online too through customer review sites like VouchedFor. The emphasis will move away from just focusing on the portfolio valuation to, am I on track to hit my financial goals? It enables deeper planning, as opposed to just product purchase."

The client experience also extends to more administrative tasks, which through automation can free up the time of advisers to focus on their core task, providing financial advice and thereby facilitating a more sustainable business model. Ascot Lloyd has introduced an e-signature solution, for instance, to speed up the client onboarding process, and automated the processes involved in preparing and reviewing documents. Advisers now have a broader range of clients using the various tools available.

Crucially, technology is helping close the advice gap, which widened in 2012 when the introduction of the Retail Distribution Review by the FCA banned advisers from taking commission and forced them to charge upfront fees instead. While the total cost of financial advice has remained broadly the same, the changing pricing model has left millions of people who want financial advice feeling they can't afford it. By embracing technology, financial advice firms can address higher numbers more easily and advisers can take on more clients while still maintaining their valued and trusted relationships.

"The financial advice industry is transforming by creating the potential for faster and more flexible links, which could ultimately improve services, change pricing models and make advice more accessible to a wider group of investors," says Balgarnie. "It has created opportunities for those able to adapt quickly and will determine the winners and losers in the future. Compared to other industries, financial services has been relatively slow in adopting technology, however consumer expectations and experiences of technology in other aspects of their lives is accelerating progress.

The financial advice industry is transforming by creating the potential for faster and more flexible links, which could ultimately improve services, change pricing models and make advice more accessible to a wider group of investors

"Advisers should continue to adapt and understand the demand for technology that is expected from younger generations who want to engage in different ways. As the use of technology becomes evermore intrinsic to everything they do in life, it's understandable this would creep into their expectations when engaging with financial advice too. Financial advice is not a one size fits all and the introduction of a digitally enabled approach is exciting as it will provide a sensible route for the younger generation and less wealthy clients to engage with saving and financial planning early on and provide much more choice."

STRATEGY

Outlook on emerging markets

From the commodity-based prizes awaiting in Brazil and Russia to India's growing importance as a manufacturing hub, the emerging economies present investors with multiple dynamics to navigate

Sam Shaw

The term "emerging market" was coined in 1981 by Antoine van Agtmael of the International Finance Corporation, almost as an afterthought.

His team was launching a product tracking ten local stock markets – Argentina, Brazil, Chile, Greece, India, Jordan, Korea, Mexico, Thailand and Zimbabwe – when an investment banker from J.P. Morgan warned their planned label, Third World Equity Fund, might meet resistance. Van Agtmael agreed. After a weekend pondering alternative options, the new moniker was born.

Definitions are far from fixed. Finance company MSCI defines 27 countries as emerging markets, while at FTSE Russell it is 19 and the International Monetary Fund names 23 nations. Countries will also be promoted or relegated from year to year in line with economic progress.

The coronavirus pandemic hit the planet with the most indiscriminate crisis since the Second World War. Yet on face value, you could be forgiven for comparing the performance of emerging and major developed markets, and seeing the former as having had a better 2020, relatively speaking.

The MSCI Emerging Markets Index gained 18.31 per cent in 2020, against the MSCI World Index's 15.9 per cent, outperforming it for the first time since 2017.

While corporate governance remains a concern, T. Rowe Price investment specialist for capital markets Ritu Vohora sees huge progress.

Most emerging markets are putting in place regulation and codes of conduct to raise and maintain standards. As responsible investing continues its exponential rise, even state-owned enterprises, common across emerging markets, are being held increasingly accountable.

Vohora sees China, for example, putting concerted efforts into its shareholder agenda, prioritising carbon neutrality and raising its transparency game, which are essential to truly compete on a global stage.

There are several reasons for optimism, according to Tom Stevenson, investment director at Fidelity. As the world releases from lockdown and international trade and travel resume, exporters and commodity producers will be key beneficiaries.

In emerging market exports, China leads, but Stevenson also names South Korea and Taiwan as well placed to profit from the general economic uptick.

The other major theme on the horizon is the hotly tipped commodity supercycle, which is an extended period demonstrating above-trend price movements, a concept only seen a handful of times in the past 100 years.

Stevenson draws a parallel between the massive fiscal stimulus imparted by the US government with previous supercycles. In the 1960s, President Lyndon Johnson's 'war on poverty' saw a widespread social welfare programme, directing money at low-income households. A similar approach is taking place today, given US president Joe Biden's $1.9-trillion stimulus programme.

"When you give money to people that haven't got much, they will buy stuff. Material goods, fridges, cars: all very commodity intensive. That drove the commodity boom in the 1970s. We saw the same thing in China in the early-2000s, with the big rise of the middle class there, and we may be about to see something similar," says Stevenson.

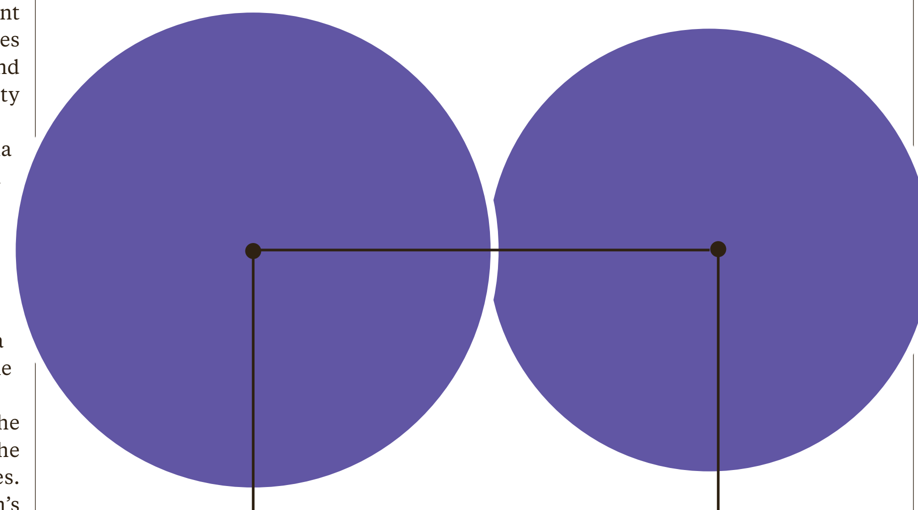
Brazil and Russia might lead commodity production, but the opportunity maps across Latin America, with fourth-quarter 2020 export prices more than double those posted globally.

The commodity story feeds into a broader trend behind the expected rotation towards emerging markets: the move from growth to value already being witnessed.

Early-stage economic recoveries tend to see value-biased, cyclical sectors perform well. Vohora flags Latin American commodities and the big Russian energy names, while financials, such as Russia's SberBank, will also be clear winners.

EMERGING MARKETS OUTPERFORMED DEVELOPED MARKETS IN 2020

Percentage growth of markets index in 2020 — MSCI 2021



18.3% MSCI Emerging Markets Index

15.9% MSCI World Index

> When we talk about emerging markets, we're talking 80 per cent about Asia. It is no longer driven by Brazil

"The main point is, when we talk about emerging markets, we're talking 80 per cent about Asia. It is no longer driven by Brazil," she says.

While China may be the jewel in the emerging market crown, countries like Vietnam could be seen as the rough diamonds as Western companies look to diversify supply chains away from China, due to trade wars but also the pandemic.

Many emerging Asian exporting countries have seen global supply chains disrupted, but those reliant on hospitality – Malaysia, Philippines and Thailand – could enjoy a rebound following vaccination rollout and a more settled travel outlook, says Teodor Dilov, funds analyst at investment platform Interactive Investor.

Vietnam has been on the "subs bench" since 2018. Technically still a frontier market, the country fell short of FTSE's emerging criteria once again in 2020, yet still features heavily among emerging market portfolios whose managers have a more forward-looking eye.

Jorry Nøddekær, who leads Polar Capital's emerging markets growth franchise, has tracked these regions for more than 20 years. He sees Vietnam as among the most exciting risk-return trade-offs, with a strong demographic profile and urbanisation drive helping its bid as a more cost-effective manufacturing hub than China.

One feature of Vietnam, setting it apart from its peers, is its focus on education. "With a strong bias towards natural sciences, their education level is higher than many other emerging Asian countries. I'm not saying they will become the new Taiwan or Korea overnight, but they appear to be on a different path to the likes of Indonesia or the Philippines, for example," he says.

While India has suffered badly from COVID, the nation's role as a manufacturing hub continues to increase, finally offering Indian people alternatives beyond the niche of IT engineering at one extreme and agriculture at the other.

But with this comes pressure on prime minister Narendra Modi to create jobs or India's demographic profile will remain a huge untapped resource that could then become a liability.

"That's the potential Black Swan event: to literally have a lot of young, angry men without jobs, which could be a future risk for social unrest," says Nøddekær.