WEALTH & ASSET MANAGEMENT

FINANCIAL INSTITUTIONS

New returns: banks move back into wealth management

Banks are switching their emphasis from investments and high-street operations to wealth management. What are the implications for clients and smaller wealth managers?

Simon Brooke

As the traditional banks deal with the threat posed by digital disruptors and the bottom-line effects of historically low interest rates, a growing number have been pouring resources into a new opportunity: wealth management.

Many big banks had stopped providing financial advice – except to the wealthiest clients, since they could afford to pay for it – nearly a decade ago after the *Retail Distribution Review* (*RDR*) resulted in the banning of commission payments. Their retrenchment encouraged the growth of specialist wealth management businesses such as St James's Place and Hargreaves Lansdown. But several banks have since come to see the provision of more personalised advice, supported by technology, as a way to differentiate themselves from the so-called robo-advice offerings that cater more for the mass market.

There are financial advantages in this for the banks. Managing wealth avoids many of the cyclical risks and uncertainties of corporate and investment banking. Instead, it provides a more predictable earnings pattern, benefiting from a lower capital intensity, and delivers attractive recurring revenue streams.

Lloyds (for which each 0.25 percentage-point cut in interest rates removes almost £150m from its annual net interest income) is a case in point. It has been widely speculated that concerns about Lloyds' reliance on consumer banking have prompted it to announce the expansion of its wealth management arm under the Scottish Widows brand. Meanwhile, Credit Suisse revealed plans to dial down its investment banking operations and focus more on its wealth management business, where it's seen as having a strong global franchise. China is expected to be a target region for Credit Suisse's wealth management roll-out.

> **The regulators might want to consider new measures to ensure that there's adequate competition here**

Earlier this year BlackRock announced that it had had its plan approved to start a wealth management business in China in collaboration with China Construction Bank and Singapore's state fund, Temasek.

BlackRock is also working with Coutts to expand the bank's wealth management offering. November saw the creation of six new exclusive funds for the 12.5 million clients it serves across the wider NatWest Group. This arrangement comprises three active funds and three index funds with the objective of further reducing the costs of investing, building efficiencies in how Coutts manages clients' assets. This is the latest development in Coutts's ongoing wealth enhancement strategy, enabling it to meet more client needs, at scale, according to the bank. The product is a part of Coutts' assets-under-management growth strategy and a key element of NatWest Group's plans for its wealth businesses.

The success of UBS's wealth management division – which in October reported a year-on-year increase in its pre-tax profits of 43% – demonstrates the appeal of this activity. The bank has plans to expand its US wealth operations with a digitally scalable advice model.

In the summer, Deutsche Bank poached a team of five wealth managers from UBS to develop its Swiss-based private banking business for wealthy British and Northern European customers.

"We will see M&As in this space, with some smaller wealth managers disappearing," predicts Professor Tapas Mishra, head of banking and finance at Southampton Business School. "So the regulators might want to consider new measures to ensure that there's adequate competition here."

For the Personal Investment Management & Financial Advice Association, a body that represents wealth managers of all sizes, the key consideration should be how to preserve competition and the quality of guidance available to consumers.

"We need more advice to be available now than ever, especially with developments such as pensions freedoms," argues the association's director of government relations and policy, Tim Fassam. "The more players in the market, the better."

Where does this leave smaller players? "They're more likely to focus on bespoke offerings and to specialise in their local area – people still want that personal contact and that local connection," he says.

As this market becomes more crowded, banks are already looking to differentiate their offerings. Michael Morley, CEO of Deutsche Bank UK Bank and head of its wealth management arm in this country, explains the approach his company takes.

"When we are targeting ultra-high-net-worth clients, we focus on our core strengths in lending and investments. These include bespoke risk management strategies; access to alternative investment routes such as venture capital and sophisticated investment solutions for professional clients; high-end real estate; complex lending collateral solutions; and leadership on sustainability issues."

But there are challenges to deal with. Where, for instance, will these banks find enough advisers with the requisite skills? Many lost their jobs when the *RDR* prompted the largest banks to move away from advice, so talent will be in short supply.

Christian Scarafia, MD and head of northern Europe bank ratings at Fitch Ratings, offers some other words of warning, noting that wealth management tends to have a relatively high cost base, because it's labour-intensive and requires a lot of investment in compliance and control frameworks.

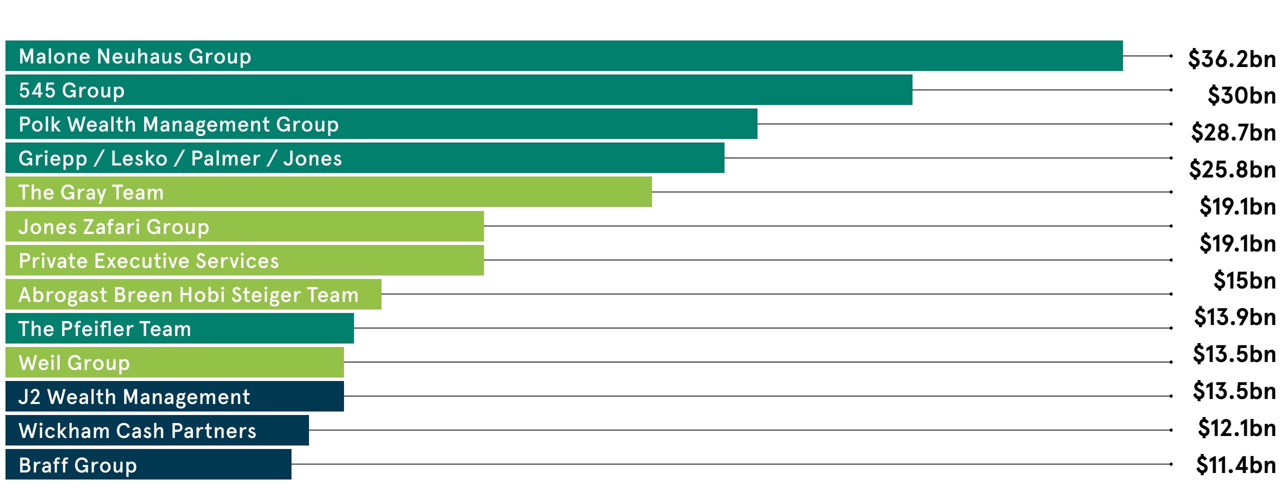
"Although wealth management revenues are generally seen as relatively stable, they are linked to conditions in financial markets," Scarafia adds. "A correction in asset prices would result in a reduction in assets under management and in fees linked to these volumes. Lower investor appetite for riskier assets (which tend to generate higher income) or for financial transactions (which can generate extra revenue for banks) would affect the profitability of wealth management activities, which means that the profitability of this business is not insulated."

But the banks are generally sanguine about their prospects. "The overall long-term trend for wealth management growth remains incredibly strong as new wealth is created and the overall number of wealthy individuals increases," Morley says. "How these clients are served and advised will be a fascinating area to watch, as the increased use of digital channels drives innovation in service models." ●

MORGAN STANLEY, BANK OF AMERICA AND UBS OWN THE LARGEST PRIVATE WEALTH TEAMS

Barron's, 2021

Largest private wealth management teams in the US in 2021, by client assets



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Pandemic fuels rise in social impact investing

Green bonds have given investors opportunities to finance a variety of environmental projects. Now the burgeoning social bond market is doing the same for a range of projects that could improve social outcomes around the world

Concerns about climate change and the need to reduce carbon emissions have helped the green bond market grow to $1.2tn; the coronavirus pandemic might have a similar impact on the growth of the social bond market. Last year, social bond issuance hit $257bn, according to Climate Bonds Initiative data—more than four times what had been issued in the previous 14 years combined.

"The Covid-19 pandemic was a social crisis which broadened investor's attention from seeking just positive 'environmental' outcomes from their investments, to encompass some of the social impacts of the pandemic, such as health, education and employment, which are all social elements" says Simon Bond, executive director of Columbia Threadneedle Investments' responsible investment portfolio management, where he manages the Threadneedle UK Social Bond Fund.

"Where we used to think in terms of the 'E' and the 'S' of ESG as being almost separate, you really shouldn't separate the two—if we get the environment wrong, it's going to create some of the worst social consequences. We need to make sure that the cost of that transition is not borne by those in society least able to afford it."

While the broader sustainability debt market has seen a growth in the flavour of bonds—such as sustainability-linked bonds (where interest payments are linked to certain ESG targets), blue bonds (which finance ocean-related sustainability projects) and transition bonds (which help borrowers fund their transition to a low-carbon economy)—the social bond market is also seeing a wave of innovation.

"Covid-response bonds were developed out of what were originally green and social bond principles and sustainability bond guidelines, but they target the clear and present danger of the health crisis," says Bond.

Bond has also been involved with the International Capital Markets Association's Social Bond Principles Working Group, which is seeking to encourage new bonds to finance social projects.

"We recently focused on encouraging the issuance of gender bonds, which invests in women-led businesses or initiatives promoting women in the workplace," he says. "This is what the Threadneedle UK Social Bond Fund is all about, trying to focus on additional benefits for society and on inequalities and deprivation, while also providing returns for investors."

That focus on channelling cash to projects in underfunded areas is something that the UK's green gilt programme is also supporting.

"This is pushing boundaries in terms of where you can go with green bonds, because it encompasses the concept of social co-benefits," says Bond. "So 100% of the money is going to go into green infrastructure and green projects, with the co-benefit of creating things like green jobs and social benefits in deprived areas."

Bond says it is vital that the market develops products that deliver on their promises so there is no risk of 'social washing'—the social equivalent of greenwashing.

> **Covid-response bonds were developed out of what were originally green and social bond principles and sustainability bond guidelines, but they target the clear and present danger of the health crisis**

One initiative Bond is working on is to ensure use-of-proceeds bonds—where the cash is earmarked for a specific purpose—don't just fund the projects, but actually make a difference to the target population. This means ensuring 'confirmation' as well as 'verification'.

Given the market remains in its relative infancy, Bond is aiming to ensure Columbia Threadneedle helps set the standard for benchmarking social bond impact.

"One of the things we look at within our fund is this concept of social intensity, or the value of the benefits," says Bond. "Within sustainability markets there has been the development of a common language that tends to reference the United Nations' Sustainable Development Goals (SDGs). We map every bond in the portfolio to its primary SDG using the 169 targets that underlie the 17 SDGs. These standards are much more granular."

In the future, Bond believes the potential impact of social bonds will be measured by 'ABC' categorisation used by the Impact Management Project.

"This is 'A', act to avoid harm; 'B', benefit stakeholders; and 'C', contribute to solutions," he says. "Again, we are mapping every bond we have in the portfolio to those classifications. We've translated what we're doing in the fund into a common language for sustainability and impact, so you can start to compare what we're doing with other asset classes and with other funds. That is something that needs to be developed equally."

The market also needs to establish a social taxonomy to improve consistency and make it easier for investors to understand what they are buying.

"We have already seen the green taxonomy create a much more commoditised market," says Bond.

Taking these steps will ensure the market continues to grow and that impact bonds will help fund projects that benefit those in society who need it most. This is what will enable investors to make a real social impact.

$1.2tn

the size of the green bond market, with growth driven by concern over climate change and carbon emissions

Climate Bonds Initiative,
Sustainable debt summary, 2021

$257bn

the value of social bond issuances in 2020—more than four times the total value issued in the previous 14 years

Climate Bonds Initiative

Q&A

How active managers are effecting change through ESG engagement

Columbia Threadneedle Investments' head of UK equities, **Richard Colwell**, and analyst **Michael Hamblett** explain why working with companies on environmental, social and governance (ESG) issues can generate long-term value for shareholders

Q The UK's FTSE 100 is dominated by fossil fuel, mining and financial companies—how challenging is that index composition from an ESG perspective?

MH BHP's exit from its petroleum business and its potential exit from the index may accelerate a trend that we've seen over the last few years: companies are becoming 'greener' and more ESG friendly. We invest actively, which means we select the companies that we invest in, rather than holding a portfolio that matches the returns of the index. This allows us to put more into those companies that are moving toward sustainable solutions or have stronger ESG credentials. The UK economy and stock market are evolving from an ESG perspective and there are good opportunities to find companies with these credentials.

Q How important is it to partner with companies to improve their ESG standards?

RC Most of our clients are people saving for their future and their retirement. We are looking to invest in companies that will provide good, sustained investment returns over the long term. Being active shareholders or 'stewards' of companies is an important part of our investment approach and we can add value for our clients by being shareholders that are fully engaged with company management teams.

We want to leave companies stronger after we have invested in them. If we feel there need to be changes in management or we support a restructure of a business, that's something we'll be involved in. This approach has added a lot of value over many years. We are very passionate about this. We're owners of businesses and therefore we're prepared to invest for the long term, locking away shares in companies where we have meaningful stakes. This gives us an edge when engaging with potential activists, the board and their advisers.

Q What makes the UK a good market for engaging with ESG issues?

MH Companies in the UK are very open, so the engagement opportunities are always there. Obviously, it helps when we have larger stakes in companies, but UK reporting requirements mean that companies are transparent. Reporting is clear, the disclosures are good and it's not just management that we have access to—it's the chair and the other board members. We're also increasingly engaging with the heads of sustainability, who are appointed within the company to speak to shareholders about the issues that we've been talking about for a long time. It's good that within companies there is now a dedicated person to speak to about these things.

Over the last few years it's all coalesced around the common buzzwords, 'ESG' and 'sustainability'. For us, we don't think the wave of interest in ESG is a new thing—it's part and parcel of strong corporate governance, which the UK market has offered for a long time through initiatives such as the Financial Reporting Council's Stewardship Code. UK companies engage with a degree of openness that doesn't happen in every market around the world.

Q In what ways can you hold companies to account if they don't meet their ESG targets?

MH We've spoken about the importance of engagement, but this is crucial when it seems like every company is hanging their hat on their ESG and sustainability credentials. Active, engaged investors like us are needed to challenge management to see if their targets and claims are credible, transparent and true drivers of business success. This is critical as we see more and more companies tying their CEO's pay to ESG and sustainability targets. These can be fantastic drivers of change, but could also lead to soft targets, which is something we don't want. As Richard said, we've been involved in board, management and strategy changes at many companies. We don't shout about it, but it's a central part of being an active and engaged investor. This is especially true in the UK market, where we see clear sustainability and ESG-related valuation opportunities at some companies that are unrealised.

Q Given the UK market's underperformance over the past five years, why is now a good time to invest in UK listed companies?

RC In a world of very low interest rates and a desire for growth, investors have been lured away from UK equities. Combined with this pull away from UK equities, we've had more than five years of uncertainty around the Brexit negotiations. That was the prelude and then Brexit almost felt like the final straw for UK equities. But I think you've got to take a step back and think: trends tend to overshoot on the way up and on the way down.

Although it's been a long period where UK equities have struggled, relatively, in a buoyant global equity market, that creates a fantastic opportunity. There's a resulting valuation cushion; the opportunity cost of other markets looking expensive. You don't need things to go brilliantly, just less bad. There's quite extreme behaviour in markets outside of UK equities and I think the real calling card is that investors with a different lens—like private equity and overseas corporates—are starting to be attracted by the valuation opportunities in UK equities.

For more information, please visit www.columbiathreadneedle.co.uk

COLUMBIA THREADNEEDLE INVESTMENTS

MANAGING WEALTH AMID UPS AND DOWNS

Wealth managers are always looking for better ways to balance risk and returns for their clients. With fixed income increasingly playing a secondary role in private wealth portfolios, managers are seeking investments that mitigate the impact of inflation while also maintaining strong returns through equity. If you invested £1m in December 2020, how would it have performed throughout 2021?

Terra was one of the strongest performing cryptocurrencies in 2021. As of 9 December 2021, its year-to-date performance was

+11,844.10%

Terra's value has ballooned since August. It now has a market cap of

£16bn

Coinbase, 2021

THE BEST AND WORST PERFORMING STOCKS OF 2021

As of 14 December 2021

GameStop (NYSE: GME)	+966.35%
General Electric (NYSE: GE)	+729.07%
Range Resources (NYSE:RRC)	+149.79%
Macy's (NYSE: M)	+140.04%
Fortinet (Nasdaq: FTNT)	+139.57%
Arista Networks (NYSE: ANET)	-53.10%
Intuitive Surgical (Nasdaq: ISRG)	-57.29%

Trading Economics, 2021

HOW MAJOR ASSETS FARED IN 2021

Data adapted from Market Watch

Changes in the price of assets between 9 December 2020 and 8 December 2021 or 9 December 2020 and their 2021 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 2021 peak (£k) · 52-week high · 52-week low

Ashtead Group plc was the FTSE 100's best performer in 2021. Trading at

6,442p

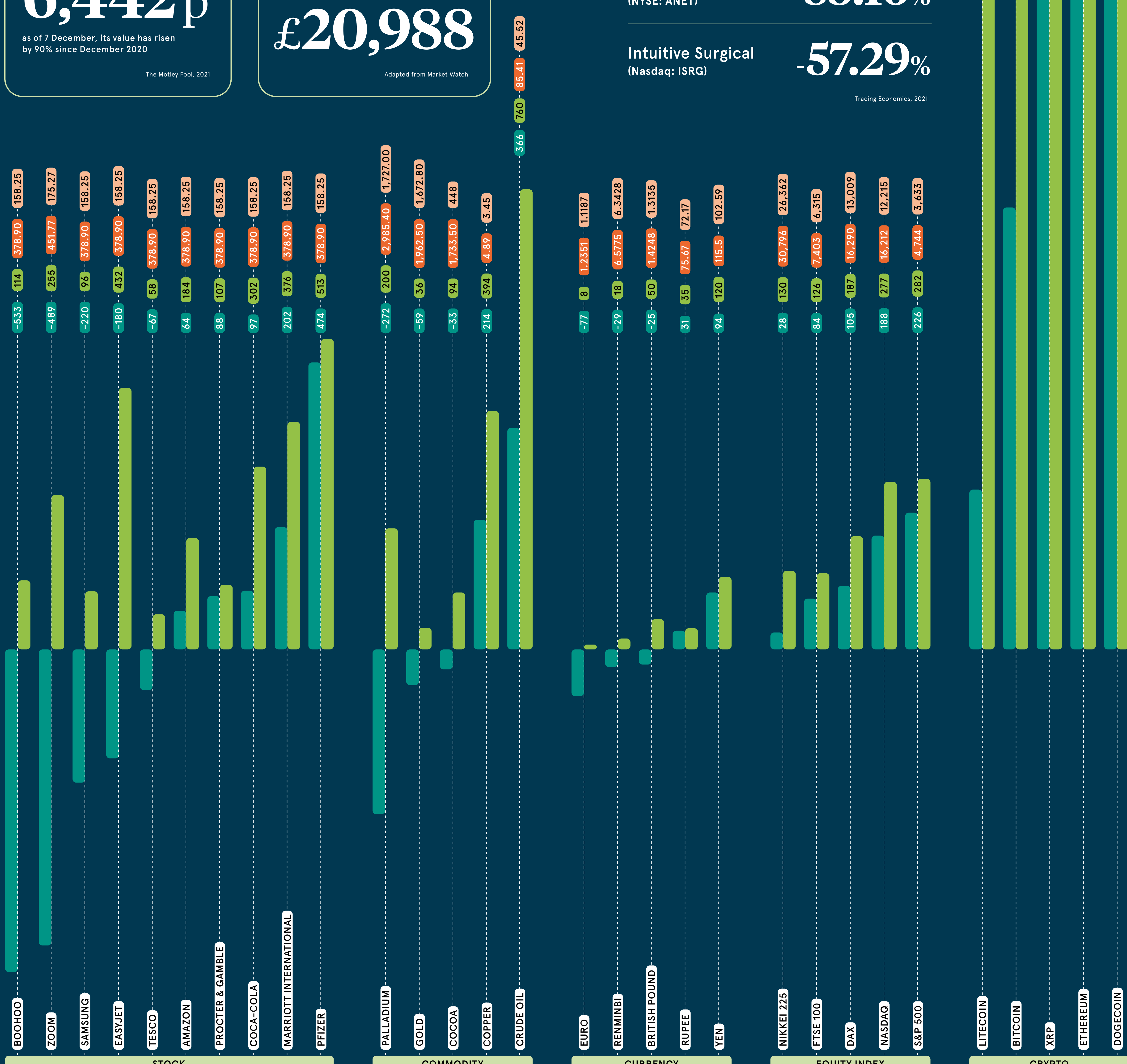
as of 7 December, its value has risen by 90% since December 2020

The Motley Fool, 2021

With £1m invested evenly in a basket of emerging market currencies comprising Brazilian Real, Russian Ruble, Indian Rupee, Chinese Renminbi and South African Rand, you would have made

£20,988

Adapted from Market Watch



ETHICAL INVESTMENT

ESG portfolios offer principled profits, yet greenwashing concerns persist

There is clear evidence to show that ethical investing can improve returns. But some firms may be claiming to be more virtuous than they really are


seksan Mongkhonkhamsao via Getty Images

Daniel Thomas

Ethical investing has become a driving force in the world of finance, with clients demanding high performance from their investments against environmental, social and corporate governance (ESG) standards. Despite this, the market is still relatively immature, with a lack of consensus on how ESG should be defined and measured.

Every year, more and more money flows into funds that claim to be ESG-focused. The value of all ESG assets under management (AUM) worldwide surpassed $35tn (£26tn) in 2020. That was a third of total AUM and up from $22.8tn in 2016, according to the Global Sustainable Investment Alliance.

At one time, the received wisdom was that profits and principles didn't mix. But a growing body of evidence suggests that firms with good ESG practices tend to outperform their less ethical peers. When S&P Global Market Intelligence tracked 27 US-based ESG funds between December 2020 and May this year, it found that 16 of them outperformed the S&P 500 index. The funds – which each featured more than $250m in AUM – rose between 11% and 29.3% during that period, versus 10.8% for the benchmark.

> **We are finding a need for constant innovation in processes, data and systems**

It's clear that investors expect companies to take a stand on issues such as climate change and workers' rights – a trend that's been strengthened by the pandemic. Nearly a third (32%) of UK investors polled this year by ethical bank Triodos said the Covid crisis had motivated them to explore investing in an ethical fund. In 2020, the figure was 22%.

Stuart Kirk is global head of responsible investments and research at HSBC Asset Management, which has $621bn of AUM. Its data, which covers the past 10 years, shows that in the US, Europe and Asia (excluding Japan), a long-only portfolio of the top 30% of companies ranked by ESG score, equally weighted and rebalanced monthly, produced excess risk-adjusted returns, he says.

"Over time, as this story becomes better known, we believe that ESG strategies will comprise a growing proportion of outstanding assets," Kirk adds.

Despite the promise of ESG-linked investing, there are caveats. It's hard to measure the real impact of such investments, while there's also a lack of widely agreed definitions of ESG. This allows some firms to present themselves as more ethical than they are by engaging in so-called greenwashing.

Listed companies are still permitted to decide how much information they disclose about their ESG performance to the market. Many report selectively, critics say. Ratings agencies offer independent assessments, but they must work with the information available to them and can therefore be imprecise.

This has led to some striking anomalies. For example, oil companies have appeared in the holdings of ESG investment funds because they've invested heavily in renewables and so have high clean energy scores. The fast-fashion retailer Boohoo was also popular with ESG funds until it was caught up in a worker exploitation scandal in 2020. The company, which said at the time that it was unaware of the alleged abuses in its supply chain, had been rated highly by agencies for its treatment of workers.

Cathrine De Coninck-Lopez is global head of ESG at Invesco, an investment management firm with $1.5tn in AUM. She says that the ESG market "suffers from lack of common definitions, interpretations and education", while reliable information is hard to come by. "In addition, it is a fast-moving area that's trying to match issues such as climate change, biodiversity, diversity and human rights to a more traditional and, in some ways, arms-length financial services industry. We are finding a need for constant innovation in processes, data and systems."

Well aware of these problems, regulators are seeking to change the rules on reporting, with the EU's Sustainable Finance Disclosure Regulation and the UK's Sustainability Disclosure Requirements. De Coninck-Lopez hopes that "a common baseline" will help to set a minimum standard for the sector.

But many newcomers to ESG find the myriad approaches taken by funds bewildering. There's an alphabet soup of ESG strategies on offer, ranging from negative screening and socially responsible investing to impact and sustainable investing.

The most popular approach is known as ESG integration, whereby ESG criteria are incorporated into investment decisions to help enhance risk-adjusted returns, regardless of whether a strategy has a sustainable mandate or not. This is a lighter-touch approach than, say, impact investing, which measures environmental and societal outcomes against specific key performance indicators but may not generate such reliable excess returns.

Integration chimes with what many investors want, research suggests. About 90% of HSBC Asset Management's ESG assets are treated this way, according to Kirk.

For someone looking to invest in ESG, it's crucial to understand whether they're investing in such factors primarily because they believe the approach generates excess returns or whether they're doing it solely with responsible objectives in mind, he says. "These are two very different ideas about ESG – and they are not always aligned."

For now, investors must do their own research on whether an ESG investment is right for them. Scepticism is growing about how virtuous investments really are, which could limit the sector's growth potential. According to Triodos's research, 26% of consumers who say they would not currently invest in an ethical fund also question how ethical many ESG investments truly are – up from 17% in 2020.

Yet, while concerns about greenwashing may be valid, the very fact that some firms feel they must pretend to be ethical shows just how much attitudes have changed. With every passing year, listed companies face growing pressure to act more responsibly.

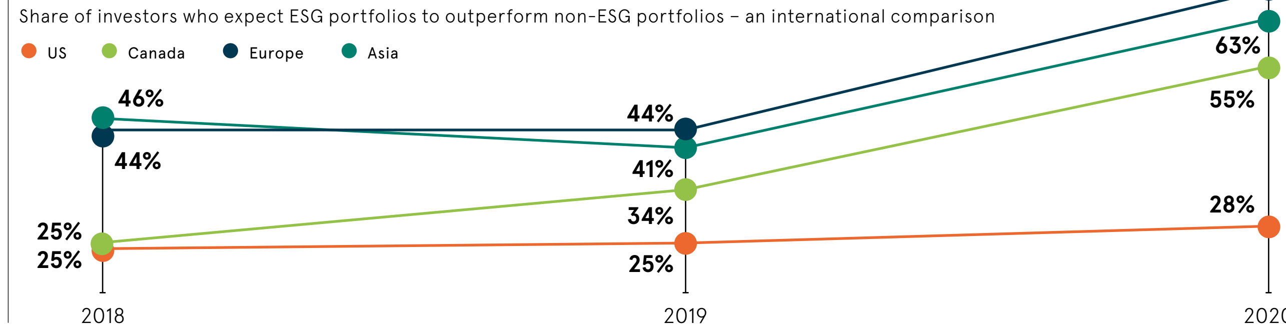
Those who shirk such obligations pose a growing risk to their investors, according to Ainslie McLennan, head of UK balanced funds at Nuveen, a fund manager with $1.2tn AUM. For example, as we shift towards a low-carbon economy, investments in fossil-fuel-intensive assets will lose value at some point, she observes.

"It's hard to identify exactly when that will happen, but there's an obvious danger," McLennan says. "Conversely, assets with a clear pathway to net-zero carbon present the greatest potential for long-term value growth. Ethical investment therefore seems to present better risk-adjusted returns."

CONFIDENCE IN ESG-LINKED INVESTMENTS HAS BEEN GROWING

Royal Bank of Canada, 2020

Share of investors who expect ESG portfolios to outperform non-ESG portfolios – an international comparison



INVESTMENT STRATEGY

How to manage the risk of lasting inflation

The Bank of England believes that the recent burst of inflation will be short-lived. Even so, it makes sense to prepare for more than a temporary spike


Richard Drury via Getty Images

Alec Marsh

Is the UK’s sudden bout of inflation a temporary condition or something more serious? Either way, investors and wealth managers should prepare themselves for difficult times.

Inflation is expected to hit 5% next spring. The Bank of England thinks that it will start falling thereafter, returning to near the target of 2% in two years’ time. Even so, the annualised rate of inflation for 2022 will probably be higher than it’s been since 1992 – the year of Black Wednesday, when the UK was forced to withdraw from the European exchange-rate mechanism.

Inflation can be catastrophic, so it’s welcome news that independent economists seem to concur that the Bank is about right. This isn’t a permanent shift, they believe, although risks remain.

“In the sense that the forces which are initially causing this inflation are temporary, I think that’s a fair point,” says Rory MacQueen, principal economist at the National Institute of Economic and Social Research. The institute expects that inflation (measured by the consumer prices index) will hit 4.4% next year and 3.4% in 2023 before falling back below target in 2024, conditional on base-rate rises in 2022 and 2023. It forecasts annualised GDP growth of 4.7% next year.

Paul Dales, chief UK economist at Capital Economics, agrees that inflation is a temporary concern. Interest rates will top out at about 0.5% at the end of next year, he believes, while “fairly soft” economic activity will help inflation to fall to about 2% at the end of 2022.

“Moderately higher interest rates are unlikely to derail the economic recovery,” Dales predicts.

So far, so good, although MacQueen points to a possible wage-price spiral as cause for concern: “If we see everyone pricing expectations of inflation into their plans, there might be self-fulfilling inflation, in which temporary factors lead to permanently higher inflation.”

But he adds that this isn’t the most likely scenario. “We do think that the Bank will take enough action to bring inflation towards target, although more slowly than some would like, perhaps.”

Not everyone is so optimistic. Ruth Lea, an economist and economic adviser at Arbuthnot Banking Group, is critical of the Bank’s failure to increase the base rate in November and worries that it may have fallen behind the curve. It needs to “start signalling that it’s going to hold back on some of the wilder excesses of demand to get to grips with what could become embedded inflation”, she argues. “If inflationary expectations do get embedded, the governor might have to put rates up by more. And, in the meantime, don’t forget that fiscal policy is still pretty generous.”

But how much freedom does the Bank really have? Russ Mould, investment director at AJ Bell, says it’s behaving as though it has “more of a US Federal Reserve dual mandate”, where unemployment is a joint priority along with inflation.

“I suspect the Bank is also aware that the debt position in the UK is far higher than it was 18 months ago, so the economy is relatively more sensitive to minor changes in interest rates,” he adds.

How should investors and wealth managers respond? Mould is clear: “There is no alternative if you assume that central banks will keep real rates negative for the time being. If you’re getting a negative real return on bonds and a negative real return on cash, you’re left looking at equities.”

> “There is a sense that real assets will do better than paper assets in a genuinely inflationary episode

Mould favours stocks that command pricing power, rather than those that can be pushed about by competitors and customers. “You need companies with pricing power, because your margins would get crushed otherwise,” he warns.

This is a contrast from the prevailing approach in recent years, where investors ploughed into tech and growth stocks promising profits in the medium term.

“They’re the very companies that you just don’t want to own in an inflationary environment, because their costs will go up and they’ll get involved in dogfights for market share,” Mould warns.

Instead, investors should be backing value stocks and cyclicals such as banks, airlines and car manufacturers. Mould reckons that we could see “a degree of violence in the stock markets and market leadership changing”. And then there is gold, which did well during the 1970s when inflation was rampant, although he notes that it started from $35 per ounce back then, rather than $1,800.

“There is also a sense that real assets will do better than paper assets in a genuinely inflationary episode because central banks can print money but they can’t print gold, oil and property,” Mould says, adding that some investors will find a place for cryptocurrencies as a hedge.

His advice is echoed by Robert Sears, chief investment officer of private wealth manager CapGen, which has £3bn in assets under management.

“There is no single pure hedge for inflation,” says Sears, who has been building CapGen’s hedging positions.

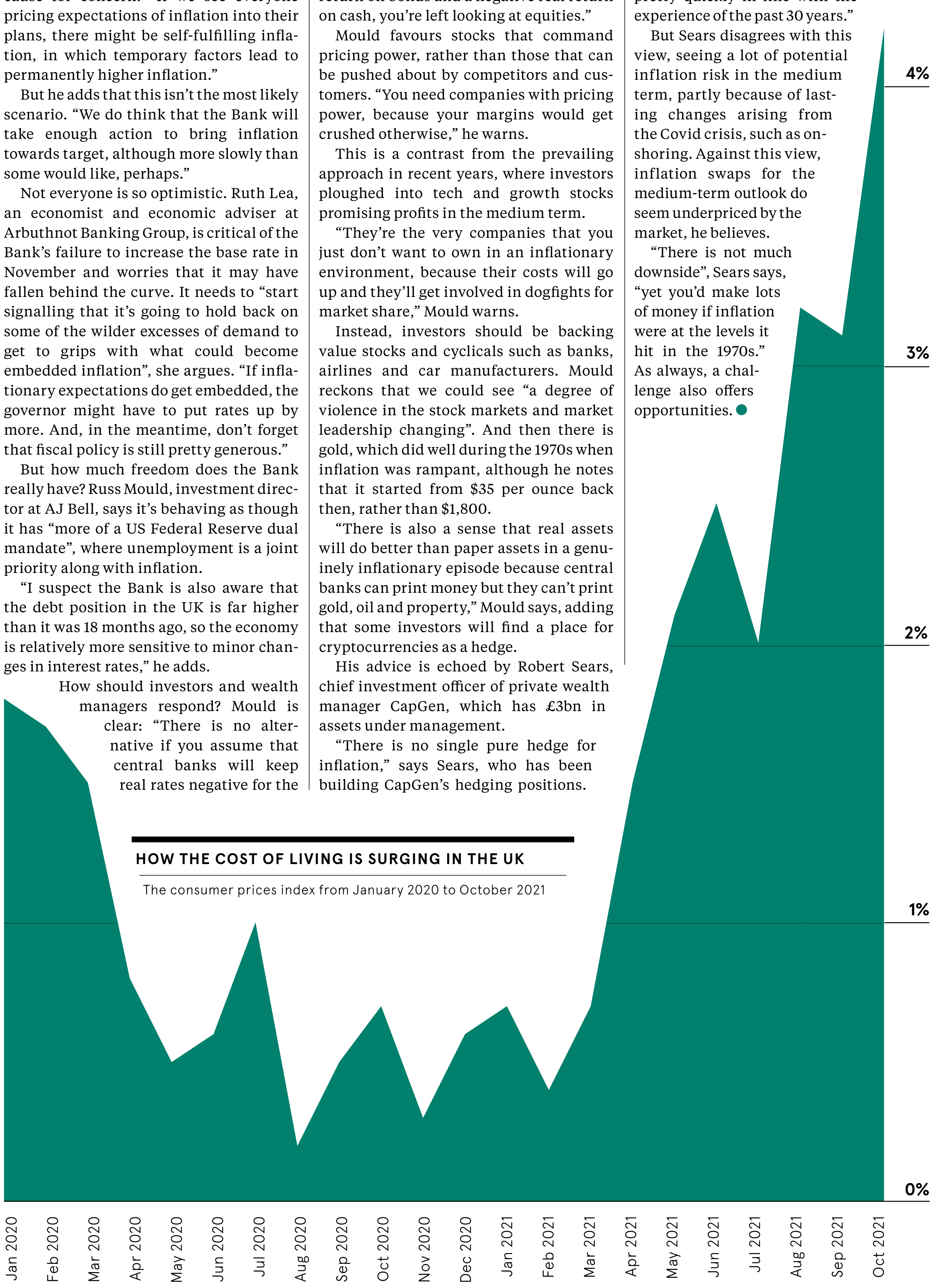
“You want a range of assets that do well in different types of inflation.”

In a low-growth inflationary period, he recommends inflation-linked bonds. If real rates go up, he backs commodities, liquid exposure to commodity futures and gold. For “somewhere in between, where inflation is high but you still have decent growth”, he favours real estate, equities with pricing power and value stocks.

Sears is particularly keen on inflation swaps today, mainly because they fit with his assessment of the inflationary cycle. “The focus next year is inflation,” he says. “But what’s really interesting is that the markets expect it to come back pretty quickly in line with the experience of the past 30 years.”

But Sears disagrees with this view, seeing a lot of potential inflation risk in the medium term, partly because of lasting changes arising from the Covid crisis, such as onshoring. Against this view, inflation swaps for the medium-term outlook do seem underpriced by the market, he believes.

“There is not much downside”, Sears says, “yet you’d make lots of money if inflation were at the levels it hit in the 1970s.” As always, a challenge also offers opportunities.



Commercial feature


For professional investors only

How ESG has become the way to better risk-adjusted returns

A strong ESG strategy has gone from a nice thing to have, to being a key contributor to achieving better long-term, risk-adjusted returns for investors and pension scheme members

Environmental, social and governance (ESG) considerations have shot up the priority order for companies and investors alike in recent years. Once perceived as a box-ticking exercise, or even window-dressing, ESG is now approached for what it is: a core risk and opportunity, impacting businesses and the long-term returns of investors and pension scheme members.

High-profile campaigns such as 'Black Lives Matter', 'Make My Money Matter' and those by Sir David Attenborough have elevated the public consciousness around social and environmental issues, and consumers increasingly expect the brands they interact with to align with their own personal values. This realisation has contributed to a growing recognition that companies that pay more attention to ESG and embed it in their core business goals are more successful and less risky to invest in.

This heightened public awareness around ESG issues and campaigns has filtered firmly through to the investor agenda. Even if company leadership teams don’t recognise the importance of ESG, increasing engagement on the subject by asset managers and asset owners is forcing them to take it more seriously. Meanwhile, regulatory pressure, especially in the area of environmental sustainability, is making ESG a concept that businesses can’t ignore.

“ESG was previously not viewed as critical – it was a nice to have,” says Adrian Mitchell, chief investment officer of Aon’s fiduciary management business in Europe. “But it is now integrated in all investment decisions, certainly for the managers in which we invest. Investment strategies have evolved from purely looking at the 'G' of ESG – how companies are run, which has a big impact on the financials – to looking much more at the social and environmental factors as well. We’re also starting the gradual move towards fully sustainable products and we expect to see that accelerate due to net-zero commitments and regulatory pressure.

“First and foremost, we are still focused on hitting the right financial returns for our clients, but we have also fully integrated ESG into our processes and make sure we manage those risks associated with the transition to a low-carbon world. There is now a growing interest and acceptance that as long as we can continue to hit the investment objectives that clients set, then it is also very important to build some non-financial goals, particularly around ESG, into investment portfolios.”

Aon’s UK fiduciary business is a huge aggregator of pension scheme assets, working for more than 100 clients with a total in excess of £23bn of assets under management[1]. This scale gives Aon more opportunity than a typical pension scheme to engage on ESG issues with the underlying asset managers and, in turn, ensure they are engaging directly with companies to drive change.

Aon’s holistic approach to building portfolios focuses on integration, incorporating material ESG risk factors into investment analysis and decision-making through its asset allocation and reporting tools, and investment manager rating process. Aon’s engagement with the underlying asset managers seeks to ensure that their ESG plans align with Aon’s and it monitors metrics, particularly around climate, to be proactive in developing ESG solutions and funds.

In September 2020, Aon launched the Global Impact Fund, its first fund with non-financial sustainable development goals as well as the objective of outperforming the MSCI World Index. The fund, which invests in equities across the world, is up by more than 20% since its launch and has been an important demonstration for the market that funds can have non-financial goals without having to sacrifice financial performance.

Communication and education are also central to Aon’s ESG strategy. On the defined benefit pensions side, Aon runs a series of webinars, roadshows and trustee training on the importance of ESG in client portfolios. On the defined contribution (DC) pensions side, in which scheme members are typically younger, the company has noticed a willingness from clients to engage on ESG, which is particularly important given members will be contributing to their pensions over multiple decades.

“Providing transparency around how members’ savings are invested is important, as well as being upfront about some of the risks,” says Jo Sharples, chief investment officer for Aon’s DC solutions. “Environmental risk in particular does make a big difference to their investments, so we share information with members and show the steps we’re taking. The willingness to engage from DC members is partly because they can relate to the things they see in the media and online, but more importantly the returns we generate directly impact on what their retirement will be like.

“For DC pensions, a lot of the pension schemes have a young age profile. For someone entering the workforce now, aged 21, they are looking at possibly a 60-year investment timeframe, so these issues become really pertinent. Younger members, who are also more likely to be socially aware, want to know their money is invested in the right way. We often hear that people aren’t engaged with their pension, but if you show what their money is doing to drive social and environmental impact, they’ll engage more and perhaps even put more in. We’ll see more tools become available to help members understand in which companies their pension is invested and what is being done to manage some of these risks.”

Greenwashing, where companies make ESG claims they don’t fulfil, can be a challenge, but Aon works diligently to ensure it only invests in underlying asset managers that are 'buy' rated by its manager research teams. And once a company is buy rated, Aon continues to measure, through active engagement, whether the organisation’s actions are matching its commitments.

ESG will undoubtedly continue to shape the investment and asset management landscape in the years ahead, and Aon is dedicated to further building on its market-leading position in this area. That is likely to include evolving from its current focus on full integration toward a much more carbon neutral and sustainable portfolio, including impact strategies with non-financial goals.

“We’ll see the focus on ESG spread from equities to non-equity asset classes such as bonds,” says Mitchell. “Reflecting this, we will soon be launching a Sustainable Multi Asset Credit Fund. Additionally, as an aggregator of pension scheme assets with stewardship responsibility, Aon is in a better position than other asset owners to influence how the underlying asset managers integrate ESG into their processes and will continue to exercise our responsibilities in this area.”

92%

of respondents have considered ESG in relation to their investments, with 20% changing their investments as a result

1in5

have already made changes to their investments, having reviewed their ESG policies over the past two years

Aon’s Global Pension Risk Survey 2021/22, UK Survey Findings

For more information please visit aon.com/responsibleinvestment

[1] The value of UK assets under management is £23.2 billion, as at 30 September 2021.

INTERGENERATIONAL ESG

ESG turns social as a new breed of investor takes up the reins

Global warming is far from the only ethical matter of concern to millennial investors. The industry has a demanding, resolute and persuasive set of younger clients on its hands

Virginia Matthews

Wealthy investors of all ages are interested in sustainability, but social justice is also an increasing priority for the younger generation, for whom actions speak louder than words.

Environmental, social and governance (ESG) criteria have become central concerns for all wealth management clients, but investors in different age groups are prioritising them in dissimilar ways. Building a healthier planet for the grandchildren is likely to be the main aim among many older clients, but achieving net zero is a given for under-40s. Having observed the many socioeconomic inequalities that the pandemic has thrown into sharp relief, many of them are looking beyond environmental issues and towards tackling other concerns, such as labour exploitation.

In their efforts to reframe their families' investments along such lines, they are proving to be highly demanding clients, according to Leslie Gent, MD and head of responsible investing at Coutts.

"Younger people can be very impatient for change," she reports. "Although many portfolios have already been cleansed significantly as a direct result of their influence, the conversations that we have with them can become emotive. While the debate about ESG inevitably starts off with their stated intention to make particular exclusions from a given portfolio, it's our job to explain to all members of the family that there will be impacts on your returns if you limit your investable universe."

> Younger people can be very impatient for change. The conversations that we have with them can become emotive

Aside from the intergenerational differences in approach to investment, there's also a marked gender split. Female clients – particularly younger ones – are more vocal than men about social inequality.

Younger women are "far more prepared than their male counterparts to start discussing these tricky issues. Going on the anecdotal evidence I have, I'd say that women also have a greater understanding of them," says Alexandra Loydon, director for partner engagement and consultancy at St James's Place.

While under-40s in general tend to be better educated than their parents about social and governance elements, younger men are "probably more interested in the returns", she adds.

The social side of ESG has tended to attract less publicity and investment than the environmental component. But younger clients have a wide range of concerns, which extend far beyond avoiding the traditional 'sin stocks' linked to alcohol, gambling and the arms trade.

"They want to know more about the effects that their investments will have on issues such as the marketing of tobacco to developing nations, unethical working practices and the number of women in leadership roles," Loydon says. "Whatever the topic, their questions can be direct."

Transparency about the potential effects (positive and negative) of investments is becoming increasingly important to these clients, notes Andrew Lee, MD and global head of sustainable and impact investing at UBS Global Wealth Management.

"This is about aligning their role with a purpose, so that they can maximise the impact they can create," he says.

The future of fossil fuels often comes up in family investment meetings. For many younger clients, removing major carbon emitters from portfolios is an obvious first step towards a low-carbon future. But for many fund managers, divesting problem stock rather than engaging with the companies concerned – all of which have vital expertise to share – is a case of throwing the baby out with the bathwater.

"Coal is a no-go for us because there's no place for it in a net-zero world," Gent says. "But, when it comes to the oil and gas sector, we have to avoid starving the big players of cash. If that were to happen, they would go into private hands and we'd have no further influence over them."

After about 25 years of dialogue with the industry, it is starting to change its ways, but significant progress "can't necessarily be achieved in anything like the next 12 months," she stresses. "This is something that our younger clients don't always want to hear."

Younger, 'dark green' investors are committed to responsible investing and want as much as possible of their portfolio invested according to their personal values. Individual investments are coming under closer scrutiny from such clients, who will one day take control of big family portfolios. The values of wealth management houses are also in their sights.

"Greenwashing is a big problem in our industry," Gent says. "It requires us, as asset managers, to draw on the knowledge of many different disciplines, so that clients can receive the guidance they need to help make informed choices. If you're going to hold other companies to account, you have to start with your own business. For us, this is about being transparent and offering detailed disclosures on our website for clients to examine."

Faced with a huge array of 'Paris-aligned' investment opportunities and 'responsible investing' hubs to choose from, investors without a PhD in environmental science could be forgiven for feeling out of their depth. This is why wealth managers who can sift through the claims and counterclaims of ESG investing are becoming ever more vital. That's the view of Tim Fassam, director of government relations and policy at the Personal Investment Management & Financial Advice Association.

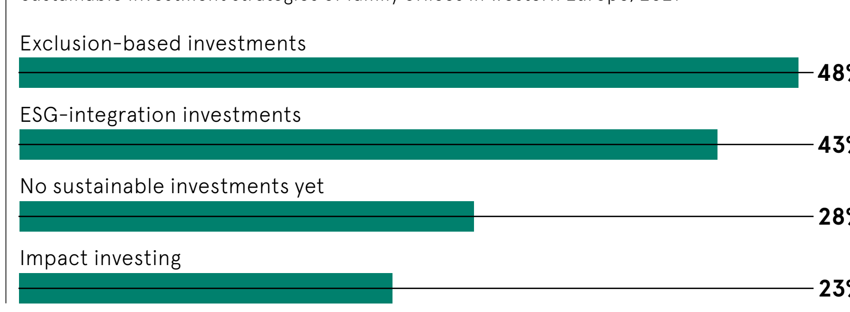
"Their ability to cut through the jargon and give bespoke advice based on their client's highly personal ethical approach – something that may have involved lengthy deliberations by the entire family – makes managers a crucial conduit between different generations and a trusted adviser for all age groups," he says.

Many wealthy investors are only too aware of their highly privileged position. They're keen to use their money to not only create a legacy for their descendants but also leave the world better off. With a growing range of ESG opportunities available to these clients, their age-old tussle between making money for the family and benefiting wider society may be losing its relevance, according to Fassam, who adds: "Investing for sustainability and investing for performance are no longer poles apart – and that's good news for all of us." ●

ETHICAL INVESTING AMONG FAMILY OFFICES

UBS, 2021

Sustainable investment strategies of family offices in western Europe, 2021



OPINION

'How can we best facilitate a digital transformation in the wealth management and advice industry?'

The way in which wealth management and financial advice firms interact with wealth holders is changing. As a longstanding profession, the wealth management and advice industry can be seen by some as very traditional and somewhat slower at adapting to technological innovation. In fact, the use of technology within the sector was largely limited to back-office operations for a long time. But the Covid pandemic has brought about a raft of changes on a scale that few would have foreseen two years ago. This has led many firms that traditionally relied on face-to-face meetings to rapidly change the way they think about and use technology. Clients' demands and expectations are changing rapidly too. As a result, the amount of data firms must hold to serve their customers and meet regulatory requirements makes the wider integration of technology solutions inevitable.

The challenges of operating in this increasingly digitised environment mean that all firms - large and small - recognise the need to enhance their proposition through the faster adoption and innovative use of technology.

Two years ago the Department for International Trade's UK Fintech State of the Nation report found that 56% of traditional financial institutions were already putting digital innovation at the heart of their strategy. It also showed that more than eight in 10 (82%) established financial services firms, including wealth management and advice companies, expected to increase fintech partnerships in the next three to five years.

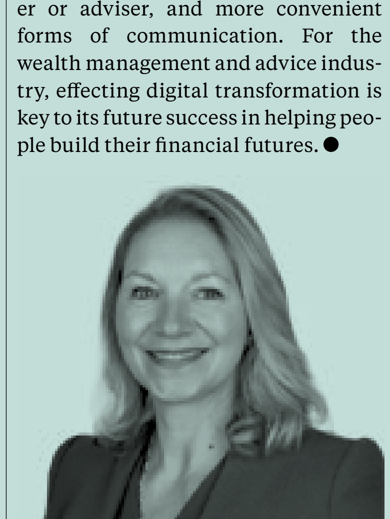
More recently, a 2021 study by ThoughtLab found that 75% of wealth executives expect digital interaction with clients will be the norm in the next couple of years. Recent research from LexisNexis also suggests a shift to digital: more than 40% of wealth management clients are prioritising digital access and 89% of clients say their preferred communications channel will be through mobile apps.

Fortunately for wealth management and advice firms, the UK has one of the world's leading fintech industries. The UK tech startup and scale-up ecosystem is valued at £442bn ($585bn) - 120% more than in 2017 - and more than double the next most valuable ecosystem, Germany, at £217bn ($291bn). Current estimates suggest there are over 2,500 fintech firms based in the UK alone and that number is estimated to more than double by 2030.

The question remains: How can we best facilitate a digital transformation in the wealth management and advice industry? Many wealth management firms don't necessarily know where to start and struggle to understand which technology solutions to prioritise in a congested marketplace. On the flip side, until very recently, fintech firms often found it difficult to access a traditional market that is still finding its way in a new technological era.

For these very reasons, PIMFA is launching its own wealth-tech platform, with the support of Morningstar, in the first quarter of 2022. PIMFA WealthTech will enable fintech firms and wealth managers to access and collaborate on digital solutions that will enable wealth managers and advice firms to digitise their operations and enhance customer service. The platform will be supported by specialist industry providers and explore developments in 20 specific market segments including blockchain technology, robo-advice, digital wallets and much more.

The Covid pandemic has forced us to learn to adapt to significant changes in our day-to-day lives. In particular, the use of technology in our daily interactions has become more common. The impact of these changes is felt differently in every industry. Today's wealth holders want greater access to markets, more flexibility in how and when they have contact with their wealth manager or adviser, and more convenient forms of communication. For the wealth management and advice industry, effecting digital transformation is key to its future success in helping people build their financial futures. ●



Liz Field
Chief executive,
PIMFA

Commercial feature

Q&A

The future of wealth: fast moving, hyper-customised and deeply embedded

Sam Handfield-Jones, co-CEO of Seccl, the Octopus-owned custodian and investment technology provider, explores the future direction of the industry to show how firms can ensure they're on the right side of change

Q What key trends are you seeing emerge within wealth management?

A The first thing I'd say is there has never been a better or more exciting time to be working in fintech, particularly in the UK. In the first half of 2021, the UK saw nearly £19bn invested into the sector. To put it into perspective, that's more than £1 of every £4 invested globally flowing into the UK. It's an astonishing number that's rocket fuel for the entire sector.

There are some exciting trends beginning to emerge within the arena of financial advice and investments. Take hyper-customisation. We've seen a real surge in the number of narrowly focused customer propositions in retail banking over the last few years, such as banking services catering uniquely for the LGBTQ+ community. And now we're beginning to see the same in wealth management.

At one level, we see it in the development of financial planning tools catering exclusively to certain segments of the population, for example the self-employed. But at a deeper level, this customisation extends to the very construction of investment portfolios.

Increasingly, clients or their investment managers can easily build fully bespoke models that align not only with their investment objectives, but with their personal values and world views. We're talking total, client-level investment customisation, not the stuff you can run on a spreadsheet. And it's now possible at the touch of a button.

We're also seeing a trend towards the embedding of investment propositions within existing services. Over the next few years, we'll almost certainly see the large and well-known neobanks launch long-term investment propositions that are nested within their existing apps, with characteristically simple and seamless user experiences.

And I think we'll see non-financial services brands get in on the act too, not with white label propositions outside the core customer experience, but with properly embedded experiences that cater for customers right at the coal face. Think Amazon Investments.

Q What's driving this change?

A Put simply, technology. In particular, the proliferation of APIs (application programming interfaces), which allow firms to rapidly and affordably integrate third-party software, and so avoid wasting time rebuilding from scratch software that already exists.

Over the last few years, firms have begun to rebuild the investment infrastructure using APIs, making it easier than ever for firms of all sizes to focus on the customer experience and leave the plumbing to someone else.

In the same way that businesses can just use Amazon for cloud storage, firms can increasingly plug into an investment infrastructure – trading, tax wrappers, portfolio management, you name it – that's powered by APIs. It's transformational.

Q What does it mean for wealth managers?

A Customer expectations are changing. As consumers, we've become used to fast, convenient and mobile-first experiences. Clients will increasingly demand the same level of speed and sophistication from their investment platform or wealth manager as they would any other service.

At the same time, the technological advancements that have ramped up consumer expectations have also lowered the barriers to innovation, so much so that any firm, new or old, big or small, can capitalise on the changes afoot. With a modern technology infrastructure to work on, businesses can, and should, aim to achieve operational efficiencies that could only have been dreamt of just five years ago.

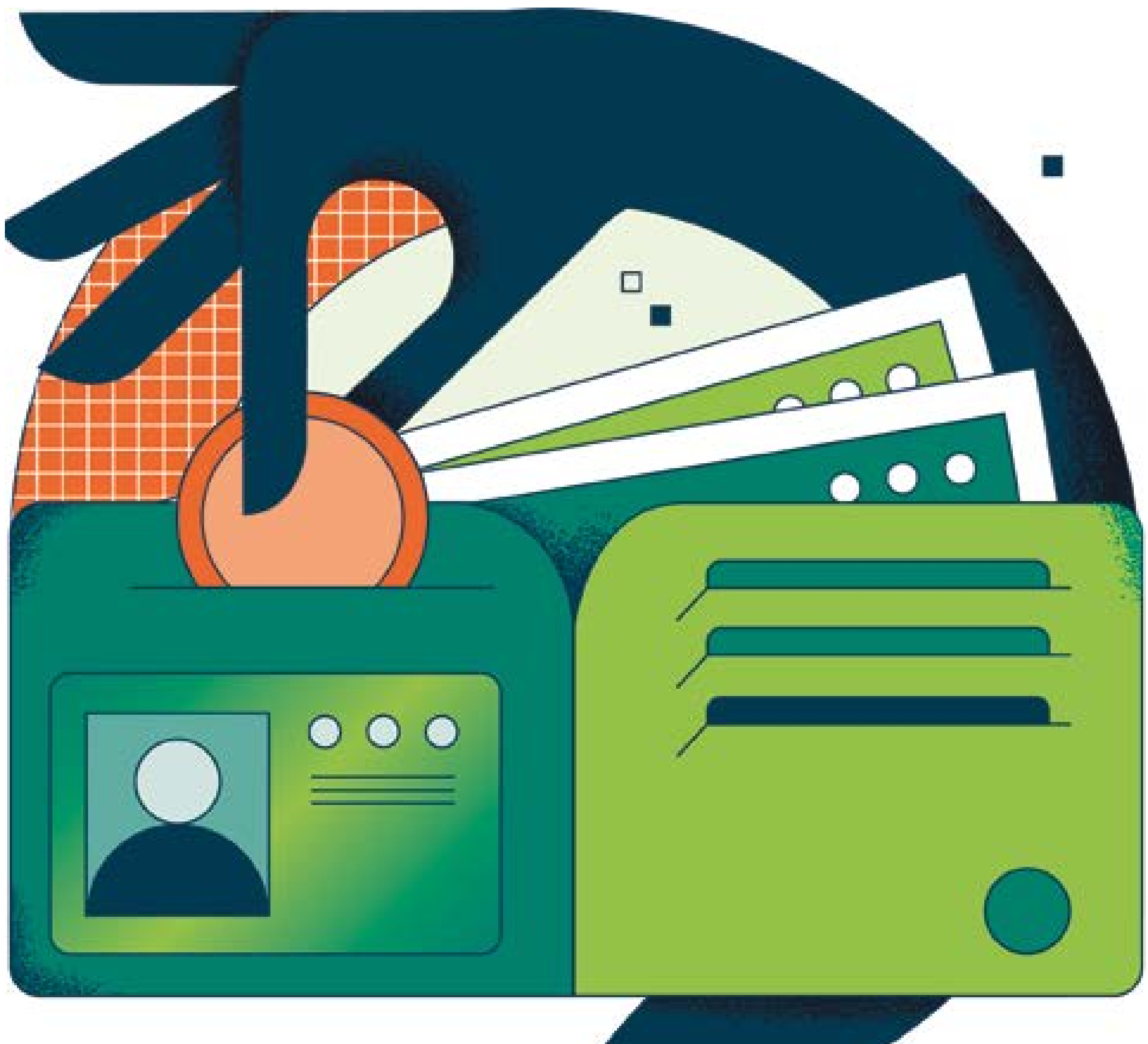
Q How can firms futureproof themselves?

A I don't think it's an exaggeration to say that the margin between success and failure in this market, as in most others, will be defined by technology. And yet most businesses in this space continue to rely on platforms that are held together with sticking plaster and a whole heap of manual intervention.

The single biggest step a firm could make is to take back control of their tech stack. Instead of relying on old third-party platform software, it's easier and more essential than ever for them to rebuild their backend on cutting-edge, API-first tech. Only then can they hope to offer the level of frontend flexibility and customisation their clients will come to expect.

Find out more at seccl.tech

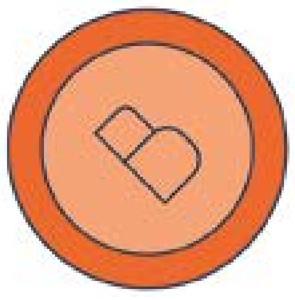
seccl



CRYPTOCURRENCIES

The crypto factor

Will wealth managers learn to love bitcoin and its ilk, or will the associated volatility risks and lack of regulation remain a deterrent for all but the boldest players?



Jon Yarker

The surging popularity of cryptocurrencies and digital assets in general has caused consternation as well as excitement. In June, the Financial Conduct Authority (FCA) estimated that 2.3 million adults in the UK were holding crypto assets – up from 1.9 million only 12 months previously. This prompted the regulator to warn investors that they should "be prepared to lose all their money".

The suitability of these assets for ordinary retail investors has been fiercely debated, but what of the super-rich, who possess enough capital to accommodate high-risk investments safely?

The UK wealth management industry has yet to engage fully with cryptocurrencies. Many of the nation's most established players have steered well clear of investing in them so far.

Charles Stanley Direct is one of them. The firm's chief analyst, Rob Morgan, says: "We don't consider crypto assets investable at present."

But he adds that the buzz being generated by crypto investments means that the subject is coming up more in discussions with clients. "We can't ignore the subject. It receives a huge amount of attention from the public and the media, so we have to hold open and honest conversations about what it is and the risks it poses."

Tilney Smith & Williamson is another big wealth manager that has yet to get involved. Its MD of corporate affairs, Jason Hollands, explains that crypto investments are difficult for the firm to consider because the asset class is still at a "nascent" stage.

"When constructing portfolios for their clients, most wealth managers are highly focused on the risk/reward balance," he says. "This can be especially true in the case of ultra-high-net-worth clients, whose objectives often include preserving the capital that they've built up over time. They can actually be less inclined than most to take unnecessary risks."

Other wealth managers are unwilling to discuss the subject with their clients. One of these is Rick Eling, investment director at Quilter Financial Planning, who describes crypto as "fool's gold".

Such investments "should be considered more akin to gambling", he adds. "Their volatile nature means that you should be prepared to lose everything. Cryptocurrencies are simply not a legitimate alternative to real investments."

Traditional investment choices are based on evidence-based assessments of a given asset's value-creating potential. For example, a wealth manager may decide to buy shares in a company because it is consistently making big profits. Hollands says that the highly speculative nature of digital assets makes this a very different scenario for portfolio management.

"They generate no yield and it is questionable whether they have any intrinsic value," he says. "Cynics might describe crypto investment as a classic example of 'greater fool theory'. That is, to know whether the price of an asset is low, fair or expensive in the absence of fundamental valuation measures, you simply invest in the hope that the next buyer is willing to pay more than you have paid."

Despite such arguments, a number of financial institutions have been exploring how they might capitalise on the attention that cryptocurrencies are attracting. They include WisdomTree Investments, which is offering crypto-based exchange-traded funds and products.

The company's director of digital assets, Benjamin Dean, accepts why wealth managers would want to steer clear of cryptocurrencies. But he argues that, with the right mix of assets, an appropriately sized crypto allocation can increase a portfolio's Sharpe ratio – an indication of how well an asset's returns compensate for the level of risk they oblige the investor to take on.

"Our analysis has indicated that making a 2% allocation to bitcoin in a sample global 60:40 equity/bond portfolio would have resulted in a 0.5 percentage-point increase in portfolio volatility during our period of study, from 9.0% to 9.5%, while delivering a return of 9.4% compared with 7.1% for a 60:40 portfolio not featuring bitcoin," Dean says. "In effect, adding bitcoin improved the portfolio's Sharpe ratio from 0.71 to 0.94. To give some perspective to those figures, the MSCI All-Country World Index returned 10.1% with 13.7% volatility – equating to a Sharpe ratio of only 0.68 – in the same period."

But it's the continued lack of regulation that remains the main reason why many wealth managers feel that they can't seriously consider crypto investments, despite the huge reserves and appetite for risk that some of their ultra-high-net-worth clients will undoubtedly possess.

"Providers of professional indemnity insurance are wary when it comes to cryptocurrencies. Very few of them are willing to underwrite crypto risks, which presents a challenge for wealth managers seeking cover," says John Greene, divisional director at Howden Insurance Brokers. "The professional indemnity market is already challenged, with businesses facing higher rates and coverage restrictions, so they are probably choosing to avoid introducing extra non-essential risks such as crypto."

The legal minefield surrounding crypto cannot be ignored, observes Kate Troup, a partner and specialist in financial services regulation at law firm Fladgate.

"It's important for wealth managers to know that the FCA doesn't want investors to be confused about whether or not a service offered by a regulated firm is covered by regulatory protections," she says. "If managers do want to provide advice or management services for crypto assets, this must be managed carefully from a compliance perspective. To protect their reputations, they will need to consider whether they have the appropriate in-house expertise to ensure that they can offer a similar level of service to that which they provide for traditional investments."

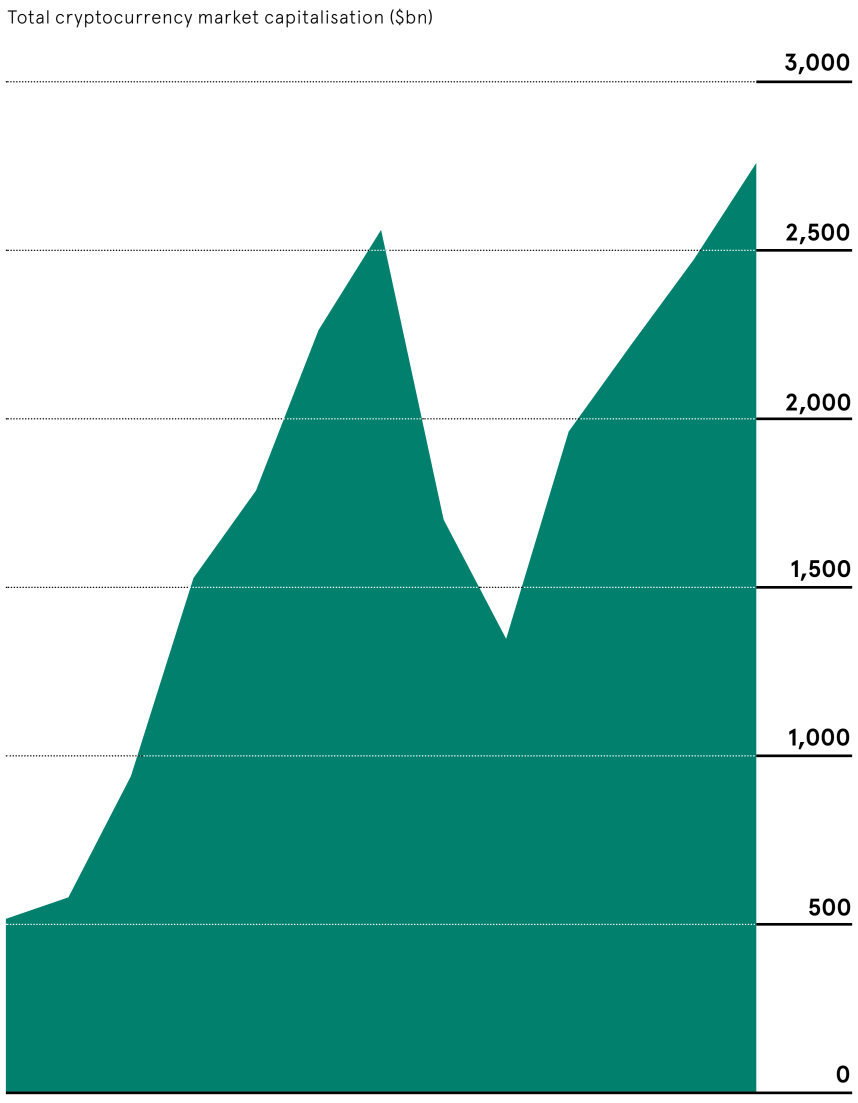
For these reasons, many wealth managers are fighting shy of cryptocurrencies, notes Eling, who argues that there's no point in allocating such assets for his clients until better safeguards are available.

"We are likely to see a devastating collapse in the crypto market one day," he predicts. "And I would not wish for our clients to be among the casualties."

THE RISE OF CRYPTOCURRENCIES

Statista, 2021

Total cryptocurrency market capitalisation ($bn)



Commercial feature

Helping clients build sustainable legacies by being a responsible bank

As Kleinwort Hambros' CEO **Mouhammed Chouker** explains, there is an increasing desire to understand the impact of our actions on the climate and society as a whole

By helping clients build sustainable legacies, we enable them to achieve their long-term, intergenerational goals.

In order to do this, as a leading responsible bank, first you need to walk the talk. That means proving, through your actions, that responsibility runs through every part of your business.

At Kleinwort Hambros we focus on the four key 'Cs': clients, colleagues, community and climate. We help our clients to build sustainable legacies; we support our colleagues by promoting diversity and inclusion (D&I); we make a positive social impact for our community and we champion climate action by reducing our carbon footprint.

Moving the dial on all of these factors in a meaningful way enables us to become a leading responsible bank.

As a wealth manager and private bank, our clients are at the heart of everything we do. By helping them build sustainable legacies, it enables them to achieve their long-term, intergenerational goals.

But, increasingly, clients are becoming more aware of the impact of their investments on the environment and wider society.

Data from the Investment Association shows that UK savers have put almost £1bn a month on average into responsible investment funds during 2020. Added to that, a recent study by American Century Investments has found that 64% of UK millennial investors are interested in impact investing.

We are focused on optimising the positive impact of our clients' investments and minimising or eliminating the negative impact. To assist them, we give clients all the information they need to make informed decisions to achieve these goals.

We want to be as transparent as possible with our clients to ensure they receive the information they need about their investments and understand the impact they're making beyond their immediate financial objectives.

> **Clients are becoming more aware of the impact of their investments on the environment and wider society**

74%

of millennials believe their workplaces will have greater innovation if management actively makes diversity and inclusion a key component of organisational culture

20%

of executive committee roles in major UK financial services firms are held by women

Oliver Wyman, Women in the Financial Services

64%

of UK millennial investors are interested in impact investing

American Century Investments

Acceleration of change

The Covid-19 pandemic has accelerated this move towards becoming a more sustainable and responsible organisation. This is achieved, in large part, by establishing and maintaining a diverse and inclusive workplace.

That means creating an environment where everyone feels included as part of the same team, regardless of gender, ethnicity or culture.

As millennials and Gen-Z are fast becoming the dominant generations in the workforce, according to the 2018 Deloitte Millennial Survey, 74% of respondents said they believe their workplaces will have greater innovation if management actively makes diversity and inclusion a key component of organisational culture.

Kleinwort Hambros is a diverse organisation, gender-balanced, and has people from all different backgrounds and walks of life, from the top down. But inclusiveness is only truly achieved by having open conversations about how people feel, listening to what they have to say, and addressing their views and concerns.

The pandemic has also required employers to be more empathetic towards their staff and take genuine care of their wellbeing.

We spent a lot of time in 2020 listening to each other about our personal circumstances and the need to achieve a proper work/life balance. Those conversations have been very powerful for us in terms of our inclusivity and have helped us to create a healthier workplace culture too.

Listening organisation

The focus now for Kleinwort Hambros is very much on the inclusion part of D&I. As a result, we have set up a dedicated Culture and Conduct network and Gender Equality Forum to make sure that everyone's voice is heard.

The big strides we have already made in establishing a diverse workforce and an inclusive workplace culture are reflected in the fact we were named as one of London's top 75 Best Large Companies to Work For in 2021 by *The Sunday Times* and were the only private bank to be listed.

The finance industry is also moving forward with the recognition of the need for a more balanced and inclusive culture. As part of this, the WealthiHer network champions the transformation of the wealth management industry's approach to female investors, and we are proud to be a founding member.

It's crucial, however, that any progress made is measured against clearly defined targets. As a signatory of the Women in Finance Charter, as part of the SG Group, we have already achieved its target to increase representation of women in senior roles by 25% across our UK platform by 2022.

We also have one of the smallest gender pay gaps in UK private wealth management and a diverse executive committee.

Our work on diversity extends to developing young talent through apprenticeship and internship schemes, as well as a next-generation executive committee of analysts and associates who work on strategic projects to gain a greater oversight of the business.

But the wealth management industry can and needs to do more to improve access for people from less privileged backgrounds. That's reflected in the fact that almost 90% of senior roles in financial services are held by those from higher socio-economic backgrounds, according to the Diversity Project.

Our role is to embrace and encourage social mobility by supporting charities like The Brilliant Club, which works with schools and universities to support students who are less advantaged to access the most competitive universities.

Mirroring diversity

Our diversity is mirrored in our client base too, which is from a host of backgrounds and has a wide range of requirements. By having a diverse workforce, we can provide our clients with the best team that understands their needs and background, to work with them to achieve their goals.

By having different views, you can have productive conversations and work together to find the best solution. As an end result, you can help your clients to build the sustainable legacy they want to achieve.

A diverse workforce that is representative of both wider society and a changing client base is essential to the drive innovation, performance and best client service and expertise.

A responsible bank with a diverse and inclusive workplace, understands these needs and can help clients build sustainable legacies.

For more information about how Kleinwort Hambros can help you to build a legacy, please visit kleinworthambros.com

KLEINWORT HAMBROS

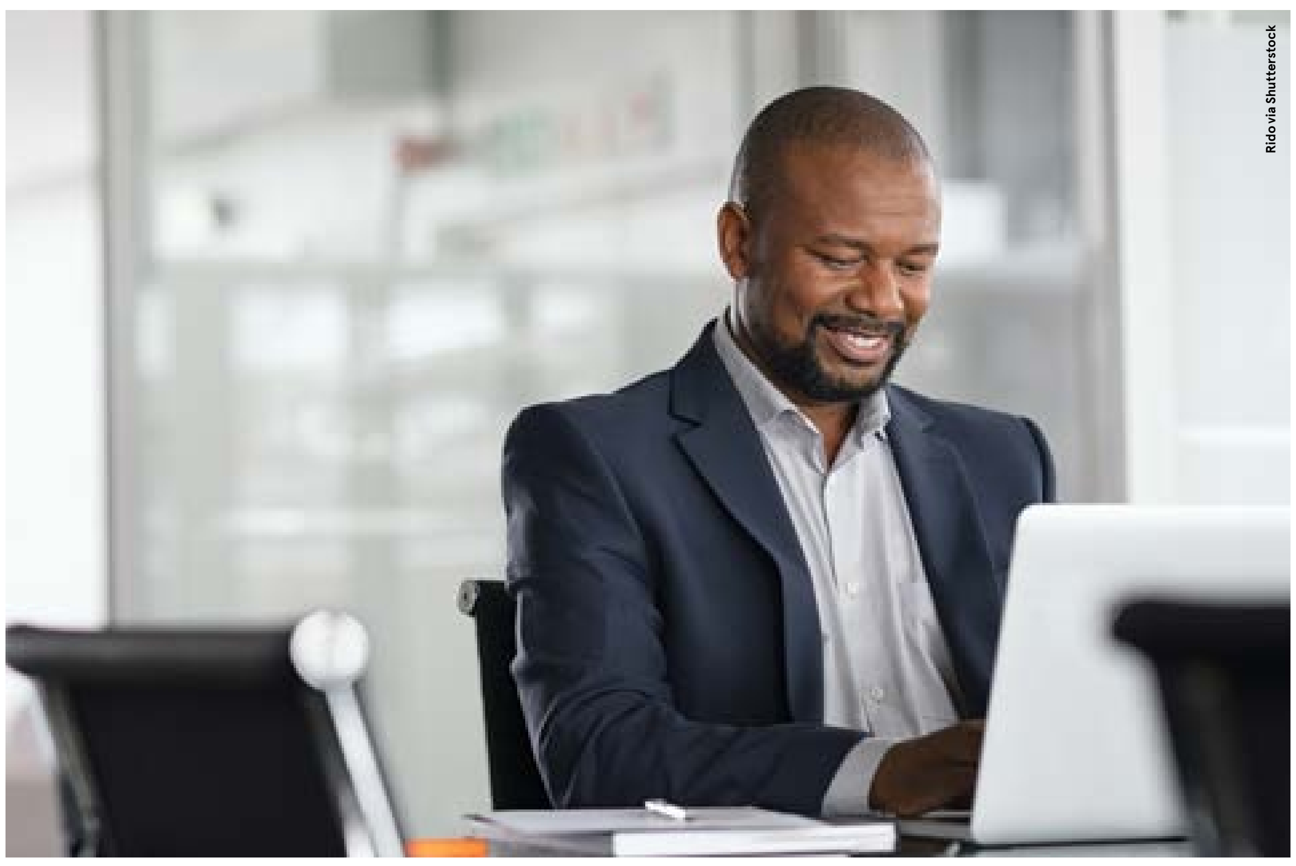
SOCIETE GENERALE GROUP

REMOTE WEALTH MANAGEMENT

Distance education: how the sector has learnt to live with the chaos of Covid

It's been a period of upheaval for wealth managers, many of whom have been forced to work remotely. And the problems they've faced in this time have been many and varied

Andy Jones



Rido via Shutterstock

The Covid crisis has turned out to be a bucket of cold water for wealth management. The pandemic has not only transformed how the industry operates; it has also prompted clients to reassess how they invest their money.

The sector aims to bring surety and clarity to its clientele. But it has undergone an uncertain period of its own as it's shifted to remote working. At the same time, the surging popularity of meme stocks, cryptocurrencies and trading platforms has represented a huge increase in competition.

On the one hand, wealth managers have led their clients through the necessary processes of data protection and security. On the other, they have sat and listened as the same clients have outlined their investments in the lawless world of cryptocurrencies and non-fungible tokens.

Online investors want both quick access to their money and the certainty that it's well protected. Satisfying these demands has been the biggest challenge for wealth managers in recent months. Smart operators can improve their chances of doing so by ensuring that their various systems can talk to each other seamlessly, according to Alexander Newton, director of Cambria Wealth Management.

"Knowing that you only need to enter details in one system not only saves time; it also helps to reduce the likelihood of error, ensuring that everyone is working on the same client data," he says. "Continuing to link systems to achieve efficiencies and improve the client experience is a never-ending task."

Successful wealth managers are offering hybrid advice through a pick-and-mix selection of communications, ensuring that clients get what they want when they want it. Videoconferencing gives personality and face-to-face access. Collaboration tools such as Microsoft Teams and Webex by Cisco enable instant communication, while programs such as DocuSign or Alt/Ave enable electronic signatures. Sophisticated client portals have also appeared, allowing advisers and clients to work together using integrated video feeds and screen-sharing, says Tim Thompson-Rye, chief technology officer at Progeny.

"Moneyinfo and CashCalc can transform the client experience pretty much overnight," he says. "The key benefits of these off-the-shelf options are the ability they give users to gain instant access to information such as portfolio valuations; sign, store and access important documents; and communicate securely with their advisers."

> **As financial education becomes more widely accessible, we envisage more people getting in the driving seat for their own financial journeys**

Technological advances have changed how clients think about their finances – and the way finance thinks about them too, notes Thompson-Rye. "Surprisingly, we found the average age of clients who use our portal is older than our overall average client age. Older clients may actually be more time-poor than younger ones and will therefore value the convenience that a tech-led offering can provide. This goes against the perception – or misconception – that technology will primarily be used by younger clients."

For compliance purposes, digital offerings can record client interactions, all of which can be married up to the files, Newton says. "One of the benefits of combining messaging, email and video calls is that we've gained a more reliable audit trail of our advice process. This links better with our back-office systems, which automatically log messages to client files. It doesn't remove the issue of human error but it does significantly reduce risk."

But recording every item does create a larger surface area for cybercriminals to target. There was a significant global spike in the number of such attacks during the first two months of the pandemic, reports James McQuiggan, security awareness advocate at KnowBe4.

"Organisations have shifted data and systems to more cloud-based solutions for easier manageability and cost reductions," he says. "But, with more users working remotely and more data in the cloud, the opportunities for cybercriminals to attack them as they are isolated grow. This exposes the organisation to various social engineering and phishing attacks or exploits against internet-facing cloud systems."

While Progeny invests heavily in cybersecurity, Thompson-Rye notes that his firm is defending against a growing number of scams targeting clients, who tend to be more vulnerable. "We have a robust cybersecurity training programme and have stepped up our client communications about potential risks," he reports.

To continue providing advice outside office hours, many firms have implemented secure online chat systems that can be used only by verified clients. This is backed up at Cambria by courtesy and security calls, says Newton, who adds: "We still rely on supporting our digital interactions with a phone or video call. For any particularly sensitive situations, our clients still need to feel that they're dealing with a person."

Remote wealth management also faces the challenge of competing advice – good or bad – from the internet. During August, shares in online brokerage Robinhood increased by 50% in one day, buoyed by 'meme stock' episodes – such as the furore surrounding GameStop – as users working at home were exposed to new products.

The biggest threat to remote wealth management could stem from the continuing low interest rates, which are tempting people to spin the roulette wheel of online trading fortune. So says Anna-Sophie Hartvigsen, co-founder of Female Invest, an advice portal for millennial and gen-Z women. "We're seeing a generation of new investors who take charge of their wealth rather than delegating the responsibility to external sources," she adds.

With the rise in remote working, investors also have more time to seek out alternative opportunities and do their own research. Big wins for those trading in GameStop stock and cryptos such as shiba inu and dogecoin have hit the headlines since the start of the pandemic, as investors have sought both financial gain and an adrenaline rush, Hartvigsen notes.

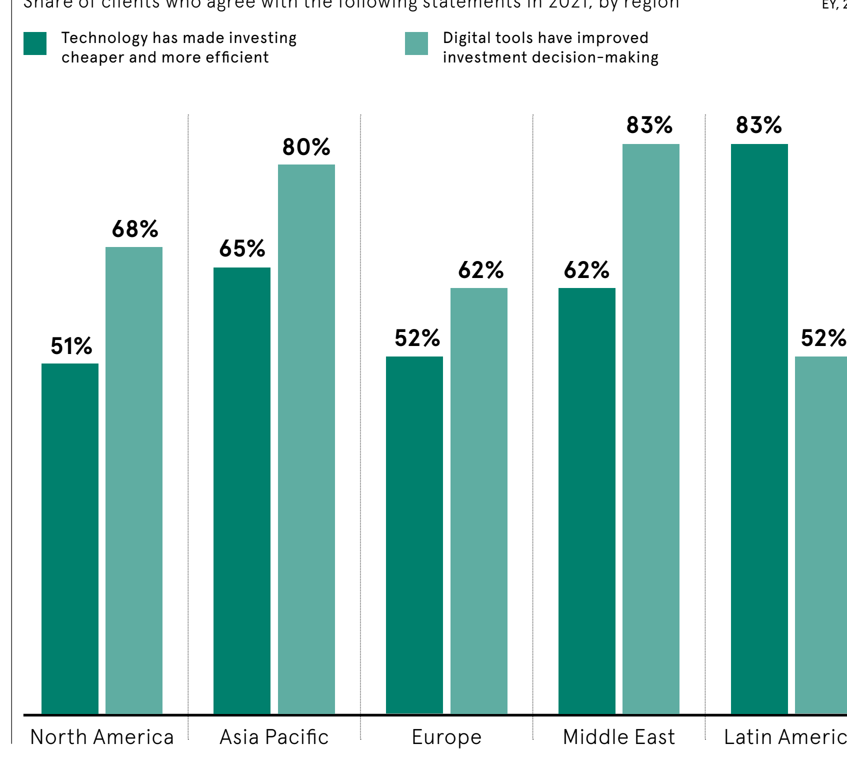
"Investing has increasingly become a topic on social media, which has led to the emergence of a new phenomenon: meme stocks," she says. "As financial education becomes more widely accessible, we envisage more people getting in the driver's seat for their own financial journeys to a much higher extent than before."

Remote wealth management services need to adapt to these trends, not resist them. They must offer calm amid the chaos of the online gold rush, while also maintaining the high standards of security that clients have come to expect.

WEALTH MANAGEMENT IN THE DIGITAL AGE

Share of clients who agree with the following statements in 2021, by region

EY, 2021



Commercial feature

How impact investors can align real estate and ESG

Aligning real estate portfolios to deliver positive social and environmental outcomes is both the right thing to do and essential to any successful asset management strategy, argues **Alexander Morris**, UK development director of BentallGreenOak

105 Victoria Street, Victoria

We are undoubtedly in an era of heightened consciousness around climate change. While the fossil fuel and automotive sectors are often challenged for their emissions records, the reality is it is real estate, or more broadly speaking the built environment, where the problem most significantly resides. As a sector, it contributes around 40% of all global carbon emissions, according to the UN. If concrete were a country, it would be the third largest contributor of emissions, after the US and China.

It's a sobering thought if you work in real estate, as I do. But it also means we have a tremendous opportunity to drive change and make a difference in the face of the climate emergency.

While real estate managers must contend with the challenge of sequentially reducing and ultimately eliminating carbon emissions from their portfolios, the investment community is voicing the imperative to do so too. Driven by their own ESG commitments, investors and occupiers are reporting across multiple KPIs with carbon footprint now a key metric, making inefficient real estate assets less desirable.

At Welput, a central London office fund managed by BentallGreenOak, we are assessing how we bring low-carbon performance to our £1bn portfolio of properties. Pushing low-carbon and net-zero products means taking short-, medium- and long-term approaches that consider the whole life of an asset.

There is already clear evidence of a 'green' premium, with the most sustainable buildings attracting higher rents and prices. That trend will only accelerate as the regulatory framework is leveraged to accelerate the transition to a low-carbon economy. Current rules on the energy efficiency of buildings are just the starting point, with future governments expected to impose stricter requirements.

Understood correctly, delivering on ESG commitments is inherently tied to fulfilling our fiduciary responsibilities. Any developer, investor or landlord that does not have plans in place to reduce the carbon intensity of their portfolio faces the very real threat of being landed with 'stranded assets' – obsolete buildings that will not be competitive in the letting marketplace and therefore can't be sold.

We want to lead our industry into the low-carbon economy with an all-encompassing approach to ESG that starts with a rigorous assessment of the whole life carbon use of each building that then informs the asset management strategy.

Critically, this includes both 'embodied carbon' (the carbon created upfront through construction) and operational carbon (the carbon emitted from the heating, lighting, air conditioning and other aspects of a building in use). In the built environment, around two-thirds of emissions come from operational carbon and the other third is from construction. Any serious low carbon strategy must focus on both.

> **We want to lead our industry into the low-carbon economy with an all-encompassing approach to ESG that starts with a rigorous assessment of the whole life carbon use of each building**

The temptation to dismiss older vintage buildings as environmentally untenable or to employ blanket solutions to reduce carbon intensity without regard for cost ignores an inescapable reality: we need our low-carbon assets to be commercially viable spaces that our tenants can afford now and into the future. This is why our approach to carbon lifecycle analysis safeguards against ill-considered asset management decisions and reveals vast opportunities for renewal and value creation.

This is exemplified in our latest project: 143-157 Farringdon Road, which is a short walk from Farringdon Crossrail station. Here, we are transforming four former warehouses into 66,000 square feet of workspace with private and communal terraces, upgraded retail at street level, co-working space and a reconfigured basement to support sustainable travel. By implementing a range of measures to reduce the carbon intensity of the existing building – and by retaining the embodied carbon in the existing structure – we will massively reduce the whole life carbon impact of these Victorian warehouses, creating characterful, sustainable workspace that is fit for a low-carbon future.

Conversely, our evaluation of the carbon lifecycle of our property at 105 Victoria Street determined that demolition of the existing building and replacing it with a future-forward asset was the right decision. Upon completion in 2026, this reimagined asset will surpass both existing and emerging sustainability standards and set a new benchmark for what is achievable through low-carbon construction. The goal is for this 470,000 square foot asset to be the UK's largest all-electric office, unhooked from the gas grid and with no diesel generator, and powered solely through renewable energy sources.

By deploying pioneering new innovations in ultra-low carbon construction, we will ensure the carbon emitted through the construction of 105 Victoria Street will be offset within six years of the new building's operation, meaning over its whole life the building is not just net-zero carbon but net beneficial to the environment. Embracing carbon reduction innovation requires bold, decisive action that creates avenues for new technology to flourish and to address the threat of obsolescence.

The building is being designed to ensure that when it reaches the end of its life, elements can be taken apart, reused and repurposed in future construction, preserving the embodied carbon. With this cradle to the grave ethos, we are approaching today's highest sustainability credentials not as targets to aspire to but baselines to build from. This gives occupiers and investors alike the confidence that our assets are aligned with their own stretching ESG ambitions.

Importantly, we are equally ambitious in addressing the 'S' in ESG, which is critical to our low-carbon future. We need to bring tenants along for the ride on our net-zero journey. To do that we consider how we deliver amenities to our assets that promote healthier and cleaner living, waste and water reduction initiatives, more natural light, outdoor access and fresh air, and support for cleaner modes of transport. Their cooperation and shifting consumption habits are how our assets incrementally lower their carbon footprint over time.

At 105 Victoria Street, we are delivering on our commitment to drive positive social and community benefits by providing 90,000 square feet of dedicated space to serve and connect the community, including a central 'village square' at street level that is open to the public. We are also creating a multi-purpose space that will be available for a range of community uses that uplift our neighbourhoods and strengthen our common interests. Within the largest greenspace of any commercial building in central London we will host allotments for use by schools and occupiers alike.

As our teams prepare for one of the most significant challenges in the history of our industry, we see the silver lining in getting it right on carbon reduction in the built environment. We are converting energy inefficiency into exemplary performance. We are treating embodied carbon with the consideration it deserves. And we are employing fresh thinking, innovation and operational excellence into what was once old to create something highly desirable and renewed.

The net zero challenge that awaits every asset in our portfolio has become our new, collective mission. But equally enticing is the enormity of the value creation opportunities we will be pursuing for the benefit of our investors and clients.

For more informtion visit bentallgreenoak.com

BentallGreenOak

TECHNOLOGY

Five tech trends in wealth management to watch in 2022

Technological advances have been transforming the sector over the past 12 months – and next year is likely to see further momentous changes

Simon Brooke

Tokenisation will increase

When Mike Winkelmann's *Everydays* – the first non-fungible token (NFT) of a digital artwork to be offered by a major auction house – sold for $69m (£52m) at Christie's in March, the excitement it caused extended far beyond the art world. NFTs are set to become part of the wealth management mainstream next year.

In November, Goldman Sachs announced that it would be adopting Daml, a development framework created by blockchain startup Digital Asset to enable financial institutions to execute agreements on a blockchain. Tokenisation represents a "vast commercial opportunity", according to Mathew McDermott, head of digital assets in Goldman Sachs' global markets division.

The ownership rights of an asset of a purely digital representation can be divided, stored and traded on a distributed-ledger system such as a blockchain. Splitting up or 'fractionalising' real objects such as a property, on the other hand, can be far more difficult or even impossible, but representing these as tokens overcomes the problem. Tokenisation can open up markets and increase liquidity, as well as making the settlement process more efficient.

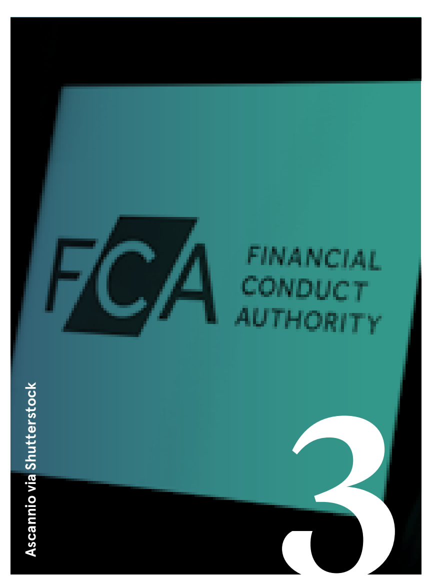
Bloomberg via Getty Images

PeopleImages via Getty Images

Compliance management processes will become more automated

As the regulatory ratchet turns again next year, with new requirements set to be issued by the Financial Conduct Authority, among other watchdogs, wealth managers will increasingly use technology to ensure compliance. Artificial intelligence systems will take over some of the routine and repetitive compliance work that people have been doing for decades. More firms will use technology to take a proactive approach to the task, anticipating the effects of potential regulatory changes.

"Two years ago, the notion that a wealth management business could take on a new client and provide them with appropriate financial advice, all without meeting that person, was unheard of. Now it's the norm," says Finn Houlihan, MD and chartered financial planner at wealth management firm Arlo Group UK. "That's thanks to some incredible strides by compliance departments and also to important investments by firms in ensuring that their teams have the right digital infrastructure to engage with clients remotely."



Ascannio via Shutterstock

Established players will snap up more wealthtech firms

Digital technology has been advancing too quickly for the comfort of some of the sector's older, bigger beasts, which have resorted to M&As to obtain cutting-edge know-how over the past 12 months. Charles Schwab acquired Motif, for instance, while JPMorgan Chase bought Nutmeg, 55ip and OpenInvest. More wealthtech startups are likely to be purchased next year.

US consultancy Forrester Research expects that relative newcomers such as Betterment and Wealthfront will continue attracting clients and assets under management in 2022, thereby increasing their appeal to potential acquirers. There would be clear advantages for all concerned in the event of further M&As, says Vijay Raghavan, senior analyst at Forrester, who adds: "Since the big incumbents have more customers than the wealthtech firms have, a broader swathe of people will begin enjoying improved digital experiences."

As the seamless personalised customer experiences offered by the likes of Amazon, Netflix and Spotify become the norm, consumers will increasingly demand the same level of convenience from their financial service providers, Raghavan predicts.

"While nimble wealthtech firms enhance the digital experiences they offer, spurring incumbents to either improve their own capabilities or acquire them, consumers will benefit," he says. "This will engender client loyalty, leading to increased retention and more assets under management."

tsyhun via Shutterstock

Successful wealth managers will make the most of advanced analytics

AI-based technologies including machine learning, deep learning and natural-language processing will provide the next big advance in wealth management analytics, according to Gartner.

The next generation of analytics systems will become more predictive, offering guidance on actions that firms should be taking. Although 88% of the wealth management executives polled in Gartner's *2021 Financial Services Technology Survey* believe that such systems are effective, only 13% are currently using them. But Gartner reports that it's observing "a steady progression on the deployment of this technology".

In November, the Investment Association published a research report that noted: "Buy-side leaders have begun to access new alternative data sources (most commonly, web-scraped data, geolocation data, social media data and credit card data) and use advanced analytics techniques to generate new insights from these."

The report, *AI and the Investment Management Industry*, quotes a study from Grand View Research forecasting that the global market for alternative data will expand at a compound annual growth rate of 58.5% between 2021 and 2028.

LightField Studios via Shutterstock

Virtual reality will transform client relationships

In April, Nasdaq noted that virtual reality and augmented reality were helping wealth management companies to "make managed investments more intuitive for their clients, especially millennials. The adoption rate of these technologies should increase as advisers become more familiar with their capabilities."

Nasdaq believes that wealth managers will start using these systems to engage their clientele, using their game-play elements to encourage effective savings and investment behaviour.

Given that the Covid crisis has made remote working widely acceptable and the use of videoconferencing services such as Zoom and Microsoft Teams routine for many people, it's a smaller step for virtual and augmented reality to provide more interactions between wealth managers and their clients in 2022 and beyond. Wealth managers will find that they can use these technologies to provide virtual scenarios that will enable clients to explore in vivid detail how the financial choices they're considering could affect them in the future.

These technologies are also set to be used more for internal training purposes. For instance, St James's Place announced in November that it would be supplying employees with Oculus Quest VR headsets. These enable users to experience the role of an adviser and engage in conversations with virtual clients through a series of multiple-choice questions.

Virtual reality technology is "improving rapidly and becoming more affordable", according to St James's Place's divisional director of learning and development, Di Macdonald, who says: "Our intention is to give people a safe space to practice in, so that they can gain confidence without needing access to trainers." ●

COMPETITION

Is big tech coming for the wealth management industry?

Many wealth managers believe that the giants of IT pose a significant competitive threat. But the potential for forming powerful partnerships is an opportunity on the other side of the same coin

Alison Coleman

Global technology giants such as Apple, Amazon, Facebook and Google have long been making inroads into the financial services industry. While they have focused mainly on payments so far, Amazon's recent investment in Indian wealth management startup Smallcase is seen by many as the first step of a deeper foray into the sector.

Is this a wake-up call for wealth managers? Most players in the US certainly think so. According to GlobalData's *2021 Global Wealth Managers Survey*, 87% consider big tech to be a key competitive threat. Meanwhile, Boston Consulting Group's *Global Wealth 2021* report reveals that some of the leading tech players are already developing the digital infrastructure required by wealth managers.

Three years ago Amazon worked with Fidelity Labs to create a digital financial adviser that people could interact with, potentially assessing their portfolios in virtual reality. The current robo-advice market could be an entry point for big tech. It's a small component of the broader wealth management market and it's seen as ripe for disruption. So how big a threat could a big-tech incursion into wealth management pose?

Brands with broad consumer appeal are more likely to overcome the resistance often seen when it comes to investing, says Alan Higgins, chief investment officer at Coutts in the UK. This could give the technology giants an advantage in wealth management.

"They will benefit from targeted advertising led by data insights as a way to gain and hold trust from consumers," he predicts. "Trust is hugely important when it comes to money management, so this will certainly act in big tech's favour."

People's anxieties about making crucial money decisions and a misconception that wealth management firms cater only for the wealthy could also play into the hands of big tech, says Marcus de Maria, founder and CEO of Investment Mastery.

"When traditional wealth providers use words such as 'diversification', 'asset allocation' and 'risk tolerance', it puts people off," he argues. "If big brands such as Amazon or Facebook were to simplify matters and help to educate consumers, people might be encouraged to take that first step. If big tech went further and enabled consumers to use their tools, talk to each other and create a community, that could be a game-changer."

But would seasoned investors trust big tech to manage their money? New entrants seeking custom from this audience would need time and a considerable marketing budget. On the other hand, investors are comfortable with digital tech – for example, using secure portals to check their portfolio valuations and to access and share important documents.

Giulia Lupato, head of regulatory policy and compliance at the Personal Investment Management & Financial Advice Association, notes that big tech has made huge inroads in both retail and financial services, adding: "If they were interested in doing the same in wealth management, why haven't they done so already?"

Wealth management is very much a trust- and relationship-driven industry, but big tech has had its problems in winning the trust of consumers and it isn't geared to building one-to-one human relationships, she says. The UK wealth management sector is also a mature market with very well-established big players.

"A firm like Amazon would struggle to make a dent in the relationships of the type that many wealth managers have built with their clients, especially high- and ultra-high-net-worth individuals," Lupato says.

But she does see an opportunity for big tech in the shape of its data management and processing capabilities. These give it the potential to become a supplier of data services to the wealth management sector.

"We know that consumers are looking for increased personalisation. They want a transparent fee structure and the ability to use several providers," Lupato says. "They're seeking greater integrity with respect to ESG investment and they also want intuitive digital experiences. This presents an opportunity for a data-driven business to provide such services to a large wealth management firm without having to become a wealth management firm itself."

Koshiro K via Shutterstock

Technology-driven wealth management could appeal to a range of asset-holders, helping to bridge the advice gap while providing opportunities to democratise advice for broader sections of the population, according to Tim Thompson-Rye, chief technology officer at Progeny.

"The ability to communicate digitally and deliver our advice virtually changes what's possible and enables us to develop more cost-effective products tailored for new markets and fresh client demographics," he says.

Big tech will always present threats and opportunities in equal measure. The traditional players in any industry need to stay focused on the state of play if they are to protect their position. Clients' expectations about communication, access to information and levels of control have changed, having been influenced by the technology giants. Wealth managers therefore need to deploy innovative technologies across all touchpoints in order to remain relevant.

> **A firm like Amazon would struggle to make a dent in the relationships of the type that many wealth managers have built with their clients**

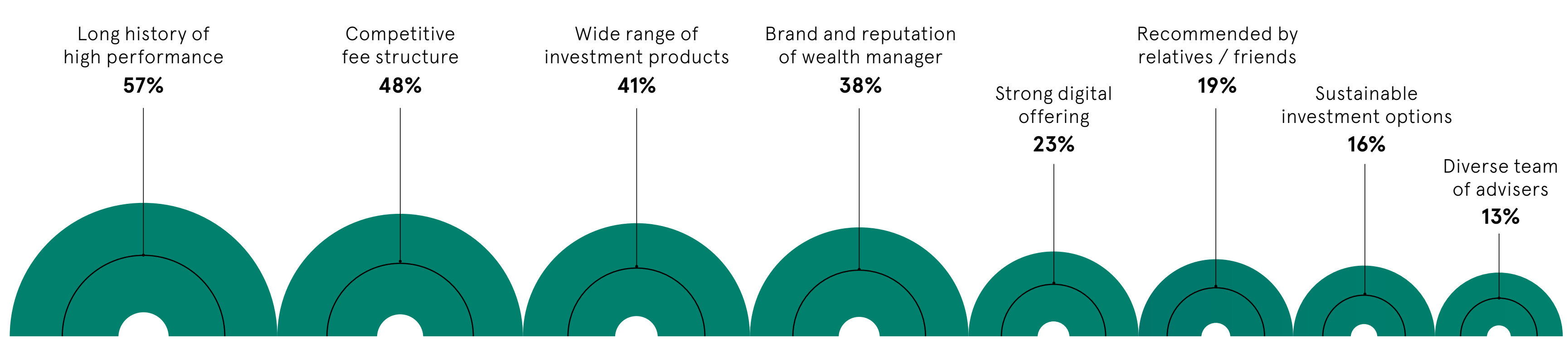
Hugo Bedford, CEO of wealth management firm JM Finn, thinks that big tech's growing interest in wealth management could be an opportunity for all. "They see the attractiveness of wealth management, thanks to the relatively low penetration of professional money management and the gaps that exist in advice and pension provision," he says. "If the world's largest businesses can encourage more younger people to start investing, that has to be good."

Bedford also believes that the involvement of the tech giants could help wealth managers to differentiate their offerings. "Democratising the industry has to be good for society, but there will always be investors whose needs won't be met by the latest algorithm," he says. "They need a relationship with someone before they will entrust that person to manage their wealth."

HOW DO ASSET OWNERS CHOOSE A WEALTH MANAGER?

EY, 2021

Leading reasons for selecting wealth managers worldwide in 2021

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RISK AND RETURN

Get the balance right: building the stable portfolio of the future

Investment trends are changing, with bonds lacking appeal as their yields continue to disappoint. What asset classes could offer a viable alternative?

Marianne Curphey

A balanced portfolio traditionally features a 60:40 mix of equities and bonds, with the latter's proportion rising after the investor's retirement to reduce volatility. But, given that bond yields are at very low levels, investors are seeking stable returns elsewhere.

Other low-risk investment options are emerging as alternatives as wealth managers look beyond the conventional portfolio structure. They're now taking full advantage of evolving asset classes such as property and green infrastructure.

Mike Deverell, partner and investment manager at Equilibrium Investment Management, thinks that the days when a balanced portfolio relied purely on equities and bonds are over.

"Central banks are likely to put up base rates in the next few years – perhaps only to 1% in the UK and maybe 2% in the US, but substantially higher than the levels they're at now," he says. "They will also want to scale back or even reverse quantitative easing. If this were to happen, it would probably be bad for bonds."

That could also have an effect on the stock market, which has been supported by quantitative easing. Big tech stocks in the US would be vulnerable, while inflation could erode purchasing power.

Deverell believes that the balanced portfolio of the future should have an allocation to 'real assets' including infrastructure, selected property and alternatives such as forestry, which will benefit from the green agenda as businesses look to offset their carbon emissions.

"If chosen wisely, these assets can provide a solid, high level of income, which tends to rise at least with inflation," he says.

Adam Walkom is co-founder at Permanent Wealth Partners, a firm of financial planners. For him, the traditional 60:40 portfolio is dead. "In a world of low and rising interest rates, having a significant portion of your portfolio in an asset class that is almost guaranteed to lose money is not diversification – it's stupid," he stresses.

Walkom adds that, thanks to the traditional 60:40 approach, it "became too easy for the adviser to bundle a client into a balanced portfolio because they ticked boxes on the risk questionnaire a certain way – good for the regulator; bad for the client".

If you won't need the funds for 20 or more years, you should hold 100% equities, he argues. For nearer investment horizons – say, five or so years – an "all-weather" portfolio could be an option. This uses a spread of assets for the non-equity portion, such as real-estate investment trusts, gold, private equity and maybe some inflation-linked bonds.

Traditional bonds simply no longer maintain purchasing power for investors, according to Hinesh Patel, portfolio manager at Quilter Investors. He suggests that clients look for selective opportunities in real assets such as infrastructure projects, care homes and warehouses, which can provide attractive income yields.

Some wealth managers believe that thematic investing will be the winning strategy of the future. Over time, there will be a continued increase in exposure to theme-based investing, potentially at the expense of geographic allocations, says Chris Ainscough, director of asset management at Charles Stanley.

> **Having a significant portion of your portfolio in an asset class that is almost guaranteed to lose money is not diversification – it's stupid**

"A clean and easy way to break up the investable universe is to do it on a geographical basis, but this doesn't always take into account overlapping regional exposures across the globe or the fact that the domicile of an investment may be very different from the economic exposure of that investment," Ainscough observes.

An example might be the green energy transition, which will probably have no borders as the world unites to tackle the problem. This thematic move will also involve a shift to real assets such as real estate and gold as an alternative to traditional fixed-income investments.

Heightened awareness of environmental issues such as climate change has also given individual investors a reason to be more vocal about how their money is allocated. ESG issues have come to the fore in investment decisions.

"The fastest evolution of asset markets in recent years has been to cater to clients' preferences regarding ESG, impact and other ethical concerns," Ainscough says. "A balanced portfolio will have to adapt to cater to these."

While the guiding principles of portfolio diversification won't change much, investors' preferences are shifting, notes Dr Harjoat Bhamra, associate professor of finance at Imperial College Business School. "In the future, a well-balanced portfolio will have more exposure to greener assets," he predicts.

Exchange-traded funds focused on investment-grade green bonds are another alternative to traditional bonds. They could be a useful option at a time when the EU has started to issue green bonds.

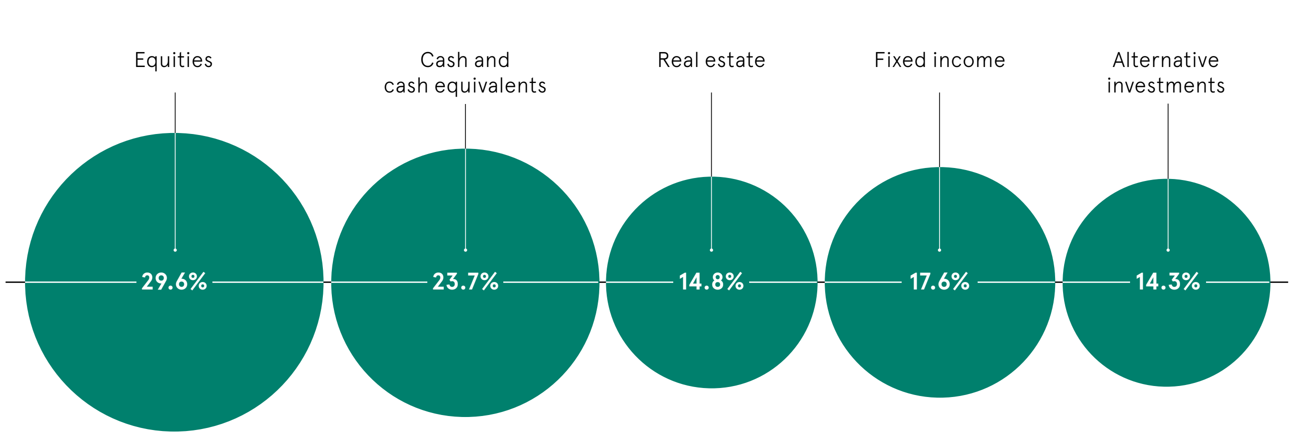
"With most government bond yields at rock bottom, the traditional income and diversifying role they have played in portfolios for decades is challenged," observes Vivek Paul, director and senior portfolio strategist at the BlackRock Investment Institute. He adds that another key question facing investors is how they can integrate sustainability. "There's a deeper and more widespread understanding that sustainability risk is investment risk. Climate change affects every aspect of modern life, so it's not surprising that it is shaping portfolio construction too."

David Ko and Richard Busellato are the co-founders of Rethinking Choices, a sustainability consultancy, and authors of *The Unsustainable Truth: how investing for the future is destroying the planet and what to do about it*. They think that bonds make a poor investment choice because of the associated inflation and credit risks.

"The future balanced portfolio needs to be underweight in those companies that rely on volume growth, clever leverage or significant ongoing investments in selling images of perfect futures," Ko argues. Instead, Busellato advises, investors should be seeking out resilient "street-smart" firms that know how to thrive in a hostile environment and produce goods and services that are genuinely needed.

HOW DIVERSIFIED DO YOU NEED TO BE?

Asset allocation of high-net-worth investors worldwide, 2021



Capgemini, 2021

Commercial feature

How to shore up your investments in turbulent times

Bespoke investment solutions are the answer for businesses buffeted from all sides

The investment world has been hit by a perfect storm of problems. Regulatory changes are coming thick and fast, while inflation is rising – an issue for companies such as insurers – as are cyber risks. And as scrutiny from outside and inside companies increases, the risks of getting a step wrong have become much higher. Being caught flat-footed by regulatory changes and crackdowns, an errant decision to invest in a company that turns out to have issues, or overlooking your ESG credentials can be significant.

For decades, investors have relied on providing clients solutions at scale – but the economics of this can mean investment managers create additional and collective risks for their clients. Each client that has an identikit investment solution is exposed to the risk of a single investment decision compromising all clients in the same strategy. Tailored investment products, designed specifically for a client's needs – and adaptable to their changing circumstances – are the way forward. And London & Capital is at the forefront of the boutique investment solution.

"Unless you're an insurer of a certain size, you're not going to get any tailored approach or service from a large asset manager, whereas the benefit of engaging a small asset manager as a smaller client is you're a bigger fish," says Kate Miller, partner at the firm and head of its institutional business.

London & Capital is a boutique, privately-owned asset manager that deals with three key types of client: ultra-high-net-worth individuals, usually with complex financial situations; Americans in the UK; and institutions – including a focus on those with liabilities, such as insurers and intergovernmental agencies.

> **We're not just an asset manager. We like to think of ourselves as an outsourced CIO**

It's those latter clients that Miller works closely with and has across her more than 25 years in the industry. "Rather than a client coming to us and saying: 'I want you to do this for me,' we work for those small to medium-sized institutional investors who are looking for advice," she says. "We're a consultant-led asset manager."

By looking at a business' cashflow, broader industry issues, regulatory regimes, capital structure and availability of capital – and talking to the board about their goals and aims –we help clients develop an investment strategy that best meets their needs.

For insurers, which Miller has helped support throughout her career, the challenges are more acute than ever. As the insurance market hardens and new products are launched to cover previously unforeseen insurance challenges, the market is developing so quickly that it's difficult for insurers to stay on top of each key internal function, including investments.

Regulatory changes are piling up: in the UK and EU, Solvency II and Brexit are colliding in a way that forces insurers to think twice about how they've set up their businesses. In the Caribbean, BEPS and Economic Substance are coinciding with the global minimum tax regime. And that's before you even consider the IFRS Standards 9 and 17 making significant changes to how companies report data and its effect on profit and loss.

"Regulatory changes are constantly going on at the moment," says Miller. "It's been quite a whirlwind." In Europe, the ongoing negative yields environment creates a real problem for insurers, which hold the majority of their assets in investment-grade, fixed interest assets, companies are paying to hold their money.

Because of that, insurers need investment advice from insurance experts, and they need their money to work harder – the old way of doing things doesn't cut it. "The traditional asset manager is really a product seller for the smaller institutions," says Miller.

Because London & Capital is so embedded in that investment decision with their clients, as change comes about in the underwriting, economic and regulatory landscape, the company can adjust the portfolio to meet changing circumstances. It provides a consultancy and asset management service combined, saving the double-whammy of fees that can shave five or more basis points off what can be an already anaemic return from basic, off-the-shelf product.

"Having this overlay on the front, where a team of experts come in, see what you need to do, advise and lead, is where we set ourselves apart," says Miller. "It's not common."

London & Capital's experts integrate with clients' pre-existing businesses and teams, having constant conversations at a board, committee and finance director level to ascertain where a business is and where it's going, and to develop a unique investment profile based on needs.

"It's about defining the specifics that make the business run," explains Miller. "Do you need your money to just sit there being safe? Or do you need a 3% or 4% return on investment? Do you need something that pursues profit primarily, or do you have shareholder needs to meet around ESG that require careful involvement in the markets?"

By having those deep conversations and drilling down into what a business needs and wants – and what it absolutely cannot do – London & Capital are able not just to help clients achieve the returns required, help them manage and govern the ever growing list of things that can cause reputational risk.


Kate Miller
Partner and head of institutional business

"The benefit of creating a bespoke portfolio is you can talk to a client and say: 'What are you doing? Is there a regulatory push? Is it your clients that you're appealing to? What is the sort of demographic who are looking for this? Is there something in the business we need to be aware of to avoid correlations between assets and liabilities?' For instance, if you're a medical insurer, investing in tobacco is a non-starter," says Miller. London & Capital finds that it is better if that comes out of conversations, rather than diktat and prioritises working with businesses, rather than offering them pre-packed solutions.

The firm is also conscious that clients are busy and require a different style of reporting than out-of-the-box answers. "You're not going to sift through a 60-page valuation and figure out where your exposures are," says Miller.

Instead, the company clearly establishes the issues and what individual readers' roles and responsibilities are. It's all in aid of working towards the same goal: helping firms navigate tricky times in the best possible way. "We're not just an asset manager," says Miller. "We like to think of ourselves as an outsourced CIO."

For more information please visit londonandcapital.com/clients/institutional-business

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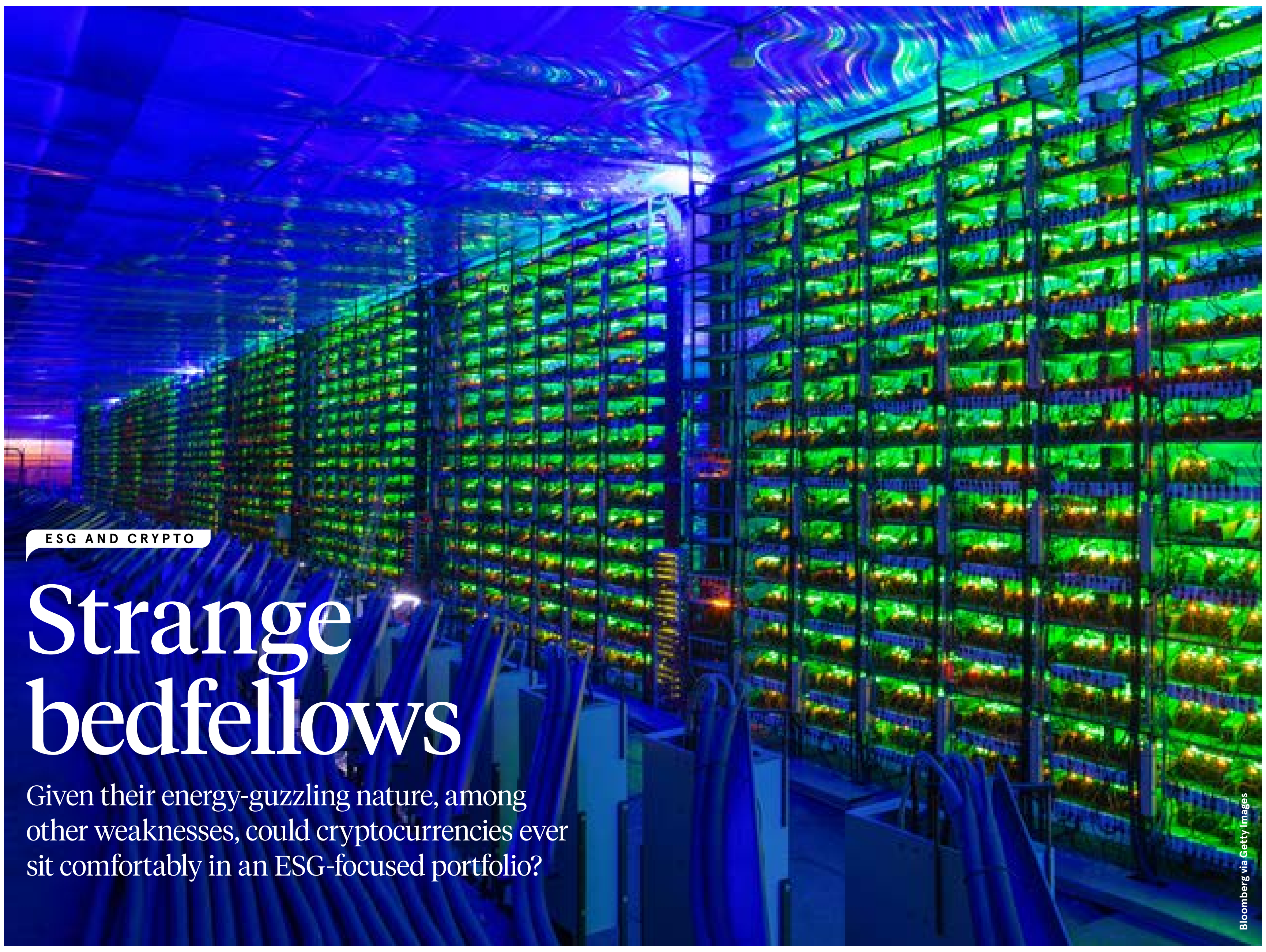


Bloomberg via Getty Images

ESG AND CRYPTO

Strange bedfellows

Given their energy-guzzling nature, among other weaknesses, could cryptocurrencies ever sit comfortably in an ESG-focused portfolio?

Rich McEachran

The popularity of ESG investments has rocketed in recent years, while cryptocurrencies are coming to be viewed as a hedge against inflation in this era of ultra-low interest rates. The question for investors is: could the two ever be compatible?

Crypto fever is starting to infect wealth management, with some private banking institutions responding positively to demand from their clients. In March, Morgan Stanley became the first big US bank to offer its wealth management clients access to bitcoin funds. JPMorgan Chase followed suit in August, even though its chairman and CEO, Jamie Dimon, admitted that he considered bitcoin to be "worthless".

The argument that crypto, unlike a physical asset such as gold, has no intrinsic value is only one of the reasons why most other players in the sector have steered clear of the asset class so far.

If crypto is ever to be added to ESG portfolios, it will be subject to much scrutiny, particularly regarding the environmental element. It has been well reported that bitcoin mining – the computational process of producing new coins – used more electricity last year than the amount consumed by the whole of Argentina.

The booming popularity of bitcoin mining in Kazakhstan, for instance, has led to energy shortages in recent weeks. These have been caused by a ban on the activity in neighbouring China, which prompted miners there to move their operations across the border.

On the flip side, there are miners that offset their greenhouse gas emissions. Some are exploring the possibility of using renewable resources, while others are focusing on clean energy goals. One such project is blockchain company Efforce, led by Apple co-founder Steve Wozniak. Holders of its crypto token, WOZX, are entitled to a share of profits from energy-efficiency projects.

> **Blockchain is still a young technology. It will evolve and take a few more years to mature, but cryptocurrencies will inch closer to being environmentally friendly**

Ecological concerns about crypto are not shared by the socially conscious investors who've spoken to Daniel Wolfe. He's the co-founder of Simoleon Long-Term Value, a fund with a minimum investment level of $100,000 (£75,000) that specifically provides exposure to cryptocurrencies and blockchain-related assets.

"The need to increase the use of green energy sources is critical, regardless of the amount of electricity being consumed, but we shouldn't conflate issues concerning mining with cryptocurrencies in general," Wolfe stresses. "When people talk about cryptocurrencies and sustainability, they are usually referring to bitcoin. Its proof-of-work consensus mechanism, which is used to validate transactions, does require large amounts of computing power."

But some crypto assets are starting to rely instead on what's known as a proof-of-stake model, he adds. This is a less energy-intensive process that's also faster and cheaper. Ethereum plans to switch to proof of stake in 2022, for instance, although no date has yet been set for bitcoin.

In effect, miners are competing to produce coins under the proof-of-work system. Under proof of stake, miners must pledge coins in order to take part. As a result, there are fewer participants.

"There's a clear movement: developers of new crypto projects are becoming conscious of their environmental impact, so they're shifting from proof of work to proof of stake," notes Philip Radford, director at Saffery Champness Registered Fiduciaries. "While the answer isn't just to use renewable energy to power their networks, this is certainly a good starting point."

Beyond the ecological concerns, there are other ESG issues that wealth managers and their clients should consider when assessing crypto opportunities. Jeremy Cheah, associate professor of decentralised finance at Nottingham Trent University, points to the matter of governance. Cryptocurrencies have no CEO or board, but their creators have been known to publish white papers setting out a digital token's real-world use, thereby helping potential investors to gauge how sustainable it might be. Nonetheless, the sector's general lack of accountability means that it remains shrouded in mystery.

"Investors should not feel restricted – there is huge upside for ESG and cryptocurrencies," says Cheah, but he adds: "The question is whether they understand all the risks or not."

Another ESG weakness of crypto concerns the sector's diversity – or lack thereof. For instance, a report published in 2019 by campaign group Diversity in Blockchain criticised a dearth of female and ethnic minority representation, particularly at senior level. Appropriate regulation could ensure better governance standards and make this field more inclusive. In theory, it could also help to make crypto markets less volatile. For instance, the price of bitcoin plummeted by 20% after the emergence of Covid's omicron variant was first reported.

Mitigating such risks, along with reducing the energy consumption of the mining process, should strengthen the appeal of crypto as a long-term investment opportunity, according to Cheah. And, if the associated transaction fees, which are received by miners, can be reduced, this should incentivise investors to buy sustainable cryptocurrencies. He adds that, although crypto clearly has its downside risks, not all ESG projects will provide good returns in the short to medium term. Investments in crypto and ESG are therefore compatible in the sense that both have the potential to deliver gains over the longer term.

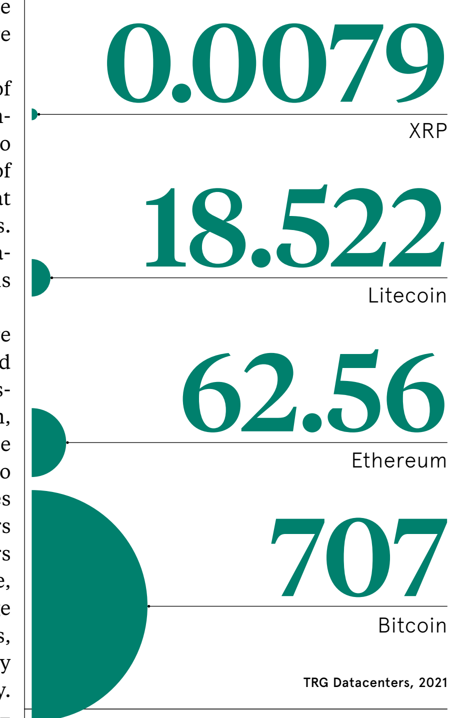
Radford stresses that blockchain is still "a young technology. It will evolve and take a few more years to mature, but cryptocurrencies will inch closer to being environmentally friendly."

Use cases for blockchain-based sustainability, such as using digital assets to raise ESG finance or trading carbon credits on digital markets, will only grow in number. This should encourage more investors and wealth managers to consider exposing their ESG portfolios to cryptocurrencies.

Wolfe says that his advice for investors who have been "convinced about the transformative nature of blockchain and crypto assets" would be: "Don't let current ecological concerns hinder your investments." ●

SOME CRYPTOCURRENCIES ARE FAR MORE SUSTAINABLE THAN OTHERS

Kilowatt-hours consumed per transaction for the following cryptos



TRG Datacenters, 2021

BITCOIN AND ETHEREUM STILL RULE THE ROOST

TradingView, 2021

Share of overall cryptocurrency market capitalisation