Showcase of articles from The FM Report 2018

E-book series 1
I am delighted to introduce the first annual showcase of articles from The FM Report for 2018 drawn from a wide variety of topics that hopefully you will find beneficial.

As many of our readers will already be aware, I believe there is a strong need for people to have access to quality financial writing in Ireland. There is an emerging professional class of investment and financial planners that can add real value to the public.

I have always had a passion for education, for myself, investors and professionals alike. It helps investors make informed decisions that can save them from making terrible decisions; like those that were painfully exposed in 2008, and that can hurt a lifetime. While this project will not transform the industry, I am a strong believer in the Tanzanian phrase "little by little a little becomes a lot"

You will not be disappointed with the line-up for our first edition with some of the world's leading international and domestic experts sharing their thoughts and ideas.

Your Sincerely

Frank Mulchy,
Editor
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Blockchain: Looking to the future

Mark Hawtin, November 2018

Blockchain, the technology behind cryptocurrencies like Bitcoin, is making waves as its potential to be a next generation platform technology starts to emerge from the all the hype. It did not start out with the cleanest reputation, given its first use cases were all based around cryptocurrencies, many of which have crashed after the peak at the end of 2017. In our view, however, the blockchain technology base itself could have very widespread use across every part of the economy in the near future.

What is blockchain?
Blockchain is a technology that allows for the transfer of assets (for example money) in a trusted and secure environment without the need for a central trusted third party like a bank - it automates the process of trust. The first use cases were in cryptocurrencies where the technology allowed the transfer of money in digital form, like Bitcoin, without the need for a trusted counterparty. To gain an understanding of the potential for future use, imagine being able to transfer money peer to peer without a bank, or buying a concert ticket without using a platform like Ticketmaster while knowing that the transaction is totally genuine, safe and secure. Blockchain technology can also be used to ensure the validity of assets such as land registries, artwork and even our personal identities. Driven by the internet and network effects, blockchain utilises a number of technologies that exist today - networks, ledgers and cryptography – and combines them to achieve this effect. Multiple computers worldwide can each hold a copy of a complete transaction ledger and, through a verification process, are able to make sure that every copy of the ledger is identical and constantly updated for each new transaction. The ledger of record is immutable, meaning it cannot be changed retrospectively – once a record is written to the blockchain it is there forever.

The process of maintaining multiple copies of a transaction history creates a very high degree of security, trust and auditability. It is the integrity of this distributed system that could well change the landscape for trust-based activity in the future like banking or national identity management. While still in its infancy, blockchain could be the next foundational technology creating a huge new computing cycle in the technology market.
Major technology shifts have occurred on about a 20-year cycle starting with mainframe computing in the 1960s. Each cycle has driven change in central and decentralisation as the chart above shows. The cloud computing cycle, while appearing in many ways to offer us a much more democratic world, actually centralises the control of technologies. While we can all have a bigger say and our voices can be heard over platforms like Facebook or Twitter, the actual platforms themselves are centralised and all powerful. It is no surprise that the top five companies in the world are now all leading technology companies - Apple, Amazon, Google, Microsoft and Facebook. Each has a strong grip on its specific area of use. The interesting and exciting development that blockchain may bring could be the decentralisation of this platform strength - allowing many users to effectively own and manage the platform in a federated system. This part of the opportunity is very much driven by the development of edge computing: the ability to manage, store and compute at the edge of the network rather than at the core.

Where could blockchain be used?
The possible use cases for this technology are endless but it is likely that in most cases, the user will never know they are part of a blockchain technology application. In the same way that we do not think about email being a cloud-based application (it is just “email”), blockchain will be operating in the background allowing a trusted network for its applications. The key umbrella feature of any application using blockchain is that it will involve the transfer of something of value - that could be money (fiat or digital), a concert ticket or a work of art, or the secure registration and transfer of identity information.

An example of this, that will resonate with many in the financial world, would be the management of the KYC (know your client)/AML (anti-money laundering) process. Research and Markets estimated that over USD 8 billion was spent globally in 2017 on KYC/AML. One of the biggest problems is that every institution gathers, checks and logs information on each individual or organisation with which it does business. As an individual, supplying information to multiple different providers like banks, accountants and lawyers is time consuming and irksome. If there was a trusted repository for the base information required for KYC/AML, then duplication of process could be avoided. Imagine if Bank A collects the identity information required to approve a client
and then places that information on a blockchain database. When Bank B needs to perform the same process, it can get approved information from the blockchain database, know it is trusted and avoid the cost of replicating the process. It might pay a fee to Bank A for doing so but would still likely save overall. To take it one stage further, imagine that an individual was prepared to submit the information directly to the database via a portal and keep it up to date; Bank A and Bank B could access the approved information and pay the individual a fee. The banks would make savings and the individual would generate an income. The process of removing the need for a trusted counterparty may create significant cost benefits and income opportunities.

On the consumer side, we believe concert ticketing would be a perfect blockchain opportunity. The annual cost of chargeback alone due to ticketing fraud is estimated by Riskified to be over USD 9 billion – this could be entirely eliminated through a blockchain-based ticketing system. Concert and sports venues would ensure that tickets reached the correct owner with total control over the path of that ticket from issuance to event. Additional controls can easily be added to the system; if an artist did not want tickets to be resold, then that could be written into a smart contract on the blockchain for that particular event. If the artist was happy to have resale, but at a maximum of two times the face value, the same would apply. Tickets would be digital and could be unavailable on a device until a pre-determined time ahead of the event or when the ticket holder is within a certain radius of the event, adding even more security to the process. The ways to secure and manage the ticketing system are numerous, adding more and more layers of security.

A case of when, not if
Blockchain is still at a very early stage, probably akin to the internet in 1995, and broad adoption is many years away. One of the key barriers to its development is the need for governments and legislators to adopt new laws and processes to allow for its use. By their very nature these organisations are slow moving, although it is already clear that they see the value inherent in using it. Estonia, for example, has adopted a blockchain-based national identity scheme and Singapore is looking to do the same. These are small countries where the barriers to adoption are more easily surmountable. However, the opportunity is so great and the ability to prevent or reduce financial fraud, crime and terrorism so clear that, in our view, it will be a case of when, not if. At present, there are few ways to gain exposure to blockchain investments directly, but we believe there will be a slew of opportunities in time. Much like Software as a Service (SaaS) saw multiple opportunities emerge just after the great financial crisis, a full 10 years after mass adoption of the internet, blockchain as a Service (BaaS), will likely follow a similar path and we estimate it will be another five to 10 years before there is a real sub-sector. However, fortune favours the brave and we believe there will be early opportunities to be had in the same way that Salesforce led the SaaS revolution.

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The only thing bad about a pension is the word ‘pension’

Paul Murray, November 2018

What if I told you I could give you an opportunity to take money from a company without any tax bill, you’d be interested right? What if I said you can invest the money you took from the company tax-free as well; your interest peaks a bit more? What if I said you could take a lump of cash tax-free at the end as well, your interest should have peaked at this stage, yes?

Why then, when we call it a pension do so many people go glass eyed and are no longer interested? Because we still call it a ‘pension’.

It appears, to me anyway, that the phrase ‘pension’ makes people think of being old and grey and getting some pittance of a weekly payment. That no longer is the case and hasn’t been for a long time, but we haven’t educated people well enough about what a ‘pension’ actually is.

Let’s take an example;

You have a client who owns their own business, (s)he is 40 years of age, married and business is going well, and they are thinking of buying an investment property for their ‘retirement’.

Your client has a choice – they can pay approximately 52% tax (highest marginal tax rate) taking the money from the business in salary to buy a property. The rental income from the property would also be taxed at their marginal tax rate.

Now there is nothing necessarily wrong with this as that is the tax system in place, but there is a better and much more tax efficient way to do it, a perfectly legal way to make your clients money go roughly twice as far.

Going back to our example above, (I’m going to give the client a name at this stage, Dave’s business has been going since January 2010 and Dave draws an annual salary of €70K p.a. from the company. Based on the above and assuming no other pension benefits (there are always assumptions in our industry!), the business could make a contribution of approx. €350K to a self-administered pension scheme to allow Dave to buy that property.

**Buying the Property**

So instead of having to take over €700K from the company to buy the property after tax, €350K can come from the company and buy the property – so Dave and the business are now €350k+ better off already.

Straight away this makes sense from a tax and cash-flow perspective for both Dave and his company.

**Rental Income**

It’s a pension, or as I call it, an extremely tax efficient savings plan, therefore the rent rolls in to the pension scheme tax free, Dave is up to 52% better off by not paying tax on the rental income.

**At Age 60 or beyond**

From age 60 Dave can take a tax-free lump sum from his ‘pension’ of up to €200K from the scheme (subject to rules – 1.5 times salary or 25% of the value of the scheme).
Let’s say the value of the property is now €500K and between rental income and a few contributions by the company there is €300K in cash in the fund.

Dave can take 25% of the value, i.e. €200K tax free – another gain, Dave has been on a winning streak for quite some time now!

The property and cash can now be transferred to an ARF and the rental income taken as annual income for Dave for his retirement, just like his original intention at the outset.

This approach was a lot more cash and tax efficient for him and his business. In essence Dave can do roughly twice as much through an extremely tax efficient savings plan known as a ‘pension’ scheme than if he were to take the funds from the company as salary.

**A few things to be aware of when buying a property in a self-administered pension scheme**

There are a few things advisors and their clients need to be aware of when buying a property in a self-administered pension scheme;

- **You pay stamp duty on the purchase**
  A pension is exempt from Income Tax and Capital Gains tax, not all taxes – be aware of rates of stamp duty for residential and commercial property.

- **If the property is a new build there will be VAT payable on the purchase**
  See above, if it a residential property the VAT cost will most likely have to be absorbed by the pension scheme as a cost. If a commercial property there may also be on going VAT obligations – registration, VAT on lease payments etc. Self-administered pension schemes can register for VAT so can claim VAT back but VAT advice may well be required.

- **LPT** is payable on a residential property and **PRTB** registration fees and obligations apply to residential properties.

- **Legal fees** will come in about 1% of the purchaser price of the property, also factor in VAT on fees and the likes of **Property Registration Authority fees** on registration of a property.

- **You should always seek independent investment advice** when investing in a pension scheme, to ensure you understand, the investment risks relating to property and other investments

- **There are restrictions** on the use of property within a pension scheme,

- **Property is not necessarily a liquid asset** and may have implications on the ability to **access a lump sum at retirement**

**In summary;**

In summary, we need to educate people for the need to plan for the day when their income will stop, we need to stop using the word ‘pension’ and highlight to them that there is an extremely tax efficient savings plan available that will allow then save for their future in a manner that provides for that day where the government will effectively contribute to it through very generous tax relief, it worked for the SSIA, it can work for a ‘pension’ once we explain it well enough.

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Death and Pensions

Derek Ryan, May 2018

When it comes to pensions, it is becoming increasingly important that we do not just ask our clients what do they have in their pension pot but more significantly what type of pension is their pension pot in? As the pension rules can result in dramatically different outcome for clients.

Pension Types in Ireland
Clients are surprised to know that in Ireland we have the following pension arrangements:
- Personal Pensions
- Buy Out Bonds
- Personal Retirement Savings Accounts
- Approved Retirement Funds
- Defined Contribution Plans
- Annuities
- Defined Benefit Plans
- Additional Voluntary Contributions
- Small Self-Administered Schemes

Each of these pension types have different rules as to how the benefits are paid in the event of the death of the member and it important to understand the rules as they apply to your pension pot.

Rules on Death after Retirement
First of all, I am fond of saying to my clients that one will only die in two places. They will either die before they retire or after they retire. Therefore, that is always the first question worth considering. Have you retired all or some of your benefits? Of the arrangements mentioned above only two of them are post retirement vehicles, namely Annuities and the Approved Retirement Funds (ARF).

Annuities can often die with the member (if they are single life for example) and rarely have the ability to be passed on to adult children (unless in full time education).

ARFs though have the ability to be passed on to next of kin in their entirety including all the capital to adult children. The ARF is much more of an asset than the Annuity as it will pass on to your beneficiaries, where it is often said the Annuity will die along with the second spouse.

Rules on Death before Retirement
All of the other arrangements are pre-retirement vehicles with one little exception and that is the Personal Retirement Savings Account (PRSA). The PRSA is the only one that can be used in both pre and post retirement.
So why is it important for you to know what type of pension you are in? The answer is explained in the following table that tries to simplify what benefits are paid on death:

<table>
<thead>
<tr>
<th>Type of Pension</th>
<th>Tax Free Lump Sum</th>
<th>Annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Pension Plan</td>
<td>Fund Value</td>
<td>N/A</td>
</tr>
<tr>
<td>Personal Retirement Savings Account</td>
<td>Fund Value</td>
<td>N/A</td>
</tr>
<tr>
<td>Personal Retirement Bond</td>
<td>Fund Value</td>
<td>Annuity</td>
</tr>
<tr>
<td>Defined Contribution</td>
<td>4 times Salary</td>
<td>Balance</td>
</tr>
<tr>
<td>Defined Benefit</td>
<td>4 times Salary</td>
<td>Defined Formula</td>
</tr>
<tr>
<td>Additional Voluntary Contributions</td>
<td>Return of Fund</td>
<td>N/A</td>
</tr>
<tr>
<td>Small Self-Administered Scheme (DC)</td>
<td>4 times Salary</td>
<td>Balance</td>
</tr>
</tbody>
</table>

So therefore, if I have €1m in my PRSA, in the event of my death my surviving spouse will receive that €1m tax free. If I have €1m in my Defined Contribution Scheme and my salary is €50,000 then my surviving spouse would receive €200,000 tax free and the €800,000 would have to be used to purchase an annuity. Annuity rates today in Ireland for a 50-year female are circa 2.6%. That would be a pension of around €20,800 per annum. which benefit would you prefer Most would say the €1m tax free because of the flexibility it would bring and the ability to spend more in the early years when children are younger, and more funds are needed to get them reared and on the “ladder of life”.

This is area is particularly relevant for people with terminal illness as they are able to structure their pensions so that it most meets their family needs.

**Summary**
Understanding the testamentary rules on your pension will help you ensure your estate plan provides for your beneficiaries in line with your wishes.

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Enthusiasm for crypto currencies and bitcoin in particular has gone truly global. Mainstream media has been buzzing with reports on rapid price appreciation and commentary from both evangelists and sceptics. This article seeks to outline some of the key things you need to know about bitcoin and crypto currencies.

One thing I have established, is that most people don’t understand what crypto currencies or blockchain mean. Why are they asking? There may be many valid reasons, for example the security of a decentralised ledger; potential lower cost and greater efficiency of doing business; a currency that cannot be devalued by Central Banks; a new asset class to trade; or simply because it’s going up.

**What is bitcoin and where did it come from?**

Bitcoin is the poster child for crypto currencies, digital assets designed to work as money and secured by cryptography. Blockchain is the technology enabling crypto currencies to exist, acting as a decentralised ledger recording transactions. A decentralised ledger is a huge database which is shared and updated constantly by thousands of computers around the world without any central authority like a Central Bank or government at its core. Decentralised ledgers are very difficult to hack because they are copied thousands of times across computers around the world.

Bitcoin was created by a person or persons with the pseudonym Satoshi Nakamoto after publication of a whitepaper in 2008. Few people outside of a tiny crypto currency universe paid it much attention initially, but it has gained enormous popularity since its massive price increase during 2017.

New bitcoin are created by a process called mining, whereby individuals are rewarded for processing transactions on the blockchain with fractions of newly issued bitcoin. As of mid-January 2018, there were 16.8 million bitcoin in existence against a maximum of 21 million to be created in total.
Is bitcoin a credible currency?

For a currency to work it needs to be a medium of exchange, unit of account and a store of value.

Bitcoin is a medium of exchange – it has been used for transactions, but it’s not widely accepted, has had high transaction costs, delayed transaction processing and limited capacity (far less transaction capability than a major credit card for example).

It has not proven yet to be a useful unit of account or store of value – the price volatility is simply way too high, regularly moving up/down in price by 10% or more in a day.

Legitimisation by the financial community

Bitcoin took a huge step toward being broadly accepted by the financial community in December 2017 when the two largest US futures exchanges (CBOE and CME) listed futures contracts with prices linked to bitcoin. Also, in December ’17 several bitcoin ETFs were filed for listing on the New York stock exchange.

How to buy and store bitcoin

Bitcoin can be bought at many bitcoin exchanges on the internet. Once purchased, bitcoin needs to be stored in an electronic wallet, usually on an exchange.

As with all transactions on the internet, people deciding to buy bitcoin should ensure they properly research the entity they are dealing with. Although it would appear that bitcoin is difficult to hack, it does not automatically follow that bitcoin exchanges are difficult to hack. Potential buyers of bitcoin should investigate what happened when the Mt. Gox exchange filed for bankruptcy in 2014 after hundreds of millions of dollars’ worth of bitcoin were stolen.

How to value bitcoin

Traditional methods of asset valuation do not work with a cryptocurrency. There is no book value or cashflow to analyse. We can compare bitcoin to other crypto currencies but that doesn’t really help. There is a transaction value and a quoted market value, but they are highly volatile. Some analysts will say bitcoin is worth $100,000 or more, while others say it’s worth zero. I believe it does have value but cannot think of any credible way to calculate that value, nor have I seen any worthwhile analysis to date.

Initial Coin Offerings (ICOs) – Caveat Emptor!

Initial Coin Offerings (ICOs) are unregulated markets where new crypto currencies are launched, and money raised. Hundreds of new crypto currencies were issued via ICOs in 2017. This is an extreme case of ‘buyer beware’. Some of the new crypto currencies may be successful, but it’s also likely that many will be worth zero.

Official crackdowns on ICOs have taken place, most notably in China where ICOs were banned in 2017.
Investment vs. Speculation

One primary reason for people asking about bitcoin is because the price has been shooting higher, and people are suffering from FOMO – the fear of missing out. Could this be like the proverbial shoeshine boy giving stock tips?

Some people have undoubtedly bought bitcoin for investment purposes. However, a great many have bought simply because they think the price will rise further, perhaps a large majority of people buying during the run-up from c. $2,500 to c. $20,000 in the second half of 2017.

Another major feature of the market of late has been companies announcing changes to their business and/or their name around Blockchain technology. A notable example in mid-January was Kodak, the formerly high-flying photography company founded in 1888. The announcement of ‘KodakCoin’ caused its stock price to more than triple from $3 to $10. A US soft drink maker saw its stock price soar by 500% in December when it announced a change in focus to exploring opportunities that leverage the benefits of Blockchain.

Many other similar stories exist, and some sound eerily similar to the mania during the dotcom bubble of the late ‘90s when existing companies added .com to their names. We should remember that even some of the most successful technology companies like Intel, Cisco and Amazon saw their stock prices fall by 80%-90% during the dotcom bust in late 1999 to 2001.

What about Regulation and Tax?

Governments have had a monopoly for centuries on the issuance of currency. Since the end of the gold standard in the 1970s when President Nixon ceased the convertibility of the dollar for gold (after large scale European exchanging of dollars for gold), the world has been operating on a fiat money system. Fiat money is currency issued by governments without any intrinsic value.

The fiat money system is rife with government manipulation. In recent years we have seen hyperinflation and the destruction of currencies such as the Zimbabwe and Venezuelan dollars by gross economic mismanagement. We have also seen enormous Central Bank balance sheet growth in the US, Europe, Japan and elsewhere as a result of the financial crisis which began in 2008.

The advent of crypto currencies could challenge the role of government at the centre of the financial system. Therefore, it is reasonable to assume that we will see further attempts at regulation and taxation of the crypto / blockchain world. The shift away from paper money will not happen without turbulence.

I have not seen any commentary by Revenue in Ireland regarding crypto currencies, but one should assume that any gain on trading or investing in crypto currency is taxable like gains from trading other financial assets. Each individual should consult their tax adviser for advice on their specific situation.
Conclusion:

To wrap up, blockchain may indeed be transformational and may bring enormous changes to how the financial system works. However, this will not happen overnight. Individuals interested in cryptocurrency and blockchain need to do their research and should determine and document their reasons for getting involved. It is likely that some cryptocurrencies will survive and thrive, but I expect attempts at regulation by governments, failure of some poorly designed cryptocurrencies, hacking, theft and other unforeseen bumps on the road. It may even be the case that the eventual winners from blockchain have not been launched yet. It is still early days in this new market and for now traditional ways of doing business and investing in stocks, bonds and other asset classes will remain to the fore.

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Cyber Risks A Threat to Investors and Financial Markets

Mark O’Byrne, January 2018

Cyber wars are a bigger threat to humanity than nuclear weapons, the world’s most famous investor Warren Buffett, warned in May 2017.

“I do think that’s the number one problem with mankind,” Warren Buffett warned during Berkshire Hathaway’s annual shareholder meeting on May 6th.

“I’m very pessimistic on weapons of mass destruction generally although I don’t think that nuclear probably is quite as likely as either primarily biological and maybe cyber,” Buffett cheerily told Berkshire Hathaway’s annual shareholders’ meeting.

“I don’t know that much about cyber, but I do think that’s the number one problem with mankind” said Buffett

Last year, Buffett told CNBC — cyber, nuclear, biological and chemical attacks — posed a major threat to the economic well-being of Berkshire shareholders.

Echoing Buffett’s cyber concerns, leading experts on financial warfare, cyber terrorism and cyber war have warned that cyber threats could badly impact financial exchanges and financial markets leading to a sharp selloff in risk assets.

The threat posed by cyber fraud, terrorism and war to our increasingly complicated, technologically dependent and vulnerable financial institutions, markets, banks and indeed deposits becomes clearer by the day.

Source: Statista

Internet Shutdowns on the Increase
Number of government internet shutdowns worldwide (Jan 2016 to Sep 2017)

The source lists another 20 countries with a total of 24 internet shutdowns
As of September 11, 2017
Source: accesnow.org

Source: Statista
Here are just a few reminders of the many cyber “events” in recent months and years:

- The New Year and the first week of 2018 brought news of the ‘Spectre’ and ‘Meltdown’ security flaws identified in Intel, ARM and AMD chips, exposing nearly all computers worldwide, including smartphones and other devices, to major security risk

- The personal data of over 140 million American and British people including credit card numbers and their financial data was stolen from Equifax, the consumer credit reporting agency, in one of the biggest hacks in history, uncovered in September 2017

- Cyber fraud in the global Swift payment system resulted in $81 million being stolen from the New York Federal Reserve Bank in February 2016

- JP Morgan Chase were hacked in the summer of 2014 by unknown parties who stole the personal details of 83 million customers

- Yahoo (1 billion accounts), MySpace (360 million names and passwords), eBay (145 million passwords) and several more massive companies have been hacked

- In July of last year Bloomberg reported that malware had been detected in the IT systems of the Nasdaq exchange. Its purpose was unclear but it was believed to have been embedded there by Russian hackers

- EU country Estonia, a technologically advanced nation, experienced a complete internet shutdown in 2007. It is believed that Russian cyber warfare took down the internet

- The number of ‘internet shutdowns’ increased in 2017 as more than 30 countries were hit by internet shutdowns

- In October 2017, it came to light that Deloitte was hacked and clients’ sensitive emails and data compromised

- NatWest, RBS and Ulster Bank all experienced online banking “issues” in November 2017 with clients left without access to funds & experienced failed payments with little to no recourse

This is part of a much larger problem. Alas, barely a week goes by without some company or government agency announcing that one of its systems has been attacked and compromised. There are many more examples of cyber fraud, hacking, theft and terrorism. There are also many examples of slow and frequently inept responses from hacked companies, banks and governments, cover-up attempts and a lack of responsibility and accountability.

The very frequent cyber-attacks being seen internationally highlight the growing nature of the threat, and the need for much greater security and caution regarding online assets and banking. The events above suggest that we appear to be sleep walking into a global cyber financial crisis.
Many analysts, including geopolitical and monetary expert James Rickards, the bestselling author of ‘Currency Wars’ has warned that cyber-attacks may have already compromised the U.S. national security and could turn a “bad day on Wall Street into a full-blown crash”.

He warned that WikiLeaks’ March 2017 release of 7,818 web pages, called the ‘Vault 7’, was a major development. This collection amounted to more than several hundred million lines of code, and gave away the entire hacking capacity of the CIA. It was by far the largest release of CIA intelligence documents in history. The WikiLeaks’ released documents proved that U.S. intelligence agencies have lost control of their hacking tools.

There are other risks that are more relevant to those of us who work in finance and manage client’s wealth. In 2010, the Department of Homeland Security and the FBI found an attack virus in the computer systems of the Nasdaq stock market. They disabled the virus, but there are concerns that others remain. In August 2013, the Nasdaq was abruptly shut down for over three hours which prevented investors from buying/selling technology stocks such as Facebook, Amazon, Apple, Netflix and Google and other investor favourites.

Military tacticians and planners make use of a fighting doctrine called “force multiplier.” The idea is that any given weapon can be used with greater-than-normal effect when combined with some other state or condition that gives the weapon greater impact. For example, if say North Korea, Russia or China wanted to disrupt a U.S. stock exchange, they might wait until the market is down over 3%, some 800 points on the Dow Jones Industrial Average, for reasons unrelated to a cyberattack. They then launch an attack on a day and at a moment when the market is already nervous and volatile.

This would “multiply” the impact of the attack and possibly result in a crash comparable in percentage terms to the one-day ‘Black Monday’ drop on Oct. 19, 1987 of 22.6%.

These scenarios are real risks to financial markets but there are also risks to online payments and banking systems.
As we have seen our modern digital financial system, banks, institutions and governments are all vulnerable and many have been compromised.

The digital financial system of today and online investment and savings providers including brokerages with their massive dependency on single interface websites, servers and the internet face serious risks that few analysts have yet to appreciate and evaluate.

These also pose risks to online investment providers and brokerages who do not allow clients to interact and trade on the phone and are solely reliant for pricing and liquidity from online portals and online trading platforms.

These real risks highlight the increasing importance of not having all one’s financial eggs in the ‘online financial and banking system’. One way to hedge these risks is to diversify into hard assets and have an allocation to hard assets such as property, land and gold bullion.

Physical assets outside the banking and financial system are less vulnerable potential cyber terrorism, war and contagion.

The hope is that these cyber risks will not impact the global economy and financial markets. Hope is never a strategy. It is prudent to be aware of and take appropriate measures including re-evaluating asset allocations due to these risks.

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Cryptocurrencies have dominated the financial headlines in the last few months, initially with jaw dropping gains followed more recently by rollercoaster trading. Jamie Dimon, CEO of JP Morgan and Warren Buffet have both cast their doubts about the longer term sustainability of Bitcoin, Ripple and others. In truth, cryptocurrencies have a long way to go before being considered a suitable investment for the average private client portfolio. Despite this, Bloomberg now reports on the price of Bitcoin alongside more established and recognised market exchanges like the Dow Jones and the NASDAQ. While Bitcoin and crypto currencies have hogged the news flow, the technology sector has been the engine room driving equity markets to new highs.

The sector, including both hardware and software companies, was the top performing sector in the FTSE World index in 2017. This strong performance continued from previous years with technology rarely out of the top three contributing sectors for the same index. For Irish investors, this performance was achieved despite the effect of the weakening of the US dollar versus the euro.

Market commentators Jim Cramer and Bob Lang christened the acronym FANG on CNBC’s Mad Money in February 2013. Their suggestion to viewers was: “Put money to work in companies that are totally dominant in their markets and put money to work in stocks that have serious momentum”. The FANG stocks consisted of four technology equities which have been the darlings of investors since; Facebook, Amazon, Netflix and Google (now Alphabet). Following this strategy rewarded investors handsomely.

When investors analyse technology firms as an investment, it is usually the American names which are the first to be considered. The FANG’s plus other household names here in Ireland, including Apple, Intel, Microsoft and Salesforce for example. All experienced impressive returns in 2017 in euro terms and this has continued in early 2018.

While conventional wisdom would say the majority of the largest IT companies are American, it is interesting to note that the US only accounted for 15 of top 25 tech companies in the Forbes list of the largest companies published in May 2017. Asian companies in particular have been making significant strides on the list since the turn of millennium. The continent was home to four companies breaking the US dominance within the top 15 – Cannon (No.15), Hon Hai Precision (no. 10), Samsung (no. 2) and Taiwan Semiconductor (No.12).

Spotting this trend back in September 2016, Cramer updated his acronym from FANG to FAAAS. This consisted of updating Google’s rebranding to Alphabet, dropping Netflix and most interestingly adding a Chinese platform for global wholesale trade, Alibaba.

If asked to name a handful of Asian technology companies, it is likely an Irish person would offer up one or all of Alibaba, Lenovo or Samsung. While not as well known on this side of the world, companies like Tencent, a Chinese digital media and telecom conglomerate, SK Holdings, a South Korean conglomerate or Baidu, a Chinese company specializing in Internet-related services and products, have established themselves as some of the biggest players on the internet. Tencent in particular experienced a stellar 2017 in the equity market.
It was not in the top 15 of the Forbes list in May 2017, but by November had become the first Asian business to be worth in excess of $500bn and in the process surpassed Facebook in market value.

However as Alibaba and Tencent are making waves in the developed world, their perceived dominance in China may not be as secure as expected. Another Chinese company JD.com has set its sights on topping Alibaba on various metrics. To achieve this goal, the company have been investing heavily in its supply chain while offering a higher end product within a more controlled market place. The company CEO, Liu Qiangdong, during an interview with CNBC in September 2017 claimed that his company will have surpassed Alibaba within the next 5 years. Another one to watch.

China in particular seems to have leapt ahead in its use of technology. Where many of us are becoming increasingly familiar with Apple Pay, usage in Ireland and Europe at large remains relatively low. However, Alibaba’s Alipay and Tencent’s TenPay appears considerably more widespread in China. The move away from holding cash in your wallet may be one of the first examples of emerging markets leading the developed world.

European names should not be excluded from this conversation. The region is home to leading companies like ASML, Infineon, Nokia and SAP, who are at the forefront of global developments involving driverless cars, iris-scanning technology and augmented reality to highlight a few themes.

Many fear as we close in on the 10th year of the current bull market that it can’t continue to propel itself forward. If the early indications of 2018 continue, it will be again the tech names to the fore. Most technology companies still see themselves in growth mode despite the large cash piles held on their balance sheet. Rather than paying a substantial dividend to shareholders, these companies believe they can reinvest these funds back into their businesses, generating a higher rate of return for their shareholder.

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*Investors should remember that the value of investments, and the income from them, can go down as well as up. Investors may not recover what they invest. Past performance is no guarantee of future results.*

*Any mention of a specific security should not be interpreted as a solicitation to buy or sell a specific security.*
Investing with a Conscience: Integrating Smart Beta and ESG

Jennifer Bender, June 2018

In a world of lower returns, investors face the challenge of meeting their return objectives without taking on too much risk or incurring significant costs. At the same time, a growing number of investors wish to ensure their underlying investments incorporate an awareness of environmental, social and governance (“ESG”) issues. Innovations in both Smart Beta and ESG investing are helping investors address this diverse set of requirements.

Smart Beta Investing
Smart Beta investing is based on the insight that factors—company attributes that have been shown to explain stock returns—are the underlying drivers of performance. Academic research demonstrates that factor-based investing can deliver returns in excess of cap-weighted benchmarks over time by capturing so-called “factor premia”. It also shows that multi-factor (as opposed to single factor) exposure can offer diversification benefits. We use the five factors we believe represent the primary drivers of equity returns – value, size, volatility, momentum and quality. These diversified Smart Beta strategies are growing in popularity because they offer the potential to outperform a cap-weighted benchmark with lower fees compared with actively managed funds.

Why ESG Matters
Investment strategies with an ESG dimension are also increasingly prevalent. This style of investing can help to align an investor’s portfolio with their personal or institutional values, as well as with policy requirements. In the past, choosing values or performance was often presented as zero-sum, i.e., the tilt towards ESG came at the cost of better returns. But many studies now suggest this is a false choice and that a company’s environmental actions, social behaviours and governance practices can have a meaningful impact on its financial performance.

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<td>Proportion of cost-capital studies showing that high ESG scores lower cost of capital.</td>
<td>Proportion of studies showing that strong ESG performance yields better corporate operating performance (e.g., ROA, Tobin’s Q, etc.).</td>
<td>Proportion of studies demonstrating a positive correlation between high ESG and superior stock performance.</td>
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Source: From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance, March 2015, University of Oxford and Arabesque Partners. Retrieved January 20, 2016; State Street Global Advisors. The authors reviewed 29 cost of capital studies, 51 operating performance studies, and 41 stock price studies, respectively. Past performance is not a guarantee of future results.

The Integration Challenge
Our Smart Beta research team has found ways that investors can take full advantage of both Smart Beta and ESG investing within the same portfolio. Portfolio construction is critical, as there may be trade-offs between targeted factor exposures and a favourable ESG profile. For example, companies with better ESG scores tend to be large, while factor premia are often found in small cap firms.[1] Fortunately, as both ESG profiles and factor exposures can be quantitatively measured, our team can aim to achieve balanced exposures through the use of optimisation.
Optimization-based portfolio construction methods offer a means of building a portfolio with the desired aggregate characteristics, while minimizing any unintended exposures such as currency or sector exposures. The result is a balanced and systematic method of integrating ESG exposure into a diversified Smart Beta strategy.

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Disclosures
The views expressed in this material are the views of Jennifer Bender and Todd Bridges through the period ended May 29, 2018 and are subject to change based on market and other conditions. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected. Investing involves risk including the risk of loss of principal.

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Investment pitfalls and how to resist them.

Guy Stern, October 2018

Investing is an activity that’s rife with opportunity to fall into bad habits, be led astray or make decisions for the wrong reasons. Being aware of the behavioural traps and temptations that lie in wait for the unwary investor is the first step to avoiding them. The Seven Deadly Sins were formulated in early Christian teachings to make followers mindful of man’s natural vices – lust, gluttony, greed, sloth, wrath, envy and pride. In this article, we’re adapting The Seven Deadly Sins to the world of multi-asset investment, revealing the all-too-common investor tendencies that we look to avoid in order to achieve reliable long-term performance. We hope our take on sin is a fun but useful insight into the way we think about the world and multi-asset investing.

1. Lust – Resist the siren call of short-term opportunity

Investing for the long-term sounds like an obvious strategy but it is surprising how few investors actually adopt it. In our fast-paced world, the desire for instant gratification can overwhelm. The prospect of immediate gain invites temptation to pile into whatever is the flavour of the month long after the opportunity to profit has passed. Done mindfully, however, moving in and out of markets or asset classes can work. But it needs to be done for the right reason: to take advantage of short-term mis-pricing. Selling high and buying low has typically led to happier endings. That aside, a less lusty approach that weathers market ups and downs over years, not just weeks, almost always proves more fruitful – as well as cheaper – in the long term.

2. Gluttony (gula) - When it comes to information, less is more.

In a data-overloaded world it is easy to gorge on information. But analysis that involves lots of inputs is not necessarily more effective. Simpler but disciplined analytical frameworks can be the most robust. When evaluating asset classes, for example, the simplest approach is to look at yields and growth prospects. If valuations are high (and therefore yields are low), the chances are that valuations will fall (and therefore yields will rise). Conversely, if yields are high, there’s a good chance that they will fall, and valuations rise. Having the discipline to screen out market noise also means resisting the temptation to change your basis for valuation every time a new fad comes along. People lost fortunes in the dot.com bubble by being attracted to fashionable new metrics such as counting eyeballs, instead of analysing company cashflow. Keeping your basis for selecting equities or bonds sound and lean is arguably the key to rich pickings.

3. Greed (avaritia) – If everyone else is investing, probably best you don’t

Whether it’s equities, bonds or property, the avarice of the herd is always to be treated with caution. The periods when a sector is rocketing, and investors are piling in at any price can be the time to steer clear (or quietly sell). Conversely, the time when the market is getting agitated and bailing out can provide rich territory for smart, selective investors who know what they want to buy and why. Patience is paramount, however. If you have a strong conviction about a company or asset class, it may take a while for others to come around to your point of view. During this time, prices may move against you, requiring mental strength to stick with your position. Equal discipline is required to keep your portfolio balanced. If everyone is moving to equities, it can be tempting to sacrifice your fixed income exposure. But with that, you could also jettison your risk diversification. Wherever you invest, invest for the right reasons.
4. Sloth (acedia) - In investment there are no short cuts

Investing is easy. Understanding what you’re investing in is a completely different matter. Whether analysing the relative merits of entire markets or simply individual assets, only invest in what you really know and like. In active equity investing, that means doing all the hard work to get to understand every single company first hand. Likewise, in bonds, don’t just look at yield; measure and compare bonds against other valuable criteria, such as default rates, the underlying nature of the company and its industry (or economy). Only through this graft do you really understand what the right valuation for an investment should be. From some vantage points, sloth is one of the better sins. If you have chosen the right business in which to invest, it is often best to let the stock grow without fussing over it or trading unduly. So, our moral is not to be lazy in doing due diligence, but rest fairly comfortably once a sound long-term decision has been made.

5. Wrath (ira) - Being diversified is the key to calm – even in volatile markets.

Markets are plummeting, the outlook is bleak, and everyone is selling. But if your portfolio is properly diversified you can afford to be an oasis of calm. There are rare cases when the majority of asset classes have fallen together (the 2008 global credit crisis), but usually it’s a case of swings and roundabouts. Historically when equities were falling, and the economy was gloomy, interest rates were cut, then fixed income assets were likely to be standing firm. Equally, if inflation is threatening to rise, equity and commodity exposure may hold you in good stead even if your bond holdings fall. The wrath and unpredictability of markets can be daunting and never more so than today given the extraordinary measures taken by governments and central banks since the global credit crisis. Allocating to the highest-quality assets you can find across a spread of lowly-correlated asset classes remains arguably the most sensible protection.

6. Envy (Invidia – Imitating the index is the poorest form of flattery

‘Benchmark hugging’ is a cardinal sin of the ‘active’ investor. This deviant behaviour, especially among professional investors, is driven largely by fear. After all, if you follow your benchmark index at least you can’t be sacked for underperforming it. The sin with this approach is partly that it’s lazy and unthinking. It means you are constantly investing only in assets that have done well in the past, rather than those that might do well in the future (stocks only enter indices following good performance and leave after poor). When constructing a portfolio, it might be a good idea to take little or no notice of market indices but to invest in those assets that offer the best potential for future return at an appropriate level of risk. This gives you the freedom to invest only in what you really rate— with no obligation to hold anything simply because it’s in the index. Modern multi-asset strategies judge their performance not against relative market index but against meaningful outcomes like steady growth of their nest egg or reliable income. For most investors, these are the things that really matter.

7. Pride (superbia) – Overconfidence comes before a fall

‘It’s a human survival instinct to be overconfident – note the survey from a Swedish psychology journal, where 93% of American motorists claimed they were ‘above average’ drivers. The natural tendency to be overconfident in one’s own abilities is fatal for investors. It leads them to make judgements based on inadequate information, overestimate the accuracy of their predictions and believe they aren’t prey to the same mistakes as everyone else. Overconfident investors, as a result, often make the same mistakes over and over again. What’s more, people stay overconfident even
when they have made mistakes that highlight the errors of their own judgement. In these circumstances, people are likely to blame events outside of their control. So, when an asset in a portfolio goes up, an investor is likely to take the credit. When it falls, they’re more likely to blame unforeseen events. Whatever your assessment of your own confidence, spending more time asking yourself why your judgement could be wrong, rather than gathering proof that it is right, can lead to a better outcome.

Conclusion

Hindsight is a wonderful thing – particularly in investment markets, where instinct and emotion all too often override sense and logic. So, for anyone looking to buy (or sell) an investment, we hope this article proves an enduring reminder just to pause, consider, and think hard before taking action. Being a ‘virtuous’ investor is clearly a challenge. It demands that you resist impulsive behaviour, screen out market noise, remain thorough in your research and stay calm and dispassionate whatever market conditions you face. But armed with the knowledge of which vices to avoid, hopefully those good habits can now become a little easier to cultivate. Please remember, the value of investments and the income from them can go down as well as up and you may get back less than the amount invested.

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RISK WARNING

The value of investments, and the income from them, can go down as well as up and you may get back less than the amount invested.

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How will physical risks of climate change affect companies?

Andrew Howard, August 2018

The potential costs to some companies of insuring their assets against the impact of climate change could equate to more than 4% of their market values, according to our new physical risk assessment.

This new analysis focuses on the often-overlooked risks posed to bricks and mortar from climate change. Disruption from the effects of changing weather patterns globally looks unavoidable – it seems inevitable that risks to physical assets and infrastructure will get bigger. However, most climate analysis focuses on the impacts of steps to limit temperature rises, such as carbon prices or clean energy investment. Physical risks, on the other hand, have received less attention. We feel that this oversight is remiss; the impacts are lower, but they are also more certain.

The analysis is based on the premise that – in theory – companies could insure themselves against the physical damage they may sustain from climate change-induced environmental changes, such as extreme weather events.

Our physical risk framework – which we have applied to over 10,000 companies globally – calculates what businesses would have to pay to insure their physical assets against hazards caused by rising global temperatures and weather disruption.

Comparing that implied cost to companies’ market values provides a systematic way to help measure, monitor and manage the risks companies face.

Which sectors are most affected?
We have identified oil & gas, utilities and basic resources as the sectors most exposed to the physical impact of climate change. The potential cost of insuring their physical assets equates to more than 3% of their market values.

The sectors least at risk are technology, personal & household goods and healthcare.
Predictably, capital-intensive sectors operating in more vulnerable parts of the world face the biggest impacts, whereas those with asset-light business models are least exposed.

The lag between greenhouse gas emissions and temperature rises means a further rise in global temperatures looks inevitable given the emissions we have already released. This physical damage analysis will help inform the investment decisions of our analysts and fund managers, as well as gauge the exposures facing the portfolios they overseer.

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To reduce inequality, focus on inclusive growth

Neil Dwane, September 2018

Burdened by too much debt and growing societal frustration, the global economy is faced with stark choices, including fiscal austerity and rising defaults. But what if we took a page out of Henry Ford’s playbook, creating a highly paid, highly trained workforce to help usher in a new era of inclusive growth?

The global economy has been stuck in second gear since the financial crisis. Historically low interest rates and seemingly free-flowing credit have kept the economy from backsliding – and boosted corporate profits – but they have failed to reignite growth. Beyond the economic toll, we are seeing a host of social and political problems come to the fore, including a resurgence of populism and rising economic inequality.

There are no easy solutions to these problems; multiple approaches will be needed to truly fix the global economy and address growing levels of societal frustration. But one such approach may be encouraging governments and corporations to deliver “inclusive growth” – growth that is shared throughout society in a way that reduces economic inequality.

For an example of how this might work, consider the American automobile magnate Henry Ford. Although he is primarily remembered for his transformative success at using the assembly line to mass-produce the Model T, what is less widely known is how he used high wages to stabilise his workforce and improve productivity.

As the Model T’s popularity grew, Ford realised that chronic employee absenteeism and high turnover were hurting his bottom line, so he decided to pay his workers a wage so competitive that they would be unwilling to risk leaving or losing their jobs.

Ford’s strategy worked, and the payoff was significant: employee turnover decreased, workers became more skilled, production lines became increasingly efficient and profits soared. Beyond his factory walls, Ford’s approach helped develop America’s middle class, and helped create an economy that was increasingly driven by consumer demand.

In contrast to Ford’s approach, what seems to drive many corporate management teams today is the pursuit of short-term profits by cutting costs – particularly the cost of labour. And instead of making wise capital expenditures, many companies conduct share buybacks that inflate their stock options, even though buybacks can actually diminish medium-term returns by starving investments that boost competitiveness. All too often, these boosts to profits and stock prices come at the expense of employees, the environment and sometimes the quality of a company’s products.

To be sure, most companies exist to generate profits. But companies form part of the social and ethical structures of their societies, and the pursuit of profit should not be their only goal. Companies could be better off trying to make their business models more sustainable by managing long-term risks to their businesses, by focusing on productivity and innovation, and by finding ways to contribute to the societies they depend on for their prosperity.

Higher wages are part of the inclusive growth approach that society needs, but simply boosting payrolls will not instantly repair decades of increasing inequality and failing economic growth. There are too many other economic pressures at work, including the rise of artificial intelligence and...
robotics; according to a survey by Oxford University, 47% of US jobs could soon be lost to computerisation.

So, if corporations want to make their business models profitable and sustainable, they should focus on raising the skill levels of their employees, not just pay levels. And if governments truly want to reduce some of the longer-lasting effects of inequality, they should implement policies that help workers evolve into new roles.

There may be downsides to this inclusive-growth approach – profits and investment performance may take a short-term hit – but the medium- to longer-term payoff could be a widespread return to growth. This is surely more in line with what society needs: a rising tide of economic prosperity that lifts all boats and carries us towards a more sustainable future.

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Exchange Traded Funds: Not all made the same

Stephen Barrett, September 2018

Over the last 25 years, Exchange Traded Funds (ETFs) have grown in popularity. But many people are still not exactly sure of what they are, believing they can just buy a Global Equity ETF or a North American ETF. But the reality is, there are thousands of different ETFs to choose from and even two that look the same may be very different.

What are ETF's
An ETF tracks an index of stocks, bonds or commodities. They are traded on the stock exchange, so their value goes up and down throughout the day (whereas a fund is valued at the end of the day). The ETF owns the underlying assets of the index it is tracking.

One of the main reasons for their growth in popularity is the low cost of running them. As they don’t make any active decisions on which stocks to buy or sell, they don’t have to pay analysts to study companies or star fund managers to make investment decisions.

What it is tracking?
Each ETF has an index that they try to copy. These indices are created by companies such as MSCI, S&P or FTSE. You need to be aware of what they are tracking as the indices themselves can be very different, even if they sound similar. Here is an example of three of MSCI’s World Flagship Indexes

MSCI World Index: Covers more than 1,600 securities across large and mid-cap size segments and across style and sector segments in 23 developed markets.

MSCI World Investable Market Index (IMI): Covers more than 4,500 securities across large, mid and small-cap size segments and across style and sector segments in 23 developed markets.

MSCI World All Cap Index: Covers approximately 6,100 securities and includes large, mid, small and micro-cap size segments for all 23 developed markets countries.

Not only do they invest in a varying number of companies, they invest in different sized companies. These will all have an effect on the performance of the index.

Tracking Error
Do not assume that all ETFs are the same. When deciding which ETF to purchase, it is very important to look at the tracking error of the ETF. That is, how good is the company at actually replicating the performance of the index that it is tracking. Remember, when people invest in ETFs, it is because they believe in market efficiency and want to capture the returns of the market. If an ETF has a high tracking error, they are not capturing the returns of the market accurately, and so not doing what they are being paid to do.

US v European domicile ETFs
The taxation treatment of ETFs for Irish investors are very different depending on where they are domiciled. Despite ETFs being traded on the stock exchange like any stock, in Ireland they are taxed under the “gross roll up” regime. That is, any dividends or sale of shares are rolled back up into the fund without you incurring a tax liability. Gross roll up funds are taxed at 41% on profit and you must pay deemed disposal every eight years.
US and Canadian ETFs however are taxed like shares, so deemed disposal does not apply and gains are taxed under Capital Gains Tax which is 33% on profit less the annual exemption of €1,270. The reason for this is that US and Canadian ETFs pay out dividends every year which are taxed as income. The Revenue are happy to get some tax income each year and so tax these ETFs under the CGT tax system.

Recent European legislation has prevented lots of people from investing in US or Canadian ETFs. From the beginning of 2018, regulations state that anyone investing in an ETF or fund has to be given a Key Investor Information Document (KIID) before they invest. A problem arises however with US/Canadian ETFs. As they are domiciled outside of the EU, they do not produce KIIDs so they cannot be sold on the retail investor market in Europe. The fund managers have no intention of producing them. Most ETF providers have European versions that satisfy EU regulations but are taxed at 41%.

**Synthetic ETFs**
A traditional ETF will own the actual underlying assets that they are tracking. But with a Synthetic ETF, they try to replicate the returns of the index by using derivatives and swaps to track the index.

On the plus side, Synthetic ETFs usually have a lower tracking error when compared to ETFs that buy the underlying assets. They tend to be cheaper to run, so the cost to the consumer is lower.

However, the ETF provider has to enter into an agreement with a third party to pay the return of the index. While that third party is usually a bank, it does add a layer of counterparty risk that doesn’t apply where the fund is buying the assets themselves.

So, before you go and buy ETFs, it is vital that you know what the ETF is actually tracking; what companies make up the index, how many are in the index and what size are the companies. Also, when deciding what provider to use, how has their fund performed in comparison to the index they are tracking. All providers will make this information freely available.

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To hedge or not to hedge?

Peter Murphy, June 2018

In this article we consider whether it beneficial to minimise currency risk in your investment portfolio by hedging currency risk and we look at the tools available to implement a hedging strategy.

Currency risk is, whether you know it or not, present in your investment portfolio. Even if you have the most straightforward of investment portfolios comprising, say, Irish listed companies and those holdings are denominated in Euros, you still face some element of currency risk. That is to say, that those underlying companies probably have an element of currency risk in their earnings and you as the investor are therefore exposed to some of this risk in terms of how foreign exchanges movements may impact on the company's fortunes and thus its share price.

In truth, there is little or nothing an investor can do to mitigate or avoid this risk. Essentially you are relying on the underlying company to manage and mitigate the foreign exchange risk that might exist in their businesses. However, in a more broadly invested portfolio than described above an investor will most likely be exposed to currency risk and there are often ways in which these risks can be managed or hedged.

Taking a step back for a moment, let’s briefly consider the foreign exchange markets in general. These markets are the most liquid and most actively traded markets in the world. The volumes traded daily in foreign exchange markets dwarf those traded in equities or indeed any other asset class. It must also be said that foreign exchange rates are notoriously unpredictable. The ability of investment professionals to predict anything at all is actually pretty poor... but when it comes to exchange rates, their success rate is worse again! One might then ask whether it is worth considering this matter at all. In fact, some would say that foreign exchange risk in a portfolio is a zero-sum-game. That is, over long periods of time one will “win” as often as one will “lose” and therefore currency risk should be ignored, and the gains and losses will simply wash out over time. Whilst I somewhat subscribe to this view, it tends only to be a truism over very long periods and perhaps longer periods than investors are generally willing or able to consider. Therefore, we are presented with the question of whether to hedge currency risk and if so how?

The answer in my view is yes, currency risk should generally be hedged, to some extent at least. Hedging currency risk, however, need not be some highfalutin concept and the realm of those with PhDs who live in the land of futures and options. Indeed, hedging currency risk can be done very simply in a number of ways without getting too complicated at all. For example:

1. Only invest in Euro denominated assets. Quite simply if your portfolio only consists of Euro assets you will have no currency risk, other than that described at the start of the article. I am sure this might raise an eyebrow or two, but in my opinion, it is possible to construct a sufficiently diversified portfolio consisting only of Euro based assets. Of course, it will be the case that a more global portfolio will be more diversified, BUT it will be more diversified and will introduce currency risk.... Is this then a better outcome??

2. Extending out the previous point, one might well consider assets that are non-Euro based for investment. In this case, it is often very easy to hedge out currency risk. For example, a significant number of Exchange Traded Funds (ETFs) providers will offer currency hedged
share classes. So, for example, if it is a US equity ETF then the client can invest in US equities through a Euro denominated/hedged share class which will strip out the currency risk. Whilst there is a small cost to this approach, it basically does exactly what it says on the tin.

3. In structured product land, it is possible to gain exposure to assets (usually) equities denominated in any currency at all but have the product itself denominated in Euro. This is referred to as a Quanto product and essentially gives a one-for-one exposure to the underlying asset price movement and the currency risk element is removed.

As you can see, without getting too complicated at all one can quite easily significantly reduce or even eliminate currency risk in a portfolio.

There will always be instances where it is either difficult or too costly to hedge out currency risk, but these instances will be rare. The trick is to know where the risk lies in this regard and either hedge them out or take them on the chin.

The foreign exchange markets are fantastically complex. There are many factors which influence currency movements and trying to anticipate and second guess these is very difficult indeed. I am not suggesting that one should not occasionally take a view on a currency cross with a view to profiting as this can certainly be done when one currency is significantly out of line with long term historic valuation for example. However, it is important to distinguish between a conscious decision to take an active position in a currency as opposed to unwittingly taking on currency risk. Hedging is all about the removal of a particular risk and not about an active view one way or the other. By hedging you are trying to get to the pure return on the asset itself and remove the currency fluctuation. Therefore, when assessing your portfolio – after the event – there is little point lamenting lost currency gains that might have been had as this misses the point. Again, it all about removing or managing risk, which can only be a good thing.

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Disclaimer: The content of this article should not be construed as financial advice. You should consult a financial adviser to obtain advice appropriate to your individual circumstances.
Financial Planning – What is That All About?

Simon Thompson, October 2018

When people ask me what my job is, I tell them I am a Financial Planner, to which I normally get two responses: (1) What should I be invested in? (2) Which is the best pension product?

I am not surprised by the way people react, as financial planning by its very nature is a relatively new topic to the Irish financial market. It’s also far easier to buy something like an investment or a pension than it is to take time to think about what you want to achieve before actually doing anything. Psychologists call it instant gratification, we live in a world where everything is immediate if not sooner. Add to this, the fact that, ‘buying stuff’ is made so much easier as most people have a credit card (and probably more than one), which means we buy now and elect to pay later which can also bring its own challenges.

For most people, the thoughts of creating a Financial Plan can be daunting. It means having to meet with a Financial Planner and be prompted to decide what their goals are for the rest of their life. As part of this process, they have to face the depressing and unbearable truth about planning for retirement, so the only rationale solution is ‘not’ to create a Financial Plan.

We live in an age where we have countless access to numerous sources of financial information via books, magazines and the internet. This very often leads to information overload and thus more confusion about financial planning. For most people, all they really want is to be shown ‘What to Do’

Many of the people we meet are at the top of what they do in their professional lives, yet when it comes to money matters, they are paralysed by the fear of making a mistake. Combined with the fact that they are busy people, spinning many plates and don’t have the time to spend researching financial solutions which often results in them doing nothing at all.

It’s not just the fear of making a mistake that holds us back, it’s also the mistakes we may have already made that we don’t want to own up to, ‘the skeletons in the closet’. For some, the thoughts of opening the ‘window envelopes’ that the postman delivers with credit card and bank statements can be stressful, so they are left to pile up in the hope that something will happen to change the situation. What really needs to happen is a change in our behaviour, but that’s easier said than done.

When it comes to designing your Financial Plan, bear in mind that it really has nothing to do with what the financial markets are doing or the value of your house and everything to do with what is most important to you. It does not have to be an exact science, make the best guesses you can today, do not get too hung up on getting everything right as you can make amendments when things go off track.

The Process:
On meeting with someone for the first time, we ask a few questions and do a lot of listening. One of the most challenging questions one can be asked is, why is money really important to you? With a bit of teasing out, this question can serve as a statement of values, something that would act as a reminder why you work hard and save money. We want to help people identify what really matters to them, it can be a few things jotted down on a bit of paper or saved on your phone, upon which you can get very clear.
Once these have been identified, it’s then a case of going through the mechanics of the planning steps which are detailed below.
Financial Organisation

- Sorting out the “Shoe Box” or carrier bag full of the old policy documents and paperwork.
- Handing over time consuming administration to the experts.
- Secure electronic information.

Life Planning

- What does long term financial success look like for you?

Education and Behavioural Coaching

- Objectively trying to avoid poor financial decisions.
- Keeping focussed on systematic, structured investment paths.
- Acting as a sounding board.
- Providing an impartial second opinion.

Financial Solutions

- Implementing the Financial Plan.
- Recommending and sourcing the best possible financial solutions.

Financial Planning

- Pulling together all financial resources in one place.
- Looking at future incomes and outflows
- Current and future expenditure
- Carrying out “What if Tests”
- Attitude to and need for risk.
- The Financial Plan
- The ongoing Financial reviews of the plan.
How Important Is It To get Started?
Irish Life published figures in mid – October 2018, here are their findings.

“The average member of a pension scheme with Ireland’s largest pension fund provider is on target to retire with a pension of just 17 per cent of their salary, they analysed the company pension schemes that they administer (almost 1,400 across the State with about 38,000 members). It shows that, on average, people do not start saving towards a pension until they are 37 years of age.

They took the average current member, a male (58 per cent of the number surveyed), aged 43, earning €46,000, with six years of contributions to date and a current retirement amount of €45,000. At current projections, this average member can expect a pension at retirement (aged 65) of €190,500, giving them an average pension of just €7,900, or 17 per cent of their salary.

If you include the State Pension at today’s rates (assuming it is still universally payable by then as it has its own looming funding crisis), this person can expect total retirement income of €19,900, or approximately 43 per cent of their gross working salary”.

It is worth noting that this survey only relates to a particular product, in this case a pension. However, is does highlight the reality that the vast majority of the population in Ireland are faced with the stark fact that they will not have the same level of income in the future that they enjoy today.

Simply by meeting with a Financial Planner, someone who will help you to identify what is really important to you and help you to make some choices, you will be better off than the vast majority of your neighbours, family or friends. Getting started is the key.

Author: Simon Thompson, Financial Planner with Accumulus Financial Planners. www.accumulus.ie
Emerging markets such as China, Taiwan, Brazil and South Africa are leading the way in innovative thinking, particularly in the technology sector. In fact, emerging markets companies are leading the charge in all sorts of hardware and software developments: from the components that make the phones in your pocket to the camera technology that will allow us to use driverless cars.

In this article, we look at how the technology sector in emerging markets is providing us with many interesting opportunities.

We know technology has touched nearly every aspect of our lives. It has transformed how we communicate with each other, how we shop, work and play. This is true for consumers across the globe but it might surprise you to know that of internet users globally, it is the emerging markets of China (21%) and India (14%) that have the largest share, above the United States (9%), Japan (3%) and Germany (2%).

Of the top 10 internet using countries, 5 are emerging markets (shown in black)

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**Source:** Internet Live Stats; updated July 2017

**Embracing Technology is Helping Emerging Markets to Fast-Track Growth**

China’s “Internet Plus” strategy, unveiled in 2015, demonstrates the key role the government hopes online businesses will play in fueling its next stage of economic growth. The strategy aims to increase digitalization across the economy and to increase the presence of China’s internet-based businesses globally.

This increasing internet access means increasing opportunities. Take Indonesia, for example. Research from the International Telecommunications Union has found for each 1% increase in the internet penetration rate, unemployment growth would be reduced by 8.61%. The entire effect of broadband on unemployment is a combination of new jobs and existing jobs saved that otherwise would have contributed to the unemployment rate.
In turn, consumers have more discretionary income, and the middle class is able to gain more clout. This increased spending power has driven a more consumer-oriented culture, and new and more diverse investment opportunities.

**Increasing Access Can Mean Increasing Opportunities**

According to McKinsey research, if Indonesia fully embraces digitization, it can realize an estimated USD $150 billion in growth—10% of GDP—by 2025. Harnessing digital technology can boost productivity and expand economic participation across the economy. While e-commerce is growing rapidly in Indonesia—one of the world’s 10 largest economies by purchasing power parity—there is still room for more progress.

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Some of the Opportunities for Indonesia from Increased E-Commerce

Source: (1) ITU (2015); (2) Pew Research; (3) and (4) Mckinsey 2016

**A Changing Profile**

Not only have consumers changed, the profile of what one might think of as an emerging-market company has as well. In the past, these businesses were generally fairly simple, nascent business models. They were highly geared towards infrastructure.

During the last 10 years or so, we’ve seen a gradual migration to increasingly sophisticated business models. Emerging-market companies have established their own brand names, their own niches and have expanded beyond their home countries or region, often by acquisition.

We are seeing a new generation of emerging-market companies develop. By and large, emerging-market companies have also seen healthy cash-flow generation and improving earnings. In the past, there were certain periods where corporate balance sheets were under severe stress due to foreign-exchange debt. They ran into problems, particularly when the local currency came under pressure.

Today, these currency issues seem to be managed much better and corporate balance sheets appear to be much healthier. In general, emerging-market companies have deleveraged over time; they have cleaned up their balance sheets and repaired their business models.
It’s Still about Growth

One characteristic that has generally defined emerging markets in the past—and still does—is their high growth rate. Emerging-market economies have been growing significantly faster than developed-market economies, and we anticipate this trend is likely to continue.

Despite this higher rate of growth, the valuations of shares in emerging markets companies generally appear much more reasonable than in developed markets. You can invest in many of these companies at a price that is a significant discount to what you would have to pay to invest in an equivalent business in the developed world.

Business models in emerging markets have become far more sophisticated and robust than they ever were in the past. We are very excited about the opportunities we’re finding in emerging markets today and the potential for the future.

If you are interested in finding out more about how you can access opportunities in emerging markets, we recommend you speak to your financial adviser. They can give you objective advice about the most suitable investments for you.

Author: Carlos Hardenberg, Fund Manager, Franklin Templeton Investments

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1. Ibid
3. Ibid.
The world’s Shifting Economic Power

Robert Powell, August 2018

In less than a generation, emerging markets and developing economies have gone from being producers of goods and trading hubs for developed countries, to becoming an important destination for consumer goods and services in their own right. They now account for nearly 80 percent of global economic growth, and 85 percent of growth in global consumption – more than double their share in the 1990s.¹

The impact

China will be the new global superpower

Two centuries ago Napoléon Bonaparte said, “China is a sleeping giant… when she wakes, she will move the world.”² How right he was. Only 15 years ago, China’s economy was one tenth the size of the U.S. economy. If it continues to grow as predicted, it will be bigger than the U.S. economy by the late 2020s.²

As a result, and as an example of the urbanisation megatrend, China expects to have 200 cities with a population of over one million people by 2025.³ To tackle overcrowding in Beijing, China is building a new city from scratch 100km southwest of the capital. Initially it will be double the size of Manhattan and is expected to become twice the size of New York and Singapore.³

Global demographics will change

In 2016, Asia’s population was estimated at 4.4 billion, having quadrupled in size during the 20th century. As the graph below shows, it is forecast to grow to over 5 billion people by 2050. Asia benefits from a wealth of resources and has an ecological variety which makes it well-placed to support this growth. As a result, we can expect to see further economic growth across this region.⁴

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¹ Source: United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision, custom data acquired via website
Shift in investor preferences

Traditionally investors preferred the relative safety of developed economies, and particularly the US, believing they offered longer-term sustainable growth potential. Emerging markets offered tactical opportunities that came with increased risk, but potentially greater reward. We’re already seeing a shift towards emerging markets in investment portfolios and this is likely to accelerate as China makes equities more accessible to foreign investors and improves their global trading policies.

The outlook

Population growth is at the heart of the shift in economic power. The influence of emerging and developing economies will mean huge changes for business, society and the way we invest. Opportunities for investors to benefit from these rapid changes means that the small allocations to these areas of the globe in investment portfolios could swell in the coming years.

From west to east
Despite some challenges for the Chinese economy driven by debt levels and property market valuations, among other things, the potential long-term growth of the Chinese economy relative to the US and Europe looks likely. China is already on a path to usurp the US as the world’s leading superpower. When it does, political agendas, global trade and the sphere of influence are likely to shift towards Beijing from Washington.

Mandarin could become the setting language
The continuing liberalisation of the Chinese economy means the assumption that the world speaks English will likely become a thing of the past.

The US and Europe will steadily lose ground to China and India
Chinese business growth proves unstoppable

China now boasts at least 100 unicorns (private companies with a $1 billion valuation) and by the end of 2019 it is forecast to be the largest user of the international patent system. It currently lies in second behind the U.S.

An impressive six million enterprises were registered in China last year, up from 2.5m in 2013. The fastest growing sectors included science and technology, entertainment, sport and finance, whilst the number of mining, electricity and gas companies showed a slight decline.

This growing influence of emerging and developing economies will mean huge changes for business, society and the way we invest.

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3 China Daily USA, April 03 2017, New area to be ‘historic development’. Accessed at: http://usa.chinadaily.com.cn/epaper/2017-04/03/content_28783856.htm
6 Financial Times, Tom Hancock, April 11 2018. Accessed at: https://www.ft.com/content/16094eb4-3d61-11e8-b9f9-de94fa33a81e
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