

Coronavirus economic impact

Lock down your finances for the coming storms

From reassessing your investment portfolio to a timely remortgage, FT Money reviews the options

FT Money reporters SEPTEMBER 25 2020

When UK investors and savers first heard about the contagion spreading through China late last year, they could have had little idea of the dangers [Covid-19](#) would pose populations around the world or the havoc it would cause the global economy.

After seven months of grim death statistics, public health restrictions, business closures and volatile markets, we have a much firmer idea of the enormity of its impact and the risks it continues to hold.

There are a host of reasons to remain concerned over economic prospects for the next six months. Boris Johnson, prime minister, this week [announced new restrictions](#) designed to tackle a worrying resurgence in coronavirus cases, asking people to work from home if possible and introducing new curbs on the hospitality industry.

Rishi Sunak, the chancellor, on Thursday [outlined](#) a new Job Support Scheme to replace the soon-to-end furlough scheme, prolonging its support but tightening the criteria for companies to qualify. Many people will face the resumption of their mortgage payments in the autumn, after the mortgage holiday initiative [winds down](#). And some sectors of the economy are growing increasingly concerned over the ongoing failure to agree the UK's future trading relations with the EU as negotiations drag on.

As we head into a period clouded by uncertainty, FT Money considers the steps you can take to protect your assets and the plans you should reconsider in the face of growing risk. How can savers, homeowners and investors lock down their finances as the storm clouds gather?



New measures: Rishi Sunak, the chancellor announced the Job Support Scheme this week © Justin Tallis/AFP/Getty

Assess your investment options

Investors wondering what they should do next will find no easy answers. Instead, experts say they must start with questions. Are you more worried about inflation or deflation? Are you bullish on tech and banking? What has changed since the pandemic and which trends have accelerated?

Advisers say the most important thing about your investments is that they should let you [sleep at night](#) – and restful allocations are different for everybody.

“At the core of this question is ‘I want control, and I don’t have control’” says Georgia Lee Hussey, chief executive of US wealth manager Modernist Financial. Investors cannot control the markets or the pandemic, she says, but they can control their cash. “Cash is queen . . . Having enough cash will allow us to float through this present moment,” she says.

Now is the time for investors to pull enough cash out of an investment portfolio to ensure they have a comfortable financial cushion, as the markets remain in the flush of recovery, advisers say. The accepted wisdom is that an investor should keep a minimum of six months' worth of expenses in cash to protect them from drawing down on hard-hit investments. But as the pandemic stretches on and job losses mount, investors may want the reassurance of a bigger buffer.

Though interest rates on savings accounts have bottomed out, advisers say the risk of erosion from inflation is less urgent than the risk of a drop in equity prices. Stock prices in the US remain frothy, buoyed by a small number of large tech companies which have benefited from the pandemic, and fixed income is complicated to navigate due to ultra-low interest rates.

Bullish investors looking for value should not go “bottom fishing” and pick up [risky assets](#) that will continue to be hit by an ongoing, uncertain pandemic, despite their low price tags, says Wayne Berry, director of investment management at wealth manager Brewin Dolphin.

UK equities look relatively cheap, but some warn the outlook is not positive. “We don't think now is the time to buy UK equities,” says Graham Bishop, chief investment officer of Heartwood Investment Management.

The performance of the FTSE 100 is heavily dependent on the direction of [sterling](#), which will be influenced in part by the market's collective view on the [Brexit outcome](#) in the new year. If investors think the end is in sight, a buoyed-up pound could hurt the performance of an index whose profits are largely generated overseas, but never-ending negotiations or no-deal might have the opposite effect.

Many investors will consider bonds as part of their portfolio — not for the returns they generate, but for their role as diversifiers and hedges against volatility. With interest rates at rock bottom, gilts are expensive. Mike Coop, head of multi-asset portfolio management at Morningstar Investment Management, avoids pricey index-linked UK bonds when seeking inflation protection. “We use US inflation risk bonds, in part because big rises in inflation tend to be global instead of local,” he says.

A US inflation linked treasury bond currently trades at a 10-year real yield of -0.94 per cent, one percentage point higher than the UK equivalent, accounting for differences in the way inflation is calculated in both countries.

More broadly, decisions about where to invest overseas should include consideration of specific sectors as well as regions, says Mr Bishop. “When one region does better than another it’s not generally that one region is doing better than another economically, but that it has a higher weighting to sectors that are outperforming,” he says, pointing to the US and [technology](#). “I would reframe the question [away] from why should you own the US, instead to — should you own tech and banks?”

Investors interested in technology investment but wary of overexposure to the giants of US tech can access unlisted tech through investment companies, which can act as listed incubators for growing companies. “If you think retail investors have a lot of cash lying around, institutional funds have more. They’re in a better position to take stakes in unlisted companies,” says Mr Berry.

Advisers say there are opportunities in considering countries that appear to be recovering from coronavirus, such as [China](#) where infrastructure investment remains high. “South Korea and Mexico are also good opportunities,” says Mr Coop. Countervailing risks apply in countries such as Brazil and Russia, says Mr Berry, with a dependence on oil and concerns over corporate governance.

Another tool for investors seeking to control risk is exposure to foreign currencies that are expected to outperform, such as the euro and renminbi. By contrast, the dollar is expected to depreciate given the Fed’s recent change to its inflation targets.

Among alternatives, gold can shine in times of crisis. “We have significant exposure to gold miners,” says Alasdair McKinnon, manager of the Scottish Investment Trust. “I don’t think the world has realised what a mess the governments are in with spending.”

The [price of gold](#) has risen steadily from just under \$1,500 an ounce in March to \$2,075 in early August, though it has fallen 11 per cent to below \$1,900 in recent days, according to Refinitiv data. Investors can lose badly if they buy in a time of [peak demand](#), “but in the round, that useless piece of yellow metal holds its value incredibly well”, says Mr McKinnon. Some prefer investing in gold miners to the metal itself, since their shares tend to follow the gold price and also pay dividends.

The lesson of diversification is that it means more than having an assortment of companies or regions and countries in a portfolio. “To have diversity in your portfolio, you need things that behave differently in different circumstances,” says Mr Coop.

Growing risks in pensions transfers

The market outlook presents extra risks for those weighing up whether to accept [transfer deals](#) for their final salary defined benefit-style (DB) pensions. When a transfer offer is accepted, the DB pension fund shifts from the scheme to a personal pension arrangement, where the investor is typically exposed to investment risk.

With DB transfer values currently [averaging around £550,000](#), a transfer ahead of a significant market dip risks blowing a deep hole in a retirement fund.

However, financial experts say volatility should not be the main concern for those [considering](#) whether to trade a secure DB pension for a cash lump sum today.

“A defined benefit transfer is such a significant decision, with impacts that will last a lifetime, that I would not recommend current markets as a factor to either support or reject a transfer,” says David Hearne, chartered financial planner with Satis Wealth Management.

“It does serve as a reminder of the risks you are taking and will be taking for decades if you transfer from a DB pension. If it feels uncomfortable now, just imagine how it would feel if you’d recently transferred. Volatility is a reminder of how valuable the guarantees within DB are.”

As part of the DB transfer advice process, a financial adviser will assess the client’s risk tolerance and their capacity for loss. Transfer quotes are typically valid for three months, so investors have little flexibility over the timing of any transfer.

For those determined to press ahead while [markets are volatile](#), advisers say they could hedge against losses by phasing the investment over several months, for example by keeping the balance of the transfer in a cash or a money-market fund.

“This can protect against a major market downturn eroding the value of the full investment and instead averages the cost of the investment,” says Christine Ross, client director with Handelsbanken Wealth Management.

“There is a cost to this if markets instead rise steadily over the period, but if markets do continue to be choppy, then some investments will have been made at a lower cost and will benefit if we see a sharp recovery as we did earlier this year.”

Ms Ross adds that in taking the [decision](#) whether or not to transfer out of a defined benefit pension, market volatility should not be the main consideration, as the fund was likely to be invested for many years, over which short term effects generally even out.

Nathan Long, senior pension analyst with Hargreaves Lansdown, says he expects the current volatility to have doused the appetite for transfers, but it would not change the fundamental reasons why a transfer may be appropriate.

Act on tax advantages

Using as much as you can of your tax-free allowances is always good practice but is particularly important this year as the possibility of [tax rises](#) has increased, advisers say. “People should be thinking about tax as an eroder of wealth,” warns Nimesh Shah, chief executive at advisory firm Blick Rothenberg.

If you have used up your individual savings account (Isa) allowance and your pension annual allowance, you may want to consider higher-risk options such as [venture capital trusts](#) or enterprise investment schemes (EIS), he suggests.

These government-backed schemes have been around since the 1990s and are designed to encourage investment in small, unquoted companies or those listed on the Alternative Investment Market (Aim). They offer a number of tax benefits that are particularly useful for investors who have exhausted other allowances, including upfront income tax relief of 30 per cent — providing the shares are held for a minimum period.

But investing in smaller companies is risky, as many fail. Given the economic downturn, such companies may face bigger pressures, and this could make people “a bit more nervous” of moving into them now, Mr Shah acknowledges. However, the schemes may still be of interest to more adventurous investors, who have maximised other tax-free allowances and can put money away for the long term.

Amid fears over the prospect of an increase in [capital gains tax](#) (CGT), advisers have warned against making decisions solely to avoid a [tax change](#) that has not yet been confirmed. But people who had already planned to sell an asset may want to consider bringing forward the sale to pay tax under the existing rates.

CGT only becomes payable above the annual allowance of £12,300, which is available to all. Kay Ingram, a chartered financial planner at LEBC, a financial adviser, reminds people to make use of their spouse’s CGT allowance to double the amount above which the tax becomes payable.

“Married couples and civil partners can give investments to each other with no charge to tax,” she says. “If they gift part of the investment to their spouse or partner, prior to sale, tax will only be payable on net gains over £24,600. The spouse receiving the gift will inherit the gain made to date.”

Business owners may also want to consider moving company shares into trusts, suggests Tim Stovold, partner at Moore Kingston Smith, although this is a complicated area, so worth seeking advice on.

One increasingly popular option among his clients is [employee ownership trusts](#). These allow business owners to give their employees indirect ownership of the company which employs them. A tax exemption for selling shares into an EOT “effectively allows them to be paid the entire value of their business without a capital gains tax charge”, Mr Stovold explains.

“The talk around the CGT rate increasing has fuelled interest in EOT structures, which are a great way of re-engaging with employees who have made personal sacrifices, such as taking pay cuts during lockdown,” he adds.

Batten down the hatches on your mortgage

The coronavirus crisis has turned the housing market upside down in 2020, bringing it to a near-standstill in March before a loosening of restrictions in May and a stamp duty [holiday](#) in July touched off a “[mini-boom](#)” in buying and selling.

Unlike the financial crisis of 2008-9, mortgage providers have continued to lend and rates on their home loans remain at near-historic lows. Borrowers coming to the end of a deal on mortgage rates may be able to cut their monthly payments via a remortgage or, if circumstances allow, pay off more of their mortgage debt to access better rates.

Some borrowers may need to trim their ambitions, however, as lenders have [tightened](#) their terms in an uncertain economy. Nigel Bedford, senior partner at mortgage broker Largemortgageloans.com, says this week he had been reviving a mortgage application for a client who put a deal on ice in June. Then, the lender was prepared to offer the client a loan of £280,000. Now the same lender has limited the mortgage to no more than £150,000. The same caution applies to much bigger mortgages too.

Some borrowers seeking to take advantage of low rates on mortgages or expecting to remortgage on the same terms may come up against restrictions on types of income accepted by lenders. This will particularly hit the self-employed or those who receive much of their pay via bonuses or commissions. “A lot of lenders moved away from accepting as much variable income as they did before the pandemic,” says David Hollingworth, director at mortgage broker L&C Mortgages.

The nine-month stamp duty holiday announced by chancellor Rishi Sunak in July has added [fuel](#) to a revival in sales that was under way from June. But estate agents and mortgage brokers have warned that prices and activity are likely to go into [reverse](#) later this year or next year, as unemployment is expected to rise and the mortgage payment holiday scheme comes to an end.

The outlook creates particular difficulties for first-time buyers, who typically require higher loans as a proportion of the value of the property they are buying. Banks have withdrawn more than 1,000 such high loan-to-value deals over the past six months. “As good as rates are, they’re not on offer in the high LTV market,” says Mr Hollingworth.

Such buyers are likely to turn to the Bank of Mum and Dad to try to make up the difference. The average first-time buyer deposit has now reached £47,000, around one-fifth of the average UK house price, according to finance website Moneyfacts.

For those who have boosted their cash holdings during the pandemic — such as investors wary of holding too much in equities — an offset mortgage may be worth considering. These allow borrowers to link their savings to their mortgage, reducing the amount of debt on which they pay mortgage interest.

While there is a small premium on offset mortgage rates compared with a standard fixed rate deal, the higher your level of savings, the more likely you are to make up this difference, says Mr Hollingworth. “The appeal is you’re effectively earning the mortgage rate on your cash, with no tax to pay either. For wealthier borrowers it can work well.”

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