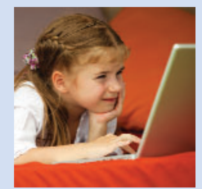
BLUECOAT
WEALTH MANAGEMENT



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Welcome to the second Bluecoat Newsletter, which will become a quarterly publication given that I now have a team of talented people to keep me on track. 2010 has been a busy year – one of transition in which we have opened an office in Shoreham-by-Sea and welcomed Lena Joyce as our Client Services Manager and first employee – with the primary objective of improving our service.

Abbie Tanner of ‘A Business Innovation’ and Keren Lerner of ‘Top Left Design’ have done an outstanding job with the new Bluecoat Wealth Management website, which I encourage you to visit and recommend to your colleagues, friends and family. You can also subscribe to regular blogs via the website or contact Lena at clientservices@bluecoatwm.com to be added to our emailing list. Your feedback is important – so please let us know what you like about Bluecoat and what we could be doing better.

One major improvement that we are introducing at Bluecoat is an increased focus on client goals and desires so that money and finance become a cog in a meaningful Financial Life Plan. We thought that we were already doing this but acknowledge that we could dramatically improve on the resulting client outcomes. To this end I am working with The Kinder Institute to become a Registered Life Planner – one of perhaps a hundred or so in the UK – so please do get in touch if you would like a review that includes this improved service.

A Different Approach to Investing

Our investment philosophy follows a rational course of action based on empirical evidence.

Often people want to believe in investment gurus and think that market timing, stock selection and active management add value. However, there is simply no credible evidence supporting the idea that active management enhances investment results over appropriate index benchmarks. At Bluecoat Wealth Management we aim to change the way you think about investing, enabling you to have a better investment experience.

Over the last fifty years, evidence from investors, financial economists and leading academics has proven that risk and return are related. Taking a chance may result in a gain, but not all risk-taking is rewarded.

Expected returns in equity markets can be summarised in three dimensions:

(1) Stocks are riskier than bonds and have greater expected long-term returns;
(2) Small company shares have higher expected returns than large company shares; (3) Lower-priced value shares have higher expected returns than higher priced growth shares.

Many economists believe that small company and value stocks outperform over the long-term because the market discounts their prices to reflect the underlying risk. The lower prices give investors greater upside as compensation for bearing this risk. Shorter-term, high-quality debt instruments such as bonds have less risk and are often used as a strategy to maximise overall portfolio gains. At Bluecoat, we design our portfolios using lower-risk bond strategies to reduce portfolio volatility. Where the required returns are greater, we use more equities.

One of the best-established methods for risk management in investing is diversification. The concept is simple: holding only one share in your portfolio makes you directly susceptible to its price changes. If its price plummets, so does your entire portfolio. Hold two shares instead, and unless they both plummet, your portfolio will remain afloat. The key to diversification is the age old adage: don't put all your eggs in one basket. The main point of diversification is to reduce risk rather than improve expected return.

We use the worldwide funds of various institutions. For example, we use Dimensional Fund Advisors to help us diversify not only in the amount of shares held in our portfolios (thousands), but also the range of capital market strategies they explore and develop. Therefore our portfolios include factors that drive investment returns and reduce excess and undesirable risk.

Asset class funds are a group of shares with similar risk and expected return characteristics, which deliver the investment results of an entire asset class. We use asset class funds as basic building blocks in our diversified portfolios.

The investment strategies we employ are usually only available to institutional investors such as corporate pension funds, banks and insurance companies. Bluecoat Wealth Management is one of a select few approved firms, of fee-only registered investment advisers in the UK able to trade in these funds.

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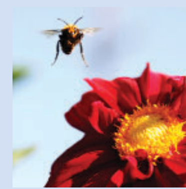
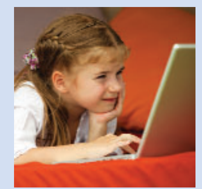

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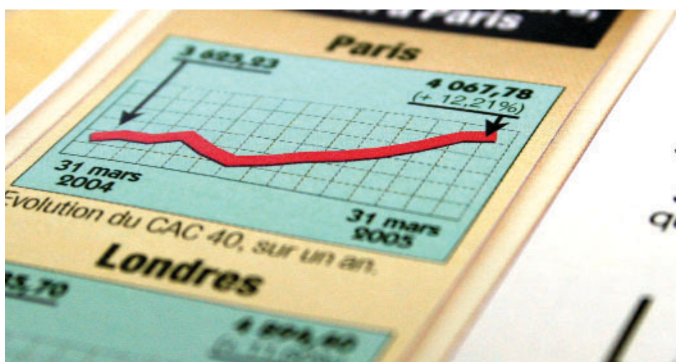
What do Joanna Lumley and Malt Whiskey have to do with Investing?

What do Joanna Lumley and Malt Whiskey have to do with creating a successful investment experience? First, Joanna Lumley; she made an amazing programme travelling to Norway to see the Northern Lights. She was there for two weeks and it was only on the last night that the spectacular Northern Lights appeared. This is how it is investing in stock markets – you have to stay invested (be there) to see the most spectacular returns. Second, malt whiskey; some malts are too smokey or too peaty, by blending them you get a smoother result. You then add water so that the final drink is not too strong (according to taste). A blend of investment exposure across different Stock Markets will give smoother returns, finally diluting your equity exposure with Short Dated Bonds according to your appetite for risk. And there we have it, the recipe for successful investment – no fancy cocktails or new fangled funds, just Joanna Lumley and a good blended malt diluted to taste.



Equities – The Forgotten Asset Class?

Equities – the forgotten investment. Given World and Stock Market events in the first decade this century, investors might be forgiven losing faith in equities as the investment for long term capital growth. Yes, savings accounts and residential property did perform better over the first 10 years of this century, but what about over 30 years? Does this mean that savings accounts and residential property will perform better over the next 10 years? History would suggest otherwise.The Table opposite sets out the returns of residential property, inflation (as a proxy for savings accounts which rarely outperform inflation), and equities from 1980 to the end of 2009.

Comparison of returns from UK equities versus UK house prices 1980-2009.

Year	UK Quoted Equities	UK Average House Price	Retail Price Index
1980 Rebased	£4,268 £1,000	£1,000 £23,497	100 Started Jan 1987
1990 Rebased	£23,947 £5,610	£54,919 £2,337	115.2
2000 Rebased	£97,023 £22,732	£81,628 £3,474	165.4
2009 Rebased	£119,238 £27,937	£168,719 £7,180	213.7

Equities data from Barclays Capital based on £100 invested in 1945 with gross income reinvested. House price data source Nationwide Building Society – regional data available on request. RPI data from Office for National Statistics. Rebased figures are to £1,000 value as at 1980 for comparison purposes.

Investors should ask themselves, "How likely are the events of the past 10 years likely to repeat themselves over the next decade?"

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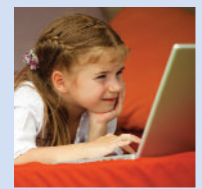

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How Investors can Benefit from the Irish Lesson

Reaching understanding on the right way to invest often starts with studying bad investment decisions. But the lessons are far less painful when they are built on others' experiences. Recent events in Europe provide case studies on what can go wrong when a wealth-building strategy is built on too much debt, too little diversification and too little awareness of risk.

Ireland in recent years was heavily dependent on a couple of industries – namely construction and banking. The consequence was rapid credit growth, inflated property prices and a lack of attendance to risk, as the IMF1 has noted. Because Ireland had put all its eggs in a couple of baskets, the adjustment has been particularly painful. While an economy is more complex than any individual, there are still lessons here in what happens when you fail to spread your wealth-building strategy across different asset classes and diversify within those asset classes. Becoming more diversified leaves you less open to idiosyncratic risks that are related to one sector or one company or one asset class. And you can do this without significantly compromising your expected return.

Another lesson from Ireland is not to base your investment strategy only on what happens during the good times or only in the bad. Real interest rates in Ireland were very low before the crisis, which encouraged people to load up on debt. That debt now has to be repaid in an environment of falling prices, higher real interest rates and sluggish growth. The problem was too much focus on return and not enough on risk.

For individuals, the take-out is that leverage, while increasing the potential upside in boom times, magnifies the downside in the bust. So people swing from greed to fear and back again. A better approach is to have a realistic, measured and long-term approach to risk. This means that during rising markets, you don't take on more risk than you originally intended. And it means that during falling markets, you don't become more risk averse than you first planned. A third lesson is the importance of liquidity. This means you can quickly turn your investments back into hard cash if you need to. Ireland's banks got into trouble because their loan portfolios were dominated by speculative property ventures. When the crisis hit, their recourse to short-term funding dried up and they were unable to call in loans because of the illiquid nature of the assets. For individuals, the lesson is there is value in having portfolios with sufficient liquidity.

That means publicly traded equity and fixed income securities that can be turned into cash if needed. So Ireland has some lessons for all of us:

- Holding concentrated portfolios exposes you to risks you don't need to take. Diversification is the answer, both across and within asset classes.
- Basing your strategy only on the good times means you can end up taking more risk than you intended. And grounding your strategy only on the bad times means you can miss real opportunity. A balanced approach to risk and return is the answer.
- Finally, staking everything on illiquid assets can leave you high and dry when you need quick access to cash. So keep a proportion of your portfolio in liquid investments.

All these strategic decisions are ones you should make in consultation with an adviser who understands your risk appetite, personal situation and goals.

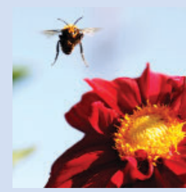
Just don't count on the luck of the Irish.

[1. IMF Country Report No. 10/209, Ireland, July 2010]

Bluecoat Wealth Management Corporate Legacy

Christ's Hospital School was founded in 1552 by King Edward VI to take poor and destitute children off the streets of London. It remains true to that value today, taking many children from poor or disadvantaged backgrounds. Parents pay fees according to their means and about a third of pupils receive their schooling for free, at one of the best schools in the Country.

Bluecoat's founder, Robin Clarke was fortunate enough to receive an education at Christ's Hospital. Now through Bluecoat Wealth Management he wants to enable one child a year to receive the same benefit. His vision is to build the firm to a size where it can continue that Charitable Legacy for many generations to come.



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5 Things to Consider Before Making a Charitable Donation

With nearly 200,000 Charities registered in the UK almost every conceivable good cause is already covered, but their effectiveness in delivery varies enormously. Here are 5 things to consider before making your donation to charity:

1. **Is there another larger or more efficient Charity already working in this area?** The Charities Commission website gives comprehensive information on all but the smallest charities, including how much of their income is spent charitably. You can research this yourself, or find a specialist adviser to do the legwork for you.

2. **Do I want to engage with the Charity, or donate money anonymously?** Many people prefer to donate anonymously so that they don't end up on a register of supporters who are then inundated with further requests for support. The downside to maintaining anonymity is that it might be harder to engage with your chosen Charity.

3. **What is the most tax efficient way to make may donation?** Usually, the least tax efficient way to give money to Charity is via a bequest in your Will. It is far better to give while living, and earning money, as this has the double benefit of attracting income tax relief, and putting money outside your Estate for Inheritance Tax purposes.

4. **Do I wish to donate cash or assets?** You can donate cash or assets direct to larger Charities. The benefit of donating assets is that the gift of the asset is exempt from Capital Gains Tax, while also attracting income tax relief. This can also be done for smaller charities or even into your own Charitable Trust Account - please contact us to find out more, if this is of interest.

5. **What sort of pension scheme does the Charity run for its staff?** Some Charities still run Final Salary pension schemes which are great for their employees. Unfortunately, if the pension scheme has a shortfall in the assets required to meet its liabilities, some of your donation may go towards making up the pension deficit, rather than being spent on charitable causes. Other Charities have switch to Defined Contribution pension schemes and arranged for Final Salary pension liabilities to be taken over by insurance companies i.e. the MS Society.

You should always take advice from a qualified person if you are unsure about how making a Charitable Donation might affect your tax position. The content of this blog is generic and should not be taken as advice to individuals. The FSA do not regulate tax advice.

Bluecoat's Support of Kiva

Bluecoat Wealth Management is helping poor, but entrepreneurial, people across the World improve their lives by lending money to them for business development purposes through an organisation called Kiva. Kiva's mission is to connect people, through lending, for the sake of alleviating poverty. Kiva empowers individuals to lend to an entrepreneur across the globe. By combining microfinance with the internet, Kiva is creating a global community of people connected through lending. Kiva was born of the following beliefs:

- People are by nature generous, and will help others if given the opportunity to do so in a transparent, accountable way.
- The poor are highly motivated and can be very successful when given an opportunity.
- By connecting people we can create relationships beyond financial transactions, and build a global community expressing support and encouragement of one another.

Kiva Promotes

- **Dignity:** Kiva encourages partnership relationships as opposed to benefactor relationships. Partnership relationships are characterised by mutual dignity and respect.
- **Accountability:** Loans encourage more accountability than donations where repayment is not expected.
- **Transparency:** The Kiva website is an open platform where communication can flow freely around the world.

As of November 2010, Kiva has facilitated over $175 million in loans. Bluecoat Wealth Management believes that Kiva's values are closely aligned to its own and is encouraging clients and suppliers to join us in making a difference by joining our community on Kiva. So far we have lent money to the following people: Namuganza Joy in Uganda to help expand her welding business; Myagmardorj Lhamhuu in Mongolia, to expand and set up a vacuum window-producing business; Erick Bett, in Kenya, to purchase and insure a dairy cow; Phon Sarin, in Cambodia, to buy a boat, as well as buying more fishing gear.

Cautionary Note: Investment types or areas mentioned may not be suitable for all investors and therefore no actions should be taken as a result of this article. Guidance should be sought before making any investment decision. The value of your investment may go down as well as up. Past performance is not a reliable indicator of future results.

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