Comment w/c 10th June

Investing for the future

“An organisation that prioritises being within the rules over doing the right thing, will not stand up to scrutiny for long.”

Andrew Bailey, Chief Executive FCA (23 April 2019)

The past week has not been short of major international news and reporting, so the inclusion of the closure of Neil Woodford’s Equity Income Fund on the main 8 am BBC Radio 4 news, plus many newspaper front pages, gives some indication how serious an issue this is.

Some may put its high profile down to the thwarted removal of the colossal £1/4 billion investment from the Kent County Council Pension Funds - how did they come to commit such a vast amount to one fund? - but I think it has more to do with Andrew Bailey’s quotation above. And, as if to underpin how serious is the underlying problem of illiquidity, Bank of England Governor Mark Carney spelt out the wider challenge for the world economy: in October last year he warned that the proliferation of open-ended funds which offer investors instant liquidity despite holding illiquid assets was a ‘major new vulnerability’ in the financial system, with the potential to turn a market correction into a crash.

The illusion on which banking operates - that of security, while in truth they borrow short and lend long in massive proportions - has been with us for centuries. Now it’s pushed its way into investment management. So in this commentary we challenge the view that professionals always know best.

Neil Woodford has been one of the best-known and, until recently, most successful investment managers in the United Kingdom. He built his reputation at Invesco Perpetual, and went on to set up his own investment management business. The growth of assets under management at his Equity Income Fund has been spectacular and swift, and his fall from grace, equally so.

It’s not the purpose of this commentary to re-visit the story in detail: **this link to The Share Centre’s report** provides a full summary, and as we note above it’s been fully reported in both general and financial media. Neil Woodford has also apologised directly to his gated investors in a **YouTube video** .

Our key concern is the long shadow that it’s cast over open-ended investment funds (or Unit Trusts as they used to be called in the UK, Mutual Funds in the USA). These are the heartland for personal investors who wish professionals to look after their money for them, and particularly so because their pricing and trading is designed to impose no discount or premium on the combined value of underlying holdings. Such an added layer of risk is expected in an investment trust, also known as a closed-end fund, but it is fundamentally important that an open-ended fund is liquid and tradable at all times.

The closure of Woodford’s Equity Income Fund, for a minimum of 28 days, has therefore thrust that second layer of risk upon its personal investors. It may be compliant by the rules, but it is not ‘the right thing’ - to quote Andrew Bailey.

Investing for the future means not just seizing opportunities in the present but thinking ahead to ensure that the promise of future value is not illusory. It means caring about the way that the financial system serves society at large, not simply providing a gravy train for the rich and powerful. That’s why this commentary speaks so often of the need to move to a more **egalitarian approach to capitalism** , and of the need to empower people with the resources and capability to enable them to take control of their own finances.

This evening (Monday 10 June) I will be taking part in a forum of retail investment firms at the offices of Winterfloods, the well-known London market-maker. We will look at the pressure on the free market, and the challenge of providing proper access for individual investors, considering the huge attrition in the number of listed companies. In the United States the number has fallen from 8,090 in 1996 to just 4,336 by the end of 2017. A large part of this is due to the massive resources of the private equity industry which, at the end of 2018, was sitting on a war chest of $2 trillion. It’s very unusual for private equity investments to be accessible to personal investors.

So, once a new prime minister is in place, incoming Treasury ministers will be challenged to take a close look at how our financial system and capital market need to be opened up.

Two weeks ago we set out in this commentary **some of the key policy elements** required for a new drive towards egalitarian capitalism, and I look forward to these being firmly on the agenda. In this respect, it was good to see Boris Johnson drawing attention over the weekend to his achievement in London in raising the standard of living for the poorest and neediest in society.

And it should not be forgotten that young people have a great deal at stake in this: our commentary has frequently spoken of the massive **opportunities and challenges of the Child Trust Fund** , in which six million young people aged between 8 and 16 have individual accounts.

Last week the Government published a set of **draft regulations for consultation** on what should happen to these accounts as their young owners approach adulthood, and how to cope with the huge numbers of accounts which are lost - particularly the most disadvantaged - if they still remain unreconciled when they turn 18 (starting in September next year).

Let me re-visit our latest estimates: out of those six million, 1.7 million were opened by HMRC because the child's family had taken no action by their first birthday. Almost all the accounts opened for children in Child Tax Credit families - the poorest 17% of the population, numbering 1.2 million - were HMRC-allocated, and over 80% of these are either 'addressee gone away' or their contact has never been registered. This means that c. one million accounts worth an average of £1,500 each - £1.5 billion in total - are lost to these most disadvantaged young people.

Investment is vitally important in delivering economic freedom and opportunity. The state of the Child Trust Fund scheme shows that it's not just the duty of investment managers like Neil Woodford to do the right thing: it's the duty of us all, whether public sector or private sector, whether financial professionals or amateurs. So if you'd like to play your part in waking up the Child Trust Fund, become a **CTF Ambassador** .

And if you're an investor who leaves it to professionals to look after your money, think again! Perhaps once you've listened to **Share Radio's investment episode** in the Managing My Money course, you'll feel more like doing it yourself. As Ian Cowie wrote in The Sunday Times Money section: 'Thanks,Woody: it's middlemen like you who convinced me to go it alone'.

Gavin Oldham OBE

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