CREDO NEWS

Issue 26

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...and more

Is active investing going the way of vinyl?

Will active investing become the preserve of only a few specialist managers and a select group of individuals, like the nostalgic music lovers who listen to their vinyl collections on *"ancient"* phonographs, gramophones and turntables?

Could the same perhaps be said about value investing? Read Trevor Black's interesting perspective, *"The real secret"* on page 12.

After a long history of active portfolio management being the dominant methodology of investment, is passive investing the new new thing?

Investing can be successfully done using a variety of styles. My simple style is to start by answering a few questions, honestly:

- **What are you trying to achieve?**
- **What is your behavioural bias? (Are you the type of investor who panics and wants to sell and run as soon as there is any bad news in the newspapers or on the TV?)**
- **What type of risk can you afford to take with your investment?**

Once you understand your risk profile and have established your objectives you could consider using any number of the alternative styles - active or passive, value, growth, momentum, thematic, the list goes on, investing in any single style or in any combination to achieve your goals. The style you choose is less important than the fact that you **start early** and invest as much as you can.

It is probable that many of today's millennials have never even seen a vinyl record, let alone ever heard one on a turntable. Will the same be said of their children, when it comes to active investing?

My advice to my 20 year old son, who starts university this week, was to sit down with his friends and start an investment club where they each contribute what they can regularly and invest in the market. It's not rocket science and they won't get rich overnight, but I know that the sooner one starts investing the longer the investments have to benefit from **the magic of compounding, said by Albert Einstein to be *"the eighth wonder of the world"*.**

Peter Lynch, best known as the former manager of Fidelity's Magellan fund, said:

"In the long run, it's not just how much money you make that will determine your future prosperity. It's how much of that money you put to work by saving it and investing."

Finally and as always, I want to thank all of you who continue to support us and I hope that you will find some interesting insights in this edition of CredoNews. ■

Deon Gouws - *CIO* | @DeonGouws_Credo

Joined at the hip

In general, it can be said that the natural sciences describe how the universe works, while the social sciences boil down to the study of human behaviour.

In the world of natural science it is possible to irrefutably prove any number of principles and define axiomatic truths (an apple will fall down to the ground if you drop it thanks to the wonders of gravity, for example, and 2+2 will always equal 4).

Unfortunately, no such mathematical certainty exists in the world of social science: human behaviour will always evolve, and people will continue to adapt to changing circumstances. Worse still is the fact that this process of adaptation will often not be optimal or even rational, as we all happen to be emotional beings driven by traits such as greed, fear and regret (to mention but a few).

This core difference between natural science and social science has also given rise to the concept of "physics envy", which can be defined as the envy of scholars in other disciplines for the mathematical precision of fundamental concepts obtained by physicists.

Economics and finance do of course form part of the social sciences, and it can therefore be said that these fields contain few if any absolute truths. Accordingly, one should be very sceptical if you come across anyone who tries to sell you an investment product which simply "cannot fail" (especially if the stated upside is purported to be particularly attractive).

Having said all of this,

it is also true in the world of investing that you can skew the probabilities in your favour by learning from the past whilst introducing disciplines designed to try and minimise the impact of irrational human behaviour.

One such example relates to the difference between a variety of investment philosophies, notably those of value and growth investing. Value investors generally buy stocks at lower than average valuation ratios (e.g. price to earnings, price to book, et cetera), whilst growth investors are typically prepared to pay a premium for a stock, based on their expectation of superior growth in future earnings.

Various studies over time have come to a very similar conclusion, namely that value tends to beat growth over the longer term. This is also the core reason behind Credo's stated value-based investment philosophy (as clients will be well aware).

One of the "problems" with value investing (or any other investment philosophy, for that matter), is that it can go through extended periods of under-performance relative to either the market in general, or alternative approaches in particular. In fact, it is probably fair to say that if value did not perform relatively badly at times, it wouldn't really work at all: it is the very pain of under-performance which "shakes out" some of the weaker holders of securities near a market or sector bottom, leading to a self-fulfilling cycle of even lower prices that do not only test the resolve of remaining investors, but also provide them with the opportunity to build their holdings at an increasingly better average cost price… enhancing future returns when eventually the cycle reverses.

...the difference between value and growth investing is often misunderstood...

From a totally different perspective, it is also important to bear in mind that the difference between value and growth investing is often misunderstood. Warren Buffett probably summed it up best in the 1992 edition of the Berkshire Hathaway shareholders letter, where he said:

"Most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth." Indeed, many investment professionals see any mixing of the two terms as a form of intellectual cross-dressing. We view that as fuzzy thinking (in which, it must be confessed, I myself engaged some years ago). In our opinion, ***the two approaches are joined at the hip:*** *growth is always a component in the calculation of value, constituting a variable whose importance can range from negligible to enormous and whose impact can be negative as well as positive."*

Some eight years later, Buffett elaborated as follows:

"Common yardsticks such as dividend yield, the ratio of price to earnings or to book value, and even growth rates have nothing to do with valuation, except to the extent they provide clues to the amount and timing of cash flows into and from the business. Indeed, growth can destroy value if it requires cash inputs in the early years of a project or enterprise that exceed the discounted value of the cash that those assets will generate in later years.

Market commentators and investment managers who glibly refer to "growth" and "value" styles as contrasting approaches to investment are displaying their ignorance, not their sophistication.

Growth is simply a component - usually a plus, sometimes a minus - in the value equation."

Based on this, it would be fair to say that a one-dimensional classification of someone like Warren Buffett as a value investor (which is how most commentators refer to him) is probably an over-simplification.

Whilst we subscribe to a value-based investment philosophy at Credo, we are also mindful of the fact that a sub-section of clients exhibit a preference for more of a growth-based approach. In response to this, we have recently launched the **Credo Growth Fund**, which, as its very name suggests, follows more of a growth philosophy rather than a value one (even though the latter will continue to be the bedrock of our main product suite).

The manager of the Credo Growth Fund has been investing successfully in this manner on behalf of himself and a number of his clients for more than 20 years; these same clients were also the first subscribers to the fund when it launched. As far as prospective new subscribers are concerned, it would be important that they understand the core differences between the Credo Growth Fund and the rest of our equity products which are all managed in accordance with a value-based philosophy. ■

For those who have any questions, we would suggest that they have a discussion with their Relationship Manager.

Alan Noik - *MD* | @AlanNoik_Credo

Launch of

Following the successful launch of the Guernsey-registered Credo Global Equity Fund (the **CGEF**) in March 2016, Credo Wealth is pleased to announce that a UCITS[1] version of the same fund (in the form of an Irish-registered ICAV[2]) launched at the beginning of July 2017, in addition to two entirely new funds; the Credo Dynamic Fund (the **Dynamic Fund**) and the Credo Growth Fund (the **Growth Fund**).

The main differences between the original CGEF and our newly launched UCITS funds are: 1) the regulation which governs each of these funds (Guernsey versus Irish domiciled), and 2) their dealing frequency (weekly versus daily dealing), though the Growth Fund is a weekly dealing fund.

(1) Where UCITS stands for Undertakings for Collective Investment in Transferable Securities.
(2) Credo ICAV is an umbrella fund with segregated liability between sub-funds and is an open-ended Irish Collective Asset-management Vehicle (ICAV). The ICAV has been authorised by the Central Bank of Ireland as an undertaking for collective investment in transferable securities pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 as amended by the European Union (Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2016. The ICAV and the Sub-Funds are recognised in the United Kingdom by the Financial Conduct Authority under Passporting.

the new Credo Funds

GLOBAL
EQUITY FUND

The performance of the CGEF (since inception, until the end of July 2017) has been 37.1% in GBP and 28.6% in USD, outperforming the MSCI World Index benchmark by 0.4% in USD and marginally underperforming the benchmark by 0.1% in GBP. The newly launched UCITS version (the Global Equity Fund) will mirror the original Guernsey-registered version of the CGEF going forward and, from an investment perspective, there is no fundamental difference between the two. Credo and its principal shareholders have all committed capital to the Global Equity Fund.

Credo Wealth has a strong track record of managing long-only, value-based, direct equity portfolios. The Global Equity Fund adopts a long-term, primarily bottom-up value-based approach to investing and there is no specific focus on industry sector or geographic region. The Global Equity Fund has a bias towards developed market, large-capitalisation companies with the aim to generate sustainable excess returns versus global market indices through careful company selection.

As with the CGEF, the Global Equity Fund has both GBP and USD share classes and we adopt no currency hedging strategies, do not use leverage, avoid derivatives entirely and maintain a simple long-only, value-based approach to investing.

For those clients who are already invested in the CGEF, there is no need to switch to the new version of this fund, however, should you wish to do so, please contact your Relationship Manager.

DYNAMIC
FUND

The Dynamic Fund utilises the long-term and successful investment strategy which has historically been employed within the traditional stockbroking arm of Credo Wealth over the last decade.

Credo Wealth identified the "wrapping" of this investment strategy in the form of a UCITS fund as a unique opportunity to fully encompass this strategy. Managed by Rupert Silver, with Jarrod Cahn as co-Fund Manager and Benjamin Newton as Fund Analyst, the Dynamic Fund draws on Credo's strong long-term relationships with various market participants and extensive (20+ years) experience of fixed income and equity markets in the UK.

The Dynamic Fund looks to achieve a balance of income and capital growth over the longer term and has the flexibility to allocate capital across asset classes depending on prevailing market conditions. It seeks to achieve high risk-adjusted returns over the business cycle with a particular focus on UK capital markets. Having said that, although the emphasis of the Dynamic Fund is on the UK and thus on sterling assets, it may, when appropriate, invest in companies operating across different geographies. The strategy is predominantly bottom-up and is likely to have some bias towards small and mid-capitalisation companies as the Fund Managers believe these provide more attractive opportunities as they are less widely held and researched. The Fund Managers believe the ability to invest in fixed income provides an even greater universe from which to select special situations and also gives a barbell approach, reducing the overall volatility of the Dynamic Fund.

Credo Wealth views the Dynamic Fund as a complementary solution to the Global Equity Fund and other core fixed income holdings. As with the Global Equity Fund, the Dynamic Fund adopts no currency hedging strategies, does not use leverage, and avoids derivatives entirely.

Alan Noik - *MD* | @AlanNoik_Credo

GROWTH FUND

Managed by the CEO of Credo Wealth, Roy Ettlinger, the Growth Fund is a reflection of Roy's personal investment style and strategy which he has successfully adopted for clients in past years. As with the Dynamic Fund, Credo Wealth viewed the encapsulation of this strategy in the form of a UCITS fund as a unique opportunity.

The Growth Fund aims to provide attractive risk-adjusted returns from several asset classes, including equities, fixed income and funds. The strategy is not benchmark driven and is largely bottom-up in nature. It is focused on developed markets though the Fund Manager has the flexibility to allocate capital across a broad spectrum of geographies. Whilst the majority of equity investments will be in large-capitalisation companies, small and mid-capitalisation companies may be included and the actual allocation will be guided by opportunities that look to provide significant growth of capital over the long-term. The fixed income component aims to reduce the overall volatility of the Growth Fund and includes bonds that are believed to provide sufficient returns for the risks associated with holding them. Capital may be allocated to bonds with varying external credit ratings, including, but not limited to, high yield and unrated.

Unlike the Global Equity and Dynamic Funds, the Growth Fund is a weekly dealing fund, which deals each Friday, and is subject to a performance fee. The Growth Fund does not engage in either currency hedging or derivative strategies and does not use leverage.

Long-term perspective
High-conviction strategy

Fund Details

	Global Equity Fund	Dynamic Fund	Growth Fund
Minimum Initial Investment	Retail Shares: £5,000 Institutional Shares: £10,000,000	Retail Shares: £5,000	Retail Shares: £10,000
Minimum Subsequent Investment	Retail Shares: £1,000 Institutional Shares: £1,000	Retail Shares: £1,000	Retail Shares: £1,000
Asset Management Fee	Retail Shares: 0.75% Institutional Shares: 0.40%	Retail Shares: 0.75%	Retail Shares : 0.75%*
Share Classes	Class A Retail: GBP Class A Institutional: GBP Class B Retail: USD Class B Institutional: USD	Class A Retail: GBP	Class A Retail: GBP
Identifiers	Class A Retail: IE00BDFZR877 Class A Institutional: IE00BDFZR984 Class B Retail: IE00BDFZRB04 Class B Institutional: IE00BDFZRC11	Class A Retail: IE00BDFZR653	Class A Retail: IE00BDFZR430
Dealing	Daily, 10pm Valuation Point	Daily, 10pm Valuation Point	Weekly, every Friday 10pm Valuation Point
Fund Domicile	Ireland		
Manager	Fund Partners Limited		
Investment Manager	Credo Capital plc		
Administrator & Registrar	Société Générale Securities Services (Ireland) Limited		
Auditor	Deloitte		
Legal Advisors	McCann FitzGerald		

(*) The Investment Manager is entitled to receive a performance fee on these shares. Please refer to the applicable Fund Supplement for further details.

Ainsley To - *Research Analyst* | @AinsleyTo_Credo

The test of time

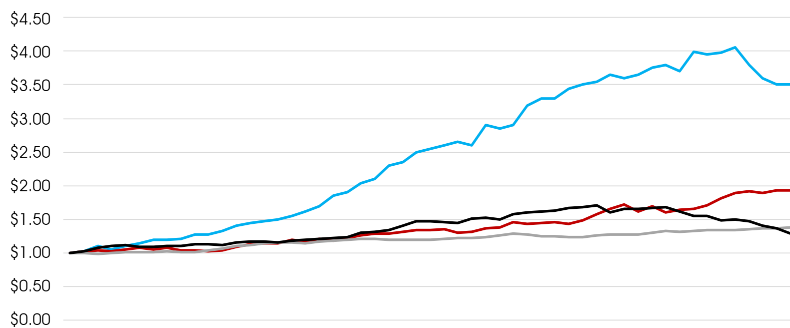
If we assume for a moment that the fears of nuclear war, climate change, and being enslaved by a malevolent AI are overblown, and as a species we are still around in one hundred years… which of the following songs would most likely still be recognised in the year 2117?

Beethoven - Symphony No. 5
Adele - Someone Like You
Psy - Gangnam Style

Whilst it may be true that Adele's 2011 hit has more staying power than the one-hit wonder that is Psy (outside of Korea, that is), it is harder to be certain than in a few generations she will still be as recognised as today, **if at all**. Yet despite being composed way back in 1808, it is most likely that if you heard Beethoven's Symphony No.5 today you would recognise it. And I would wager that of the three, it is the most likely to continue to survive as a significant piece of music a century from now.

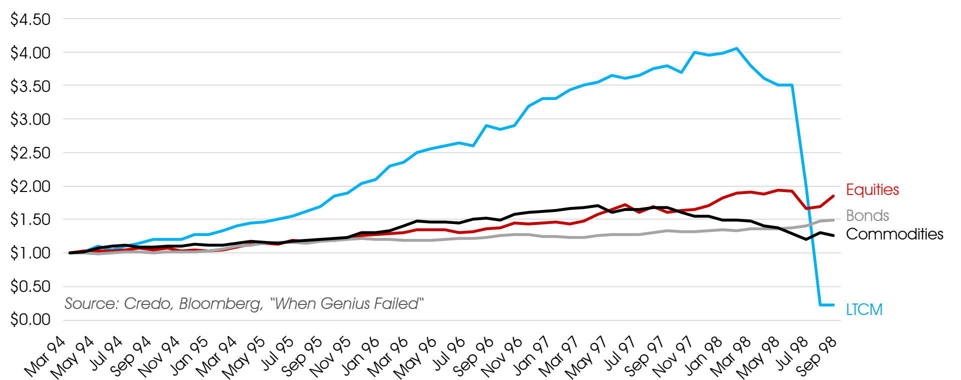
Survival is the ability to resist the ravages of time. In the physical world, ageing leads to a lower probability of survival - the older we get, the less time we are expected to continue to live. However there are many things which do not age like humans; non-perishables such as ideas, music, and technology tend to age in reverse. The longer it has been around, the longer it is expected to continue to be around for. This observation has become known as the Lindy Effect (as popularised by Nassim Taleb and Benoit Mandelbrot before him). A song that has survived over 200 years has a longer future life expectancy than one which has only existed through the last 5 years. And if we make the assumption that the investing world is a going concern over our investment horizon (I'd suggest that if you are assuming a nuclear war over your lifetime, then getting returns on your savings shouldn't be on your list of priorities), then we can apply the Lindy effect to asset classes and investment strategies. To illustrate the significance time has on performance measurement, consider the four assets in the chart above (Chart 1):

Chart 1 - Which asset is the most attractive? 3+ years of track record



The data in Chart 1 happens to be over 52 months, longer than the "3 year track record" rule of thumb many investors seem to use. And without any additional information most readers would choose the asset in **blue** (believe it or not there are many investors who base their investment decisions purely on a chart like this…or maybe after also doing a few minutes of superficial research through Google). But how much time is really required to accurately observe the behaviour of a return stream?

Chart 2 - Long Term Capital Management - Mar 1994 to Sep 1998



If we add an additional two months of data and the dates to the chart (Chart 2), it now paints a very different picture. In August 1998 after a period of stellar returns, the asset in **blue** (the hedge fund Long Term Capital Management) fell to a value of 23 cents on the dollar - and by the end of September that year it had to be rescued by a consortium of banks. Unfortunately for investors, we are unable to observe the true returns distribution of an asset, we can only view samples of it over certain periods of time. And naively using a fixed rule of thumb for how long you need to get a sufficiently large sample can in some cases end in disaster.

Unfortunately there is no hard and fast definition of "Long Term" over which an investor can be guaranteed success either. Investors in value stocks can probably relate to this during recent years. The table below summarises performance of the S&P500 versus a simple long-only value strategy (investing only in the cheapest fifth of US companies) as at the end of 2015. The summary is on 10 years of data, which is a long time even for the most patient investors.

Annualised Returns Summary (%)

2005 - 2015	Value Strategy	S&P500
1 year	-9.05	1.38
5 years	9.41	12.57
Since Inception	6.36	7.31

An investor in this strategy would feel somewhat frustrated by these numbers – it has failed to outperform the broad index over 1, 5, or 10 years. For anyone with an itchy trigger finger, the poor performance in 2015 might very well lead them to conclude that "value investing doesn't work". However if the investor had held on for one more year and included the data in their sample then the same summary table would look like this:

Annualised Returns Summary (%)

2005 - 2016	Value Strategy	S&P500
1 year	24.30	11.96
5 years	18.48	14.66
Since Inception	7.88	7.72

At face value the numbers now paint a very different picture – the same investor looking at the same strategy might now conclude that value investing works, across all the measurement periods.

It is human nature to believe that what you see is all there is… but usually what you don't see can refute everything that you believe.

So which is the correct conclusion for investors to make? The one from the 10 year window? Or that from the 11 years of data?

A more sensible take away is that if 1 year of data can make such a dramatic difference to your beliefs about what works and what doesn't work, then perhaps your investment decision making process is not robust. There are of course many other considerations beyond past performance and ***naïve empiricism*** without economic rationale carries its own dangers in investing. For an investment strategy to be repeatable in the future, we believe it has to work **both** in theory **and** in practice… but why value investing works in theory is beyond the scope of this article. In practice, the test of time is what differentiates blind performance chasing from robust long-term evidence that a strategy works. If we look at all the data we have available over 90 years from 1926 to 2016, before Benjamin Graham had even published Security Analysis in 1934, the same simple value strategy above annualised 13.33% vs 9.86% for US equities. Not many other approaches have survived through 16 US Presidents, 15 recessions, and a range of interest rates from 19% to 0.25% (just for comparison, a newer strategy such as buying and holding BitCoin has experienced 1.25 Presidents, 0 recessions, and a high in interest rates of 1.25%). And one additional year won't change the picture much.

There is no guarantee that something which has been around for the last hundred years will continue to be around for the next hundred. But if you're going to bet on Bieber over Beethoven based only on what you've observed over the last decade, then time is not on your side.

"With every new wave of optimism or pessimism, we are ready to abandon history and time-tested principles, but cling tenaciously and unquestioningly to our prejudices."

Benjamin Graham

Trevor Black | @trevorblack

The real secret

Price is a clearing mechanism. It is a mass market averaging of supply and demand, incentivising whoever sets the price to maximise profit. Value is a deeply personal reflection on what something is worth. When we decide on something's value to us, we don't much care about how many people want, or have, what we want. It is the story that matters, and that is why niche markets like vinyl records will always thrive.

Capitalism works less as a set of answers, than as a set of evolving questions. Within that there are some questions that remain golden. That never get answered. Warren Buffett wrote an article in 1984 entitled *'The Superinvestors of Graham-and-Doddsville'*. It was to celebrate the 50th anniversary of the publication of Benjamin Graham and David Dodd's book, *'Security Analysis'*. Buffett looked at the track record of nine investors who, like him, had followed what they had learnt from Graham and Dodd. Different tactics, but the same underlying strategy.

While it is likely that in the long run there will always be winners who were just lucky, it is very unusual if those winners operate independently *and* profess the same underlying strategy. Other than a shared philosophy, and a personal connection to Buffett, there was no other reason they should all have done well.

Graham and Dodd's idea was that the higher the margin between price of the underlying stock, and its value, the lower the investor's risk. The *Efficient Markets Hypothesis* (EMH) claims that the only way to make higher returns is to take higher risk. The Superinvestors of Graham-and-Doddsville successfully believed otherwise.

In the cult book *'Margin of Safety'* (you can get a copy for £2,100 on Amazon), Seth Klarman said "***The real secret to investing is that there is no secret to investing.*** *Every important aspect of value investing has been made available to the public many times over, beginning in 1934 with the First Edition of Security Analysis (1934). That so many people fail to follow this timeless and almost foolproof approach enables those who adopt it to remain successful. The foibles of human nature that result in the mass pursuit of instant wealth and effortless gain seem certain to be with us forever. So long as people succumb to this aspect of their natures, value investing will remain, as it has been for 75 years, a sound*

There is no such thing as risk-free return. There is such a thing as return-free risk...

and low-risk approach to successful long-term investing." This paragraph is quoted in the foreword of the sixth edition of *'Security Analysis'*.

What the EMH assumes is that the investing world can be simplified into two variables: Risk and Return. You get paid for taking more risk. Great investors work hard to understand the intrinsic value of an investment, and that is a factor of Risk and Return. But neither of those variables can be reduced into single numbers. They attempt to do a better job assessing those two variables. They also look at the fundamentals of what it is the business is doing. Price is one thing, but then what you buy goes on to do something. What it does matters. There is no such thing as risk-free return. There is such a thing as return-free risk. Understanding all of this deeply requires a lot of application. If incentives are aligned, you don't get paid for adding risk, you get paid for adding value.

It is true that you can bash out popular, mass music. It is true that many active investors are just replicating their benchmark, but charging more fees. See what works, and push it out at scale. Don't be too adventurous. It is true that passive investment through indices is a solid way to get low cost access to the average returns of the benchmark you have chosen. In fact, Buffett himself says, *"If a statue is ever erected to honor the person who has done the most for American investors, the hands down choice should be Jack Bogle"* (Bogle is the founder of Vanguard and the champion of passive investing).

There will however always be space for the vinyl of investing to thrive. For the analysts who do the work because it is what they love. Who get to the juice of the stuff that can't be summarised by numbers. Who see things differently. Risk is closer to music than to maths. Like sound waves, it is a distribution of things that can happen in different situations. A combination of history, psychology, economics and chance. Yes, a good ear will be able to hear reminders of events past, but the world evolves. Businesses are constantly facing new questions. Those new questions are fascinating.

The active investor needs a sense of humility about just what a challenge it is to be one, but the secret is that there is no secret. The wealth is not instant. The gain is not effortless. In the long-term, it is worth it though.

Kathryn Linde - *Relationship Manager*

Diversified equity portfolios

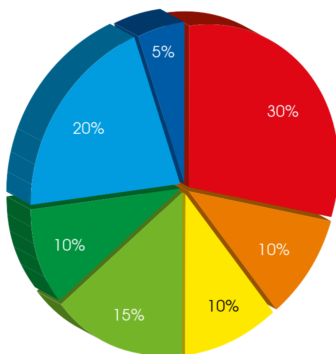
The Best Ideas and Dividend Growth portfolios are diversified global equity portfolios, which we believe to be well positioned to outperform the wider equity market over the longer term. The portfolios have biases towards developed-market, large-capitalisation stocks.

BEST IDEAS PORTFOLIO

Performance

Return (%)	
YTD	2.4
1 Month	1.1
3 Months	-2.1
1 Year	9.7
Annualised Return (%)	
3 Years	13.1
5 Years	13.6
Since Inception	12.3

Sector Allocation

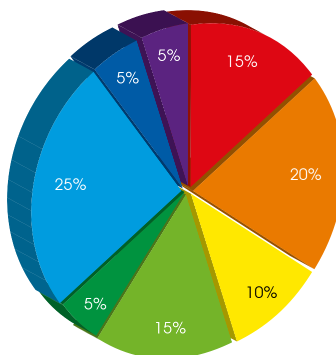


DIVIDEND GROWTH PORTFOLIO

Performance

Return (%)	
YTD	2.2
1 Month	0.7
3 Months	-1.4
1 Year	11.3
Annualised Return (%)	
3 Years	15.6
Since Inception	15.9

Sector Allocation

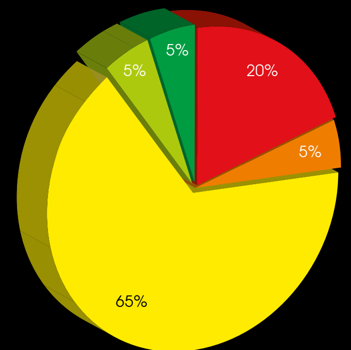


MULTI-ASSET PORTFOLIO 20/80

Performance

Return (%)	
YTD	4.9
1 Month	2.2
3 Months	1.2
1 Year	2.3
Annualised Return (%)	
3 Years	7.1
Since Inception	7.6

Strategic Asset Allocation



Value orientated investment philosophy

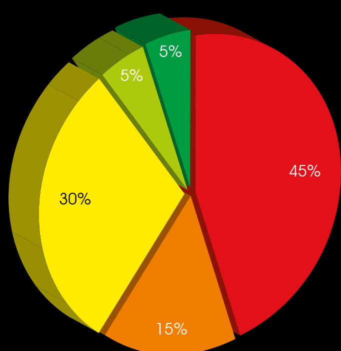
The Credo Multi-Asset Portfolios invest in regulated funds and ETFs on a global basis, with a focus on diversification across a broad range of asset classes using liquid securities. Funds are selected using Credo's in-house selection process and offered as four solutions targeting various levels of equity exposure. Portfolios are available in both GBP and USD.

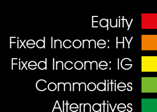
MULTI-ASSET PORTFOLIO 45/55

Performance

Return (%)	
YTD	6.4
1 Month	2.0
3 Months	1.5
1 Year	8.3
Annualised Return (%)	
3 Years	9.3
Since Inception	9.6

Strategic Asset Allocation



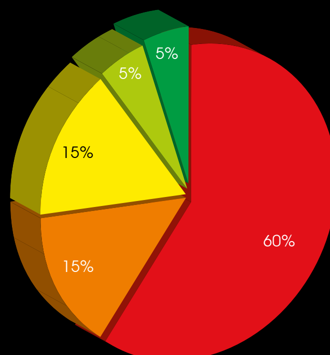


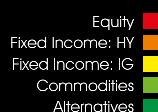
MULTI-ASSET PORTFOLIO 60/40

Performance

Return (%)	
YTD	7.2
1 Month	1.9
3 Months	1.6
1 Year	11.3
Annualised Return (%)	
3 Years	10.1
Since Inception	10.4

Strategic Asset Allocation



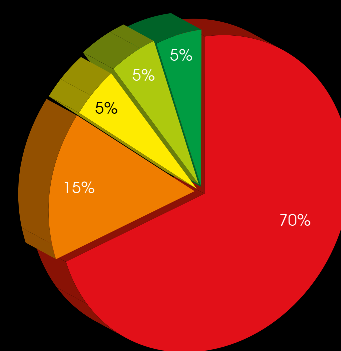


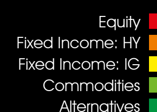
MULTI-ASSET PORTFOLIO 70/30

Performance

Return (%)	
YTD	7.5
1 Month	1.8
3 Months	1.7
1 Year	13.3
Annualised Return (%)	
3 Years	11.1
Since Inception	11.3

Strategic Asset Allocation





Performance figures are based on a notional portfolio, denominated in pound sterling, designed to track the holdings of the Credo Best Ideas, Dividend Growth and Multi-Asset portfolios. Portfolios incorporate all additions and removals. Portfolios may not be fully invested at a point in time and therefore can hold a portion of assets in cash. Performance is calculated before any fees (which can vary depending on the level of service) but includes gross dividends, reinvested. Following additions or removals, each holding is rebalanced to the model weighting. Source: Bloomberg pricing as of 31/08/2017 close. All portfolio performance is calculated using Bloomberg PORT, rounded to 1 decimal place. Inception dates: Best Ideas Portfolio 14/11/2011, Dividend Growth Portfolio 28/12/2012 and Multi-Asset Portfolios 02/07/2014.

Debra Chalmers - *Legal and Compliance Director*

Increased investor

Prior to the financial crash, the EU regulatory regime had already been harmonised in 2007 by the implementation of the Markets in Financial Instruments Directive (MiFID). MiFID created consistent regulation for investment services across the 31 member states of the European Economic Area, with all participants subject to a similar regime. MiFID regulates firms which provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives) and the venues where those instruments are traded. In many ways, MiFID was based on the UK regulatory system, which the European Commission viewed as the most versatile and functioning of all members, but it was not consistently interpreted across the EU which led to opportunities for regulatory arbitrage.

MiFID has now been updated in response to the financial crisis with the aim of improving the functioning of financial markets and strengthening investor protection. The changes brought about by the new legislation, known as MiFID II will take effect from 3 January 2018.

The investor protection framework aims to ensure that investment firms act in the best interests of their clients by seeking to:

- improve governance and organisational requirements for firms;
- strengthen conduct of business rules that cover firms' relationships with all categories of clients; and
- introduce new powers to supervisors at both national and European level.

These measures aim to deliver changes that will ensure that industry culture is sufficiently oriented towards clients' interests and that conflicts of interest are properly managed. More specifically, detailed requirements are intended to result in:

- improvements in product design and distribution strategies;
- more complete and clear information about investments;
- better assessment by firms of the suitability of products and services recommended to clients;
- an improved framework to achieve best execution;
- strengthened protection of investors' assets; and
- fair and efficient treatment of all complaints.

The main investor protection objectives of MiFID II are achieved by:

- the introduction of a completely new **product governance**

protection - MiFID II

regime which applies to the development of the product and the sales process, the objective of which is to ensure that firms, which manufacture and/or distribute financial instruments, act in the clients' best interests during all stages of the product life-cycle;

- enhancing the obligation to provide "**Best Execution**" to clients by increasing the factors that firms are required to consider (e.g. price, size of order, likelihood of execution) when executing orders for their clients and taking into account the specific markets and financial instruments in which they carry out their trading activities. In addition, firms are required to disclose to clients the results they have obtained for them, including the identities of the top five execution venues so that clients can make meaningful and quantitative comparisons between investment firms;
- extending the **transaction reporting** obligations of firms to cover different trading venues, most types of instruments that are traded and increasing the level of information that has to be reported including providing the name of the decision maker for each trade executed. The aim is to enable national regulators to have better market surveillance, allowing them to monitor the integrity of the financial markets; and
- increasing transparency to investors by requiring firms to disclose all **costs and charges** associated with a client's investment, including transaction costs, so that clients are not subject to "hidden costs".

Whilst it is difficult to quarrel with the objectives of MiFID II, the cost of implementation is, for many firms, prohibitive and so it may well have an anti-competitive effect. Only time will tell whether investors will in fact be better off as a result, or whether the added layer of regulation merely becomes another box ticking exercise for some firms while others, like Credo will continue to act with integrity and to make decisions on the basis of what they believe to be in the best interests of their clients, regardless of whether that is a regulatory requirement. ■

Alex Clark - *Head of Client Services*

Legal Entity Identifiers (LEIs)

As part of the requirements for MiFID II, the flavour of Q3 2017 for Corporates, Trusts and Entities has swiftly moved to ensuring trading continues as normal from 3 January 2018.

Registering for a Legal Entity Identifier (LEI) has become another one of those "must do" items logged in a diary which continues to be carried over onto the next "to do" list week on week.

To ease the burden of clicking through pages of online content whilst still not finding a simple guide on what it is and how to register for one, we have created a questions and answers style tool:

1. What is a Legal Entity?
Although not specifically defined in the legislation, Legal Entities include Trusts (but not Bare Trusts), Companies (Public and Private), Pension Funds (but not Self-invested Personal Pensions), Charities and Unincorporated Bodies.

2. What is an LEI?
An LEI is a 20-character alphanumeric reference code that is unique to each Legal Entity used for identifying companies or entities involved in financial transactions.

3. Why do Legal Entities require an LEI?
The LEI is used as the identifier for the Legal Entity whenever it undertakes investment activity or an investment firm undertakes investment activity on its behalf in a reportable financial instrument such as equities and bonds. The unique LEI enables regulatory authorities in the UK and the rest of Europe to monitor trading activity particularly so they can monitor for market abuse and market manipulation. The Global Legal Entity Identifier Foundation (GLEIF) has overall responsibility for the LEI system. More information can be found at *https://www.gleif.org/en/*.

4. Who is responsible for obtaining an LEI?
The Legal Entity itself, not its investment firm(s), is ultimately responsible for obtaining an LEI.

5. What is the deadline for obtaining an LEI?
Legal Entities must have obtained an LEI by 3 January 2018. The issuing organisations will have to process a significant number of applications prior to the implementation date and Legal Entities should consider applying as early as possible to ensure they have an LEI by the due date.

6. What happens if a Legal Entity fails to obtain an LEI by 3 January 2018?
Investment firms will not be able to provide Legal Entities with investment services because investment firms will be unable to execute trades on behalf of any Legal Entity which does not have an LEI. In addition, where an investment firm offers discretionary and advisory managed services, it will be forced to terminate its service as it will be unable to comply with its ongoing obligation to monitor the suitability of the Legal Entity's portfolio as it will be unable to take decisions to trade or make personal recommendations.

7. Where can a Legal Entity obtain an LEI?
There are a number of LEI issuing organisations available including: The London Stock Exchange (*http://www.lseg.com/LEI*) whose website outlines the process to be followed and the documentation to be submitted. Other LEI issuing organisations can be found at *www.gleif.org*.

8. Is there a cost for obtaining an LEI?
Yes, the cost of purchasing an LEI will be available from the issuing organisation.

9. How do I check if a valid LEI has already been obtained?
A search can be carried out using *https://www.gleif.org/en/lei/search/* which will show if an LEI has been issued and is currently valid. To check validity, "Entity Status" will need to show as "Active" and "Registration Status" as "Issued".

10. Does a Legal Entity have to renew its LEI?
Yes, LEIs have to be renewed on an annual basis and whoever applies for the LEI will be responsible for renewing it. There is a charge for renewing the LEI. ■

THE VINYL REVIVAL

Flexible ISA introduction

With Government changes to Individual Savings Accounts ("ISAs"), Credo's new "flexible" ISA means investors will no longer be required to shield cash in the tax free wrapper in order to maintain the benefits.

A Flexible ISA enables an Investor to withdraw money from their ISA and replace the funds within the same tax year, without affecting the annual subscription allowance.

Although there is no limit to how much you can withdraw, any monies that are not replaced in the same tax year will lose the benefit. Subsequently, the only way to repay these monies in the next year would be to use the subscription allowance for the 2018/2019 tax year.

For clarity, if there are no withdrawals within a tax year, the subscription allowance operates in the same way as a non-flexible ISA.

Example of how it works:

In 2017/18 the subscription limit is £20,000 and the investor decides to:

1 May 2017: Subscribe £10,000
1 October 2017: Withdraw £5,000
1 November 2017: Subscribe £3,000

The net subscription allowance remaining for 2017/18 is £12,000.

We trust you find this information useful, but please do not hesitate to contact Credo Client Services should you have any further queries.

CREDO
WEALTH

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