

# Thesis Reflection

June 2011

## The not so 'Special' Account

Over recent years there has been a raft of changes to the administration of portfolios previously looked after by the Public Guardianship Office, that have impacted on how you advise your clients.

The role of Deputy has been introduced, a role that carries a higher level of authority in making day to day decisions on behalf of their clients. There has been a shuffling of acronyms as the PGO became the OPG. In addition to these background administrative changes, there has also been one economic change which has made a sizeable difference to OPG clients, namely the fall in interest rates to historic lows which has had an enormous effect on the interest rate offered on Special Account.

### From hero to zero

In the past, funds have been kept on Special Account for years, as the 6% interest return was frequently in line or above competing accounts and it had the benefit of an implicit Government Guarantee. Since July 2009 the rate has been cut sharply to just 0.5%. Of course, the decline in the attractiveness of the Special Account did not occur in isolation, other cash alternatives also offered reduced rates and therefore simple replacements to the Special Account were, and remain, unavailable.

We used to frequently see balances of £300,000 - £1,000,000 on Special Account and using the sum of £500,000 as an example, whilst previously a 6% interest return would have provided £30,000 of gross income, a similar sum at the current rate of 0.5% will provide only £2,500. Of course, this problem was exacerbated as the reason interest rates fell was that the economy was in trouble and this meant that Stock Market levels had also fallen heavily and so other investments were nursing substantial declines in their value.

This left many Deputies with the combination of a substantial shortfall in their income expectations and concern they would effectively have to raid capital to cover the income requirements at a time when values were low.

### Don't panic!

At Thesis we recommended a two pronged approach; one taking the approach of 'masterly inactivity' and retaining a commitment to equity holdings knowing that history suggested that markets would recover and that a number of fixed interest holdings had also been aggressively over sold and offered good value. Therefore whilst we made some changes to the portfolios, (we still remain underweight in banks for example) we were largely content to retain the majority of the holdings in expectation that they would recover strongly and of course, this subsequently happened.

### Consider a different approach

However, it became clearer that interest rates were likely to stay low for some time and that this was likely to make fixed interest holdings attractive, when compared to other defensive assets that produced a useful income return, and also meant that the fall in the interest rate offered by the Special Account would not be a short term phenomenon but rather a longer term problem. For that reason the second prong of our approach was to suggest to all our Deputies that action should be taken to reduce the balance held on Special Account and, if safety was paramount, then invest in Government Securities to retain a core of defensive assets and if more flexibility was possible, also add to all areas of a portfolio.

Both of these actions worked extremely well, both in terms of recovering asset values and repairing some of the income that was lost from the Special Account.

### Planning the future

Going forward, interest rates remain low and the market now only expects the next interest rate rise to occur in spring 2012 - even then we are only expecting modest increases.

### ➔ Special Account Case Study

As an example, for one client we were holding £600,000 on Special Account in 2008, effectively this acted as the Fixed interest element of the portfolio, as it had been providing safety and a yield comparable with Corporate Bond returns.

Following the reduction in the Special Account rate we initially withdrew £300,000 and invested the majority in Government Securities and to a lesser extent bond funds. Three months later a further £200,000 was withdrawn and invested primarily in corporate bond funds. All of these holdings subsequently appreciated in value but perhaps more importantly have provided a replacement yield of approximately 4.5%. We were unable to match the original income return from Special Account but this is considerably better than the current 0.5% yield.

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We are certainly not forecasting a return to 6% interest rates from the Special Account in the foreseeable future. This does mean that many OPG clients with high income requirements are only coping with the cost of care by utilising capital withdrawals.

Using our own cash flow calculator we can guide on how long this capital will last. As long as we are provided with a picture of the current assets, how they are invested and current expenditure figures, then equipped with some conservative assumptions for future capital and income expectations we can assist clients and their Deputies in helping plan the future given the changed economic outlook. We can provide this service regardless of whether we are already the appointed investment manager to the case.

As you know, some of the restrictions previously associated with managing OPG clients have been removed. Deputies are free to consider other investment managers and the strict fee requirements on managers themselves have also eased. Whilst these changes are welcome and provide greater choice for clients, sometimes the benefit of advice comes from getting the strategy right first. We'd be happy to bring clarity and our own investment thinking to the crystal ball!

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