



Balancing act

Professional advisers must weigh up short-term gains against long-term consequences when investing for the elderly. *Karen Vidler* considers the optimal approach

Interest rates look set to remain low. This presents a huge challenge, particularly when investing money for the elderly, who are invariably more vulnerable to the effects of inflation and face the significant hurdle of meeting the cost of long-term care.

The quandary lies in the degree of long termism that can, or indeed should, be adopted. Most investment strategies are designed for the long term, so cash deposits have fulfilled the need of older clients in the past. But with many personal representatives, deputies and trustees unable to capture much more than one per cent gross interest on the funds available to them, with inflation (RPI) nudging five per cent, and the escalation on care costs assumed to be in excess of five per cent per annum, a wholly cash-deposit based solution will not prove good value and is not appropriate, except for the short term.

Healthy outlook

Here lies the challenge for professional advisers and their clients: determining when a strategy that might be appropriate for two or three years should be implemented rather than a strategy for now. As we get older, for the majority of us, our health will decline anyway, and determining the difference between what might be life shortening and what is merely a side effect of the ageing process is impossible for professional advisers, even medical experts are challenged by this. We have all known individuals in robust health

who have died prematurely as a result of something that seemed innocuous. Similarly, we have all known those who have suffered long-term ill-health into old age and have survived for a period much greater than anyone expected.

As professional advisers, you can only make your best judgment and do what you consider is appropriate. Unless there is a clear indication that an individual is unlikely to survive for a period of more than a year or two, there really ought to be some form of 'long stop' to the investment strategy in order to preserve the capital, which can be ravaged through inflation and/ or care fees. There are relatively few individuals in a position whereby they can cover all of their care fees from their pensions and other income. So invariably the objective is to stretch the capital to last for as long as possible and to attempt to ensure that there are funds to pass on to beneficiaries.

There are some instances where such a strategy simply cannot be achieved. Unless an individual has a reasonable level of pension income and/ or a substantial amount of capital, the impact of care fees of £30,000 or more per annum means that anything longer than a very short-term strategy cannot be considered. Typically, these are individuals where there is little more than state pension provision and the capital has arisen as a result of the sale of their home. So perhaps only £200,000 or so is available, which in the normal course of events might present the prospects of a decent investment amount



but, faced with care fees of £30,000 or more per annum, on the face of it there appears little that one can do.

Flood warning

But is there? Earning an extra two or three per cent per annum will reduce the capital erosion by up to £6,000 a year – so it is worthwhile reviewing the strategy.

While it is possible to capture a higher rate from a bank or building society, often this requires tying up the money for five years and, even then, the amount deposited needs to be fairly substantial. The main focus for professional advisers acting on behalf of the elderly should be to retain flexibility and adaptability. In failing health, care costs can escalate rapidly: what was originally £600 per week can rapidly become £1,000.

Having an investment strategy that is elastic enough to adapt to this is key. No one will criticise you if you have put in place a strategy that works for three years if, on the face of it, your client had a life expectancy of three years or more and they die after a year. However, if a client survives seven years into a strategy that is based on cash deposits that have yielded less than inflation, the capital will be decimated as a result. In this situation there is every likelihood that there will be a good deal of wisdom in hindsight.

While a more sophisticated and tax-efficient solution is warranted for those with reasonable wealth, for the majority there is a desire to preserve simplicity and, most of all, cost efficiency. Paying significant up-front costs for a strategy is difficult to justify if longevity does not occur. The fine balance between having a strategy that will have worked in the long term, but is cost efficient in the short term, is the ideal.

Although the banking crisis has been woeful for all of us, there have been some positives that have come out of it. There is now a wider choice of investments and it is possible to achieve cost-effective strategies for the elderly that are adaptable and can be made extremely tax efficient, where the individual's tax position requires it.

	5 years	10 years
FTSE all share (net of dividends)	28.38%	43.25%
RPI	7.58%	2.65%
	17.67%	38.40%

Source – Financial Express, 31 December 2010

Realistically, with a life expectancy of two years or less, the deposit-based solution remains the most appropriate. In reality, no investment strategy can be expected to deliver strong returns and to be cost effective over such a short period of time.

But for those majority of cases where we simply don't know what the life expectancy is and, on the face of it, where it could be anywhere between one year and ten years, considering a solution that will provide a hedge against the ravages of care costs and inflation, if longevity occurs, should be undertaken. This is an area where investment strategists perhaps haven't dedicated the same amount of

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time as to 'long-term care' policies. Don't get me wrong, long-term care policies have their place, but are not appropriate for those already in need of care or about to need it. Rather, they are an insurance-based solution that is rather akin to trying to insure your house against flood when the water has already started coming in. There is also a natural suspicion of insurance-based products, some of it merited, some of it not.

Crash landing

Something that professional advisers need to bear in mind when dealing with elderly clients is that anything above a low to moderate level of risk is simply not compatible with around 99 per cent of cases.

Attempting to race ahead of inflation with your investment strategy and to remove the inflationary risk is idealistic and unrealistic. Many of us have had to pick up the pieces when such strategies have gone horribly wrong, especially following stock market falls.

In this context perhaps it is worthwhile reminding ourselves that over the last ten years the performance of equities has not been wonderful (see box). Over the past decade the FTSE all-share index has shown a 43.25 per cent total return (if you strip out the dividend income it is just 2.65 per cent). Over the same period the retail price index (RPI) shows a rise of 38.4 per cent.

Now it is true to confirm that the ten-year period covers a number of fairly major setbacks on equity markets and a period of rising inflation. However, it demonstrates the need for there to be a sense of balance in any strategy and, while equities can be included, they need to have a dividend yield in the main to contribute to the objective of mitigating the effects of inflation, on a day-to-day basis.

While extensive tax mitigation strategies are appropriate only when there is a fairly substantial amount available, simple tax mitigation strategies are entirely appropriate. The use of ISAs and other 'tax-wrapped' investments can be invaluable, especially when dealing with someone either over the threshold for age allowance or into higher rates of tax. Utilising such strategies can be extremely low cost and uncomplicated.

The ideal solution is an investment strategy for your client that does what it needs to and no more, but at the same time costs what it needs to, and no more. It will work in the long term; but not prove a folly in the short term. ■

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