Alliance Trust

PROFIT FROM PATIENCE

Inflation & ISA edition

Have you ever searched for spoilers while watching a movie, or dipped into your hard-earned savings to buy a treat?

If so, you're not alone. Our research found that 71% of us wish we were more patient in at least one aspect of our lives, with only 29% of people feeling confident that they're patient enough.[1]

Patience seems like an increasingly rare commodity in today's world. But when it comes to your investments, patience isn't just a virtue – it has real-world value too. And it's especially relevant when markets are volatile or uncertain.

Our original research uncovered how 'patient' investing can grow a portfolio – keeping your money steadily invested in a portfolio that's designed for long-term results. You can read about avoiding what we call the 'Impatience Tax' in the original **Profit from Patience report.**

But our most recent report also demonstrates why leaving your money invested could be especially important during volatility and inflation, and why patience is more important than ever if you want to **avoid an 'Impatience Tax' of up to 192k over the long term.**[2]

COULD PATIENCE BEAT INFLATION?

During times of inflation, it can be tempting to look at our portfolio and wonder if we're getting the best returns. But the best approach for the long term is still to have a place to put your money that can help you benefit from long- term patience – such as a stocks and shares ISA.

ISAs come in different shapes and sizes, but they have one thing in common: you don't pay tax on profits. And every year, you can add more money – up to a limit that has gone up over time – to grow that tax-free pot. But our money is still vulnerable to inflation meaning the value of our savings deteriorates over time unless we beat it. For seven of the last eight months, inflation (CPI), although moderating, has consistently sat above 10%. That's still the **highest it's been since Feb 1982 (41 years)** so investors are naturally trying to keep the return on their savings above inflation.

This is a closer look at how investors can beat inflation and profit more from patience with a stocks and shares ISA.

Can interest rates beat inflation?

Practising patience can take a little nerve, especially in uncertain conditions. The 2008 Financial Crisis was a turning point for the relationship between inflation and interest rates:

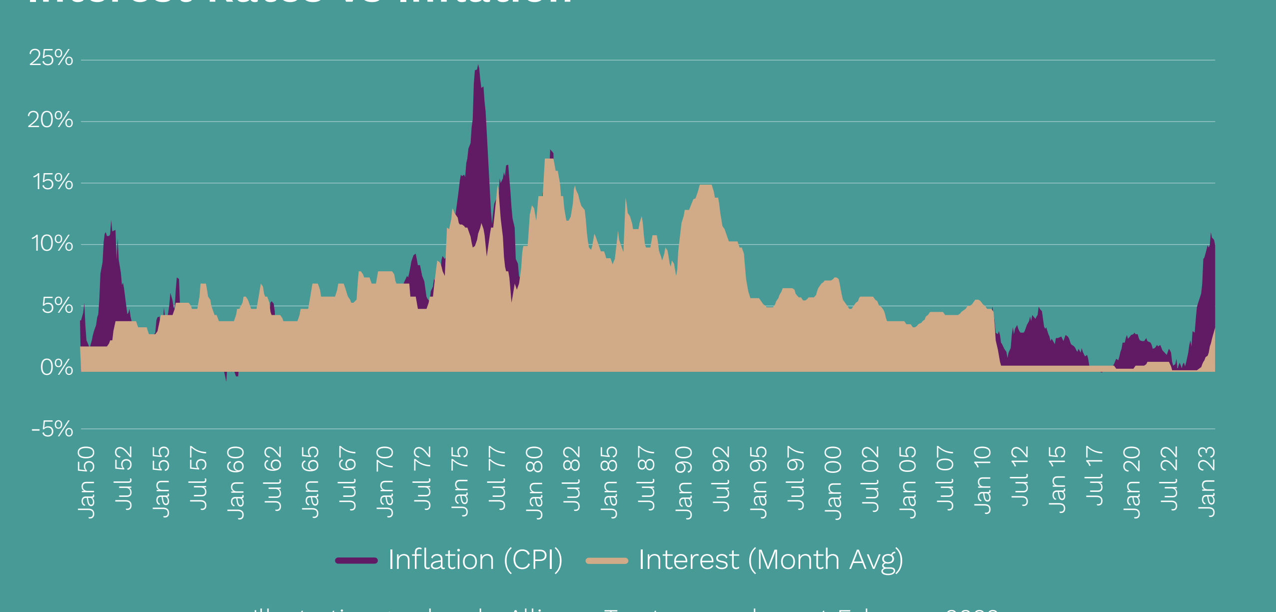
2008

From 1950 to before the Global Financial Crisis in 2008, interest rates beat inflation 81% of the time, earning cash a reputation as a haven against inflation.

Since the Global Financial Crisis, interest rates have only beaten inflation 10% of the time, suggesting we should rethink how much we can rely on interest rates to combat inflation over the long term.

Unlike the 'good old days', interest rates aren't beating inflation **today**. It might be time to consider other strategies that can beat inflation reliably and over the long term.

Interest Rates vs Inflation



Illustrative graph only. Alliance Trust research as at February 2023.

What happens if we add stock market returns into the mix?

With the FTSE All-Share Index data reflecting UK stock market performance, both the stock market and cash beat inflation 67% of the time over the last 40 or so years (data available from 1982 to 2023 year-to-date).

In the last 16 or so years since 2008, the UK stock market has beaten inflation for eight of those years (50%), with the most recent being in 2021.

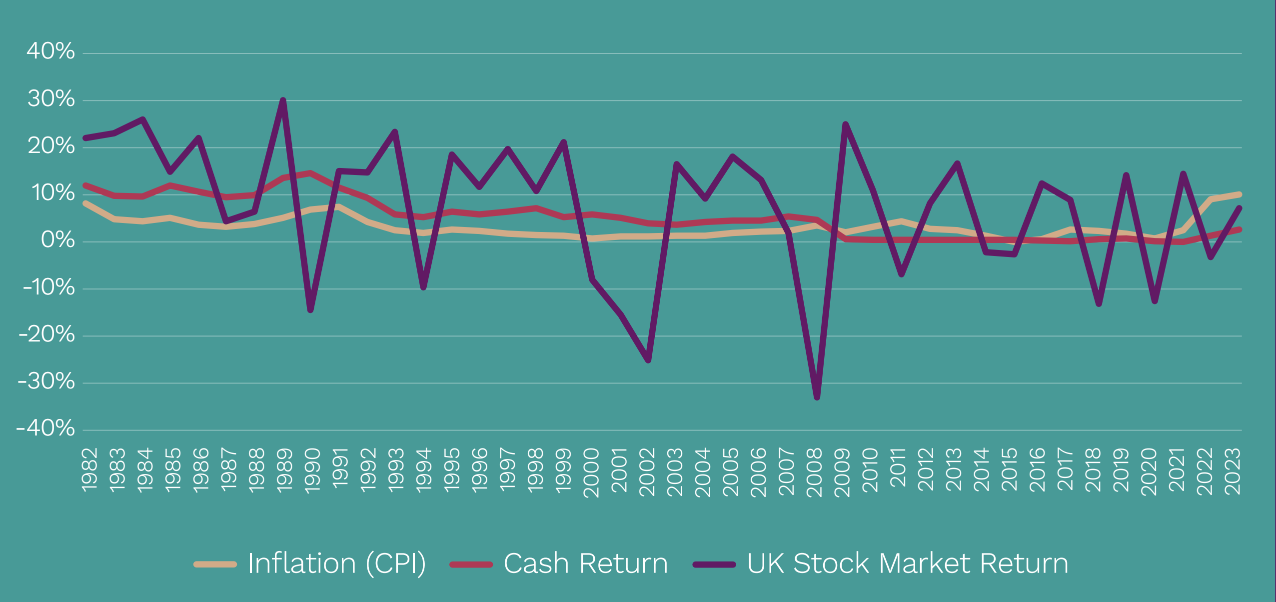
Cash interest has only beaten inflation twice (13%), with the last time being 2015 when inflation was 0.04% and the interest rate was only 0.50%.

But inflation notwithstanding, which has delivered a better return in the last 40 years – cash or the stock market?

Annual stock market returns exceed annual cash returns 63% of the time.

Although the picture looks volatile, it's worth remembering losses are only crystallised if the investor becomes impatient and sells up.

Cash vs the stock market



Illustrative graph only. Alliance Trust research as at February 2023.

How can inflation impact my profit?

Let's look at two scenarios for investing during periods of high inflation.

£100

By tracing the trajectory of £100 over the last 40 years, we can see how inflation performs against the stock market and cash returns.

Inflation erodes the purchasing power of our £100 down to **£27.82 in today's money.**

But, if we invested our £100 in the **stock market** – and adjusted for inflation – it would be worth **£362 today**.

And if we kept it in **cash**, our £100 would be worth **£241.**

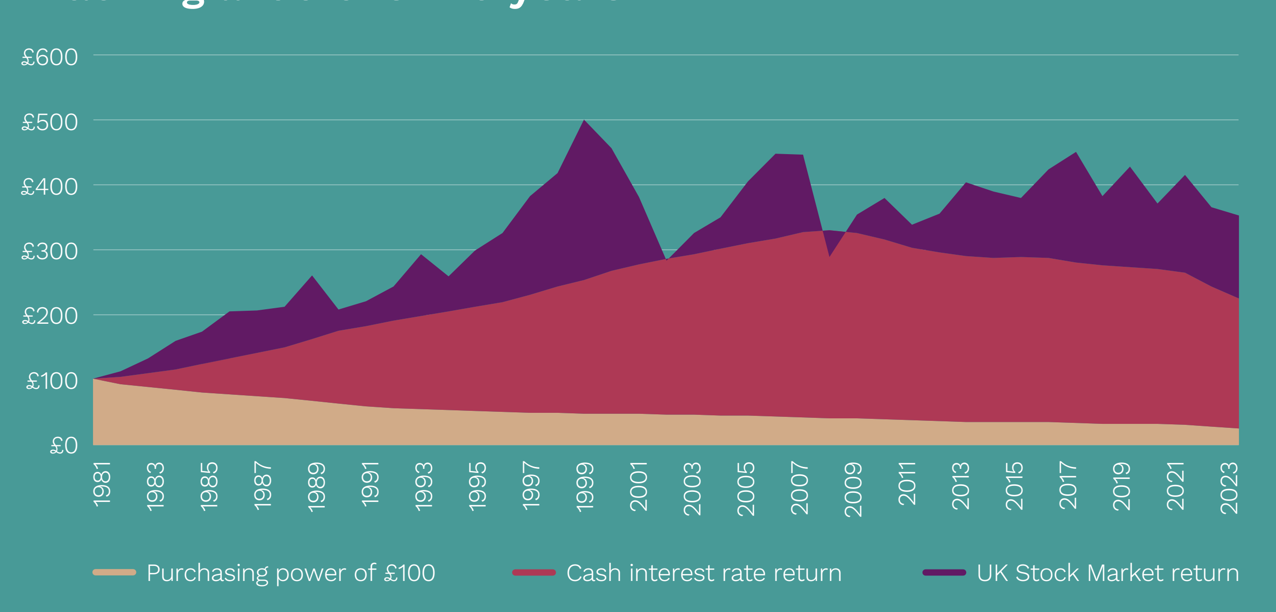
The **stock market** performs **50% better than cash** across the longer term, even through the ups and downs of the market.

Average annual **stock market return** over the last ~40 years has been **7.55%**.

Average annual **cash return** in the same period has been **5.21%**.

Average annual **inflation** has been **3.22%**.

Tracking £100 over 40 years



Illustrative graph only. Alliance Trust research as at February 2023.

Conclusions

The 2008 Global Financial Crisis might be a turning point in our ability to rely on interest rates as a profitable strategy to combat inflation.

Interest rates, though rising, just aren't what they used to be, and aren't coming close to beating inflation like they did in the '90s.

That relationship between interest rates and inflation could move in a couple of different directions:

1. Interest rates stay high while inflation comes down. Our cash might beat inflation...but for how long? And what will it cost us in potential returns to wait and find out?
2. Inflation falls dramatically, so even a small interest rate could beat inflation. This happened in 2015 when an interest rate of 0.50% beat the average inflation of 0.04%. But if this happens, are we happy with that level of return for our portfolio?
3. Interest rates stay high, but don't beat inflation. This is what we're seeing today. So yes, we're getting a good return on our cash, but the value of our money is still going backwards. If we can't beat inflation in the short term, can we beat it in the long term with a more reliable, inflation-busting strategy?

The reliability of the stock market to deliver stronger, long-term performance has been maintained in the post-2008 era.

If you invested £100 in 1982, you'd make 50% more if you invested it in the stock market – and left it there – than if you'd kept it in cash. That's profiting from patience.*

1. Consumer research was conducted by Opinium Research, who surveyed 2,000 UK adults between 6th January and 10th January 2023. Of these, 651 were investors (defined as having a Stocks & Shares ISA, a general investment account, and/or a self-invested/self-managed personal pension)

2. **The Profit from Patience Report, Alliance Trust, September 2022.** Model based on two investors each making an initial stake of £10,000 in Alliance Trust in 1992 and then adding 10% of the average national salary every month afterwards. The Patient Investor remains in the market throughout, while the Impatient Investor sells 25% of their holdings whenever the market dips 5% in a single day and buys back in when the market recovers 10% in a single day using cash accumulated from monthly contributions, previous redemptions, and accrued interest. NB: The model uses the Alliance Trust share price as a proxy for the market.

*Unless otherwise stated, all figures have been obtained as part of research conducted by Alliance Trust using the following sources and methodology where applicable:

Methodology
Sources:

Inflation figures from **ONS** (1950-2023).

Cash interest rates from **Bank of England** (1950-2023).

Stock Market Return refers to the FTSE All-Share Index sourced from **Yahoo Finance** (1982-2023).

Calculations applied to £100 capital:
Purchasing Power - value of wealth at the end of previous year reduced by the rate of inflation for the current year. Repeated for each year since 1982.
Cash Return - interest compounded daily.
Stock Market Return - annual return of the FTSE All-Share Index for each year applied to the previous year's ending balance. Repeated for each year since 1982.

THAT'S AN ISA IDEA

Making the most of your ISA allowance

Until 2014, you could hold at least double the value of your ISA allowance in a Stocks & Shares ISA than in cash. So, for example, in the 2013/14 tax year, you could put £11,520 into an ISA, but only £5,760 of that could be held in cash. Since 2014, we've had a single allowance, and we choose how much of that allowance to hold in cash or stocks and shares. We've always had the freedom to transfer our ISA balances between different types of ISA products. But just because we can doesn't mean we should.

What could an impatient ISA investor look like? And how does that impact profits?

Let's look at a few more hypothetical scenarios. We'll focus on three investors and examine how patience affects their ISA portfolio over time.

Three investors – Patient Cash ISA Investor, Patient Stocks & Shares ISA Investor, and Impatient Investor – all start investing in April 1999 (when ISAs first began), putting in an equal portion (1/12th) of their ISA allowance every month.

Over the next ~24 years, our two Patient Investors stick with either their Cash ISA or their Stocks & Shares ISA.

But what about the Impatient Investor? At the start, interest rates are beating inflation, so they take out a Cash ISA to make the most of that situation. When interest rates are no longer beating inflation, they transfer their Cash ISA to a Stocks & Shares ISA. And when interest rates start to beat inflation again, they move some of their Stocks & Shares ISA back into a Cash ISA.

It's that buy or sell triggered by impatience – this time in an attempt to try and beat inflation – **that makes our portfolios vulnerable to the Impatience Tax**. And more vulnerable to inflation.

The Patient Cash ISA investor saves up to the maximum of the cash allowance each year.

The Patient Stocks & Shares ISA investor saves up to the maximum of the stocks and shares allowance each year.

The Impatient investor, trying to beat inflation, starts putting into a Cash ISA because it's delivering a better return than the stock market at the time, and it's beating inflation.

They move their ISA savings from cash into a Stocks and Shares ISA every time the cash interest rate stops beating inflation.

They move 25% of their stocks and shares held in an ISA back into cash every time the cash interest rate starts beating inflation again.

Once interest rates rise above inflation, the Impatient investor moves their regular contributions to their Cash ISA.

And when interest rates go below inflation, they start moving their monthly contributions back into their Stocks & Shares ISA.

Results

The Cash ISA investor

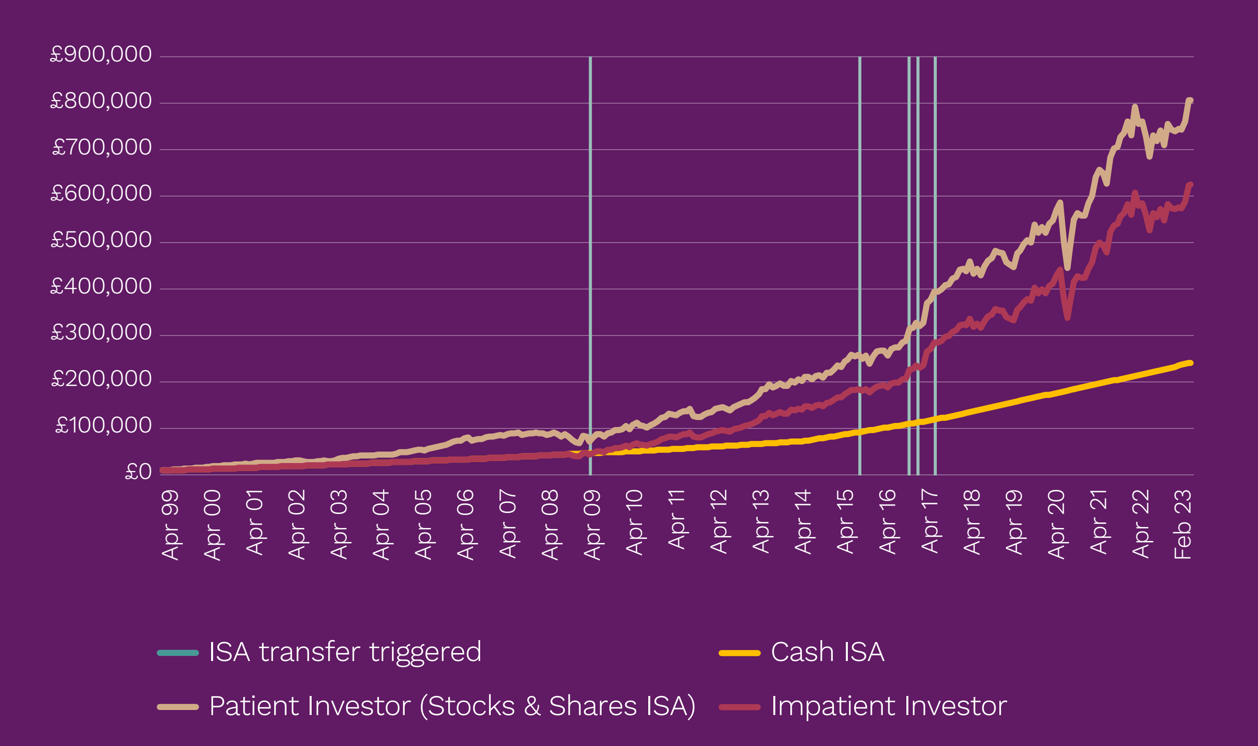
makes an overall **8%** return over the ~24 years (total return).

The Impatient Investor

who has at times held their savings in cash and stocks and shares – makes just under **£400K** by taking that mixed approach.

The Stocks & Shares ISA Investor

profits more from their patience, having kept their ISA allowance in stocks and shares, benefiting from a higher ISA allowance (until 2014) for longer to make just under **£190K more** than the Impatient Investor, and over **£500K more** than the Cash ISA investor.[3]



Illustrative graph only. Alliance Trust research as at February 2023.

3. **Methodology:**
Model based on three investors investing in either a Cash ISA, Stocks & Shares ISA, or a combination of both. The Patient Investor and Cash ISA Investor stay invested in a Stocks & Shares ISA and Cash ISA respectively throughout the period.
The Impatient Investor starts out with a Cash ISA because interest rates are beating inflation. Then, they move their Cash ISA holdings into a Stocks & Shares ISA whenever the previous month's inflation is higher than the annual interest rate. The previous month's inflation is introduced once on the 15th day of the current month. Whenever interest rates become higher than inflation, the Impatient Investor moves 25% of their Stocks & Shares ISA back into a Cash ISA.

NB: This model uses Alliance Trust as the portfolio for a Stocks & Shares ISA.

Fees and charges – we've not taken into account any fees or charges. Because fees and charges vary depending on when and how investors buy or sell, they could in fact lower returns and increase the 'Impatience Tax'.

Inflation – we've not accounted for inflation in any calculation.

Tax – other than the tax-free features of an ISA allowance, we've not taken tax into account for any calculation.

Dividends – we've reinvested all dividends.

Cash interest – we've compounded interest using historic Bank of England rates for any cash any investor holds during the time period.

Monthly contributions - we've limited each investor to 1/12th of the ISA allowance they're participating in. For the Impatient Investor, this allowance can change depending on whether they're actively investing in a Cash ISA or a Stocks & Shares ISA on any given day.

THE INFLATION BUBBLE

We're currently in an 'impatience bubble', which we define as a period of socio-economic turmoil indicated by adverse news coverage (such as the cost-of-living crisis) or other economic indicators (like inflation or global politics). These bubbles can cause markets to become volatile in the short term and appear undesirable as a wealth growth strategy in the long term. In short, this is a time when the risk of becoming an impatient investor escalates.

Have you ever been tempted to make a change to your portfolio because of market volatility or things happening in the news? You wouldn't be alone. We decided to conduct our own research with investors, to find out who the impatient investors are and what triggers them.

Inflation hitting **10%** was the event most likely to have impacted investment decisions in the last year.

The increase in interest rates last year had a large impact on investors, causing **12%** to buy more investments.

Almost **six in ten** UK adults plan to make changes to their ISAs before the 5th April 2023.[4]

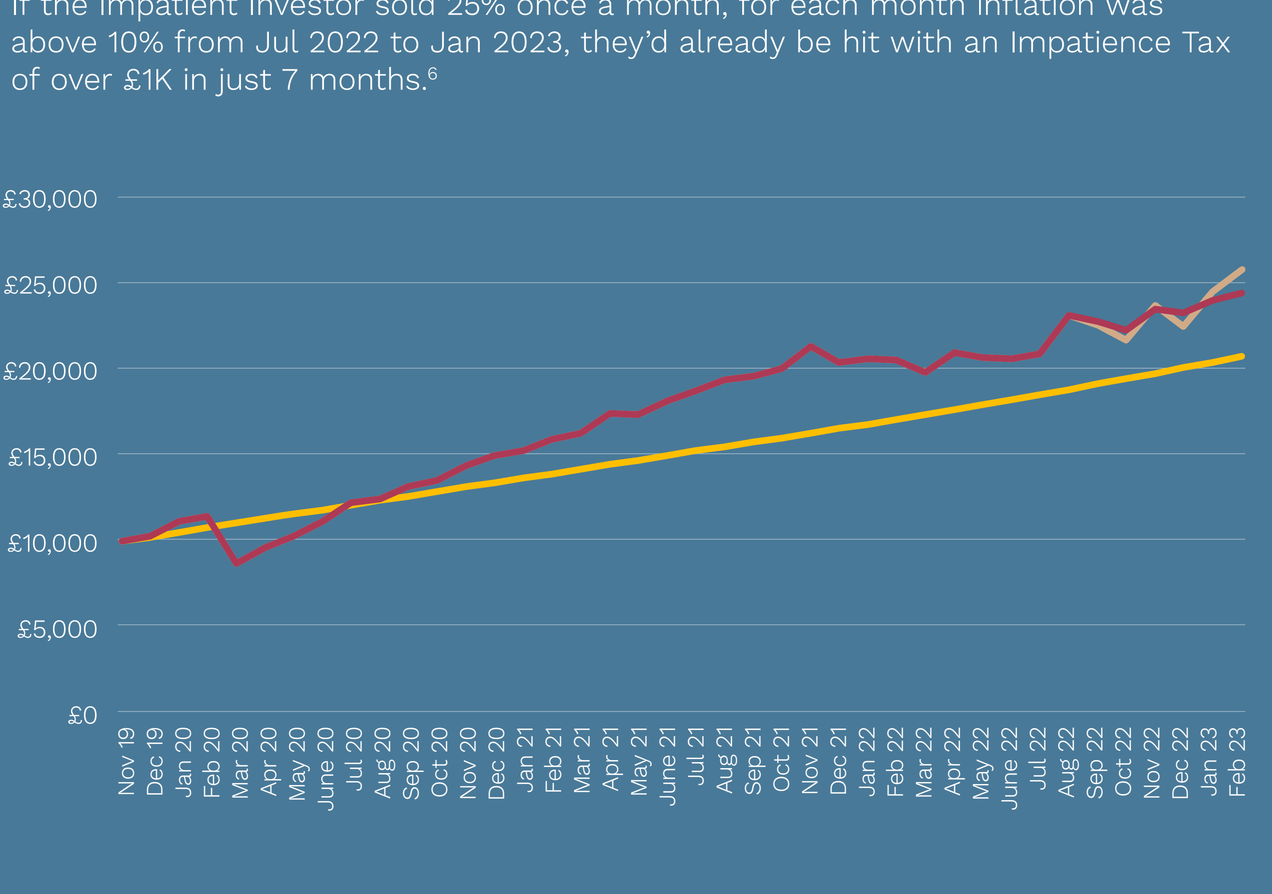
A single investment decision made during an 'impatience bubble', ignoring the historical track record of the stock market, could cost UK investors billions.

The cost of investors selling their investments when inflation hit 10% in July 2022, could have cost UK investors over **£2.2bn** in 12 months[5]

The Impatience Tax can hit early in an investor's journey. Or in other words, **patient investors don't have to wait 30 years to see how they can profit from patience**.

We explore another hypothetical scenario below. In this scenario two investors started with £10,000 in November 2019, before the UK's last General Election, Covid and Ukraine – the start of this latest impatience bubble.

If the Impatient Investor sold 25% once a month, for each month inflation was above 10% from Jul 2022 to Jan 2023, they'd already be hit with an Impatience Tax of over £1K in just 7 months.[6]



Illustrative graph only. Alliance Trust research as at February 2023.

4. Consumer research was conducted by Opinium Research, who surveyed 2,000 UK adults between 6th January and 10th January 2023.

5. A national estimate based on 86 investors who indicated they sold their investments at a profit or a loss when inflation exceeded 10% in July 2022. Total representative sample of 2,000 respondents adjusted for the UK adult population from ONS data. Investment returns based on historic annual returns of FTSE All-Share Index. Cash return based on a simple daily average of the Bank of England interest rates from the end of July 2022 through July 2023, assuming the current interest rate of 4% is maintained at least until the end of Jul 2023. Calculated using the difference between the FTSE All-Share Index return and the cash interest rate return applied to 100% of the average investment portfolio of the adjusted representative sample of investors.

6. Model based on two investors each making an initial stake of £10,000 in Alliance Trust in November 2019 and then adding 10% of the average national salary every month afterwards. The Patient Investor remains invested throughout, while the Impatient Investor sells 25% of their holdings for each month UK inflation (CPI) is at 10% or higher, up to and including the latest announcement on UK inflation in January 2023.

Fees and charges – we've not taken into account any fees or charges. Because fees and charges vary depending on when and how investors buy or sell, they could in fact lower returns and increase the 'Impatience Tax'.

Inflation – although inflation is used as the trigger for portfolio redemptions, we've not accounted for inflation in any calculation of portfolio performance.

Tax – we've not taken tax into account for any calculation.

Dividends – we've reinvested all dividends.

Cash interest – we've compounded interest using historic Bank of England rates for any cash any investor holds during the time period.

Monthly Contributions – we've based this on 10% of the national average salary each month.

HOW TO BUILD YOUR PATIENCE POT

Make sure you consider what it means to invest for the long term. It's not five or even ten years – in our view, it's 30 years or more. We hope this research and our patience tools demonstrate how, by practising a little patience and putting your trust in a long-term approach, you too could profit from patience.

TAKE OUR QUIZ TO SEE HOW YOUR PATIENCE STACKS-UP →

About Alliance Trust

At Alliance Trust, we've been practising the long-term approach since 1888, supporting shareholders and their families for generations to make the most of practising patience.

Established in 1888, we have successfully navigated many market crises and adapted our strategy over time. Today, we offer a responsibly managed portfolio, which provides individual UK investors with exclusive access to the top stock selections of some of the world's best investment managers, at a competitive cost.

FIND OUT MORE ABOUT THE ALLIANCE TRUST APPROACH →