MONEY

CARRY ON CAMPING
CHANELLE McCOY ENJOYS GOING BACK TO BASICS WITH THE FAMILY
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Bank on digital players to give you a decent deal

Alternatives to the mainstream big boys face a huge challenge but they do offer attractive features as the face of the future, writes *Eithne Dunne*

Digital banks offer hi-tech options for customers but, like characters in sci-fi film Ready Player One, you have to be prepared for virtual rather than face-to-face transactions

Although still wet behind the ears compared with our mainstream banks, Ireland's digital banks are striking a chord with the tech-savvy and the budget-conscious alike. Their appeal lies mainly in their zippy technology, fee-free business model, and cheap-as-chips currency exchange.

Despite this, the vast majority of people who use digital banks do so as an add-on to their regular current account, with few prepared to migrate fully. The only two digital banks in Ireland are Revolut and N26, although they will have company before long in the form of Starling Bank and Monzo, both of which are already operating in the UK.

Revolut and N26

With Revolut – which has just over 100,000 users in Ireland – you'll get an IBAN (International Bank Account Number) as you would anywhere else, which means you can arrange to have your salary or other money paid into your account. You can set up direct debits, hold and exchange up to 25 currencies, spend abroad or online without fees, and send and receive money transfers. For the budget-conscious, a Revolut account comes with spending notifications and analyses.

"Unlike a traditional bank where it takes a while for a statement to come through, you get instant spending notifications," said Kiran Wylie, Revolut's PR and communications manager.

It also has a feature called Vaults. Here you can choose to either round up every transaction, set up a recurring contribution or make occasional payments into your savings account or "vault". With the "spare change" function – if you say spend €2.70 on something, Revolut will automatically divert 30c into your vault.

Revolut does not charge a fee for currency exchange, and uses the interbank conversion rates, which are considerably better than the banks' retail rates. Frequent travellers might also like Revolut's pay-as-you-go travel insurance (from €1 a day). Geolocation technology ensures that this kicks in automatically when you land abroad and ends when you leave.

The basic account has no upfront charges (bar government stamp duty of a maximum of €5 per year); the premium account is €7.99 per month. With the former, you get a maximum of €200 in ATM withdrawals per month (in any country), after which you'll be charged a fee of 2% of the value of each withdrawal.

The most you can spend/transfer/exchange per month is €6,000; after this a 0.5% charge kicks in. ATM withdrawals of up to €200 per month are free in any country. Anything over this is charged at 2% of the value of the ATM withdrawal.

With Revolut's premium account, you get up to €400 free ATM withdrawals per month, free unlimited currency exchange and free overseas medical insurance (among other sweeteners).

Because Revolut has no outlets, however, you cannot deposit cash or cheques, nor can you get overdrafts or other credit services – and it does not pay interest. This may change if Revolut is granted a full banking licence.

Like Revolut, N26 doesn't deal in cash or cheques. It too has no maintenance fee (bar stamp duty) and an enhanced account (N26 Black) at €9.90 per month. With the standard N26 account, all cashless payments are free and you get five ATM withdrawals free per month (across the eurozone) after which a €2 fee is charged each time.

ATM withdrawals in non-euro countries will cost you 1.7% of the withdrawal amount (about half what a typical bank will charge for this). For currency exchange N26 charges no fee and uses MasterCard's exchange rates. Unlike Revolut, it supports Apple and Google Pay, and has an overdraft facility of up to €2,000. N26 Black includes free travel and mobile phone theft cover, and free foreign-currency ATM withdrawals

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Dubliner Mark O'Reilly has been using Revolut for six months, although he still has his regular current account with AIB.

"When having lunch with colleagues one day, I noticed one of them paid with contactless and then got an instant notification of the payment on his phone.

"I asked him what that was about, and he told me about Revolut."

Kennedy uses his AIB account for his salary and main spending – utilities, direct debits, groceries – he keeps the required minimum balance (€2,500) to avoid fees and then uses Revolut for all discretionary spending.

How do mainstream banks stack up?

The appeal of the digital banks is easy to see. While many high street banks will offer to waive maintenance and/or transaction fees if you keep a minimum balance in your account, it's a condition not everyone can stick to.

Some banks, such as Bank of Ireland and KBC, levy a quarterly maintenance fee regardless of how big your balance.

And if you don't manage to get your transaction fees waived, there's a litany of charges for everything from processing cheques to ATM withdrawals to contactless payments. If nothing else, the fee system tends to be overly complicated, and some consumers are drawn to the simplicity of digital banking. Go to buy some foreign currency from your bank, meanwhile, and you'll either be charged commission and a poor conversion rate.

If you make regular online purchases from outside the EU – or travel a lot – you'll find the digital services considerably cheaper. For example, neither N26 nor Revolut charge a fee for making purchases in other currencies, whereas a traditional bank will charge 1-2% of the purchase value plus – in some cases – a currency conversion fee on top of that.

On the other hand, if you use cash and/or cheques a lot, a digital bank is useless. Neither is it much good if you like to speak to someone face to face – rather than via email, social media or in the form of a chatbot.

Could digital banks take over?

While consumers get used to digital banking, most will probably continue to use it as an add-on to their traditional bank account rather than a replacement for it. But things seem to be moving slowly in that direction, with consumers who perhaps tried out digital banking in a limited capacity now using it for far more.

Martin Meany, founding editor of Goosed.ie, welcomes the fact that they have put pressure on mainstream banks who are, he said, "hit and miss" in terms of what they offer. However, he said they have failed the acid test of getting customers to fully commit. "I haven't met anyone who will put their wages into these accounts," he said. "They have great features but until you can get people to put their hand on heart and say 'my new bank is Revolut' it's not a huge success."

He said another stumbling block for the likes of N26 and Revolut is the fact that they are so new – and therefore unproven. For anyone worried about the security of their money, N26 is part of the compensation scheme operated by the Association of German Banks, with all deposits up to €100,000 guaranteed. Meanwhile, Revolut client funds are stored under a segregated account at Lloyd's or Barclays.

"Revolut is authorised by the UK's Financial Conduct Authority; in the event of an insolvency, customers will be able to claim their funds from this segregated account," said Wylie.

Kennedy said he would consider going purely digital. "Traditional banks are disincentivising people to use their branches, so things are going that way anyway. Then there's the involvement of our traditional banks in the financial crisis. I am very happy to use any opportunity to not give these banks my business."

Meany said having a digital account as an add-on to a traditional account is a perfectly sound approach. "You're just paying annual stamp duty, which is a nominal fee to try something new. It's like anything else; consumers should use a smorgasbord of banks if they have to in order to get the best deal."

MARKET MOVER
OLIVER SINNOTT

Oliver Sinnott has been lead fund manager of the Davy Global Bond Fund for more than six years. The fund is part of Davy Asset Management, which has €4.8bn under management. It is available for investment through Davy, with a minimum initial amount of €500.

Fund philosophy

The fund is designed to be low risk, with the aim of protecting capital against short-term volatility and, more importantly, against bear markets by investing predominantly in highly rated global developed market government bonds.

According to Sinnott, the fund's global mandate is central to this.

"Yields in the eurozone are very low because of the ECB's negative interest-rate policy and bond purchasing programme, but the fund has the flexibility to source the highest yields globally. In addition, the fund typically has lower volatility than investing in pure eurozone bond funds because it is diversified across multiple regions."

Performance

The fund has returned about 2% per annum — for a very low level of volatility — since Sinnott took it over in 2012.

However, he says the real time to shine will be when the cycle ends. "I see high-quality government bonds as an insurance policy. They reduce day-to-day volatility and, when risk assets such as equities enter a bear market, we expect the fund to rise in value and preserve the value of client portfolios."

Buying and Selling

The fund recently went overweight on Australian government bonds relative to US Treasuries.

"This is a play on two diverging economies," says Sinnott. "We are concerned about the impact of much tighter credit constraints [due to macro prudential measures] on the Australian housing market. This should have a negative impact on the consumer and economy and, with bonds, sometimes bad news is good news. Instead of raising interest rates as the market expects, the Reserve Bank of Australia may even cut interest rates, which would be good for Australian government bonds."

On the other hand, he says, the Trump administration is adding fuel — through tax cuts and fiscal stimulus — to an economy already growing above its potential and close to full employment. "This is inflationary and should force the US Federal Reserve to continue raising interest rates, which will be relatively bad for US Treasuries."

The fund's position in US Treasury Inflation-Protected Securities (Tips) has benefited from Trump's inflationary policies , he adds.

"The tight US labour market should see wage and inflation expectations continue to rise. US Tips could offer a good hedge in portfolios to protect against any rise in prices if a trade war between the US, China and the EU got out of hand, not to mention any rise in oil prices."

Outlook

After being very underweight, investors are returning to global government bonds. "While yields remain very low in Europe thanks to ECB policies, they have moved higher elsewhere, and the 10-year US Treasury yield has risen to circa 3%. Many are also looking to protect portfolios against the next recession as the cycle matures," he said.

Gary Connolly

You can only beat the market against the odds

In one of comedy's great scenes from the movie Dumb and Dumber, one of the main characters Lloyd Christmas, whose love for the female lead is unrequited, asks about the chances of the two of them ending up together. Mary, the female lead, diplomatically replies: "Not good". Lloyd's reply is: "Not good, like one in 100?" Mary clarifies: "I'd say more like one in a million." An elated Lloyd responds: "So you're telling me there's a chance. Yeah!?"

Unwarranted optimism is as much a compulsion for Lloyd Christmas as it is for active fund managers. The stock-pickers' statistical odds for success may not be quite as dire as Lloyd's, but a report from Hendrik Bessembinder of Arizona State University paints a pretty bleak picture.

The author analysed nearly 26,000 US stocks from 1926 until 2016 and calculated the lifetime shareholder wealth creation during this period to be nearly $35 trillion (€30 trillion). The top 90 stocks (less than 0.5% of the total) were responsible for 50% of total wealth created. The entire $35 trillion gain was attributable to a hardly credible 4% of the stocks. Almost as incredible is Bessembinder's finding that 58% of stocks have underperformed US short-term bonds over their full lifetime.

The fact that stock markets provide long-term returns that exceed the returns to low-risk investments, such as government bonds, has been an accepted phenomenon. It is easily rationalised on the basis of return for risk taken – a condition of capitalism. If I am going to risk my money investing in a business and accept the risks, a healthy capitalist system will be one that rewards me with a return higher than that on low- (or no) risk alternatives, such as cash deposits.

However, the fact that most of the stocks in the analysis provided returns that fell short of those earned on so-called riskless bonds and, worse still, that more than half deliver negative lifetime returns, will come as a surprise to many.

Another study by Heaton, Polson and Witte shows a similar effect for 1989-2015. Individual stocks such as Amazon, which has returned a tidy 35,000% return since 1999 versus 181% for the S&P500 index, show the extent of the "winner takes most" effect.

The observation that you need to pick winners to beat the benchmark is not news. That's why fund managers are paid, after all. But the complexities of market dynamics make the odds against picking winners prohibitively long.

Heaton, Polson and Witte distil stock-picking difficulties into a simple illustration, adapted here by Rob Arnott of Research Affiliates using a bag of poker chips as an example. "Say you have five poker chips, four worth $10 and one worth $100. The five chips have an average value of $28, but what if you reach into the bag and pull out two chips over and over? That's roughly how mutual fund managers approach stock picking, selecting portfolios that are subsets of the broader group.

"The majority of selections will fail to snag the $100 chip. Mathematically, there is an average value of $56 across the 10 two-chip combinations –the problem is that 6 of 10 times you'll grab a pair with a sum of $20. The same thing happens with stocks chosen from a benchmark. Only a few managers will own the biggies, relegating the rest of the industry to mediocrity – or worse."

This concentration of extraordinary returns in a minority of companies is tantamount to a career death sentence for anyone who gets paid for beating a benchmark. Active manager underperformance is often attributed to transaction costs and fees. These results show that underperformance can usually be anticipated for managers with poorly diversified portfolios, even in the absence of costs.

We could interpret these results as implying that the returns to stock picking can be very large, if the investor can select a concentrated portfolio containing stocks that go on to earn extreme positive returns. Based on the evidence of 20 years in investment markets, I choose not to draw this conclusion.

The investing industry is filled with brilliant people and abysmal results. Winning requires intellectual flexibility and nimbleness beyond all but the most savvy of investors.

For the amateur investor, determined to try and pick the winners, there's a chance of success, but not a great deal better than that offered to Lloyd Christmas. The good news is that diversified access to stock market returns are widely available and easy to access through exchange-traded funds or index funds. Save your million-to-one long shots for the lottery.

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