moneyminder financial services

Time to Take Stock?

Market Insights

October 2022

Money Minder Financial Services (UK) Limited
The Old Ale House, 41 Boston Road, Sleaford, Lincolnshire, NG34 7ER
Tel: 01529 300 300 **Fax:** 01529 300 400 **Email:** info@money-minder.com **Web:** www.money-minder.com

In this issue of 'Money Minder's Market Insights', Ray Black, Managing Director and Investment Committee Chairman, shares his current view on inflation, interest rates, investment markets and the economy.

Mini Budget – Major Consequences

Throughout 2022, global Interest rates have been rising, inflation spiking, bond yields have been climbing and stock markets have been falling. What should investors be considering?

There's a lot going on in the global economy and I keep getting asked 'Ray, what do you think'?

Having had this conversation a number of times over the last few weeks, it seems like a good time to put pen to paper in order to provide you with a written comment for you to read at your leisure.

The views and comments in the following article are my own. It has been written with the sole intention of helping you to 'read between the headlines' in order for you to make informed decisions in regard to your lifetime savings.

Whilst the comments in this article are my own, it is has been formulated as a direct result of my constant research in to current and historical data and market insights. This is continually being updated as I seek out market views and commentary from some of the most respected economists and investment managers from around the world.

Whilst my own market views may be similar to some of the most well-known and revered investment managers from around the globe, it may be quite different to what you read in the main stream press.

Please also be aware, similar but different views of the global economy and where we might be headed are both common and to be expected, especially when two or more economists are discussing both the global and their own domestic economies.

WHAT'S GOING ON?

The Bank of England (BoE) are behind the inflation curve and in the short term, this could lead to stagflation, (a period of high inflation and lower profits due to increased costs). I suspect that the BoE and the previous cabinet were actually hoping that higher costs for energy, food and borrowing would be the deflationary pressure that would put our own inflation genie back in its bottle.

The reason this could happen is that if people are spending less on 'fun stuff' and luxury goods because their mortgage payments, food and energy bills are all going up, it slows down the economy. This is because if the general public are spending less on non-essential items, (and for those that are able to, start to save more instead) money doesn't change hands so quickly and inflation normally becomes less of an issue.

High inflation can be devastating for those that are struggling to make ends meet already. This is the part of the UK's population that needs most help to get through the tough times. However, that does not detract from the fact that those people that are fortunate enough to have built up some savings over their lifetime, e.g. those that have retired and no longer have a wage coming in, also need some help in order to try to maintain their income levels and capital values when the economic backdrop they are investing in is difficult and uncertain, as it is now.

When interest rates on cash are lower than inflation, in real terms, it leads to a negative return. When the buying power of our cash is being eroded by high inflation, the value of those savings is effectively being reduced.

Over the last 20 years or more, the majority of retirees have needed to put a large chunk of their savings in to investments for any chance of gaining a 'real return' (a return above the level of inflation) on their money over the longer term.

WHY ARE INTEREST RATES GOING UP?

Slowing the economy down by increasing the cost of borrowing is the conventional central bankers remedy to beat inflation, it has been for generations. That's one of the main reasons why Central Banks choose to increase interest rates in the first place (it's called 'hawkish' monetary policy).

Central banks in the UK and the US expect raising interest rates, which in turn increases the cost of borrowing, to lead to the general public spending less on going out, luxury goods, holidays and impulsive purchases. The hope is that overall consumption will fall. If that happens without them having to be overly aggressive on hiking interest rates, they are less likely to be blamed if the economy goes in to recession. That may be why the BoE didn't start increasing interest rates prior to inflation becoming an issue, which in hindsight, would have been much better than waiting until it had become an issue.

If high energy, food and borrowing costs just keep on going up, the general public have to concentrate on paying their bills. The 'fun stuff' is set aside and in turn the outcome is a period of deflation, or falling prices. At least until things hopefully change for better, to a time when there is money left over after they have covered their basic day to day living costs.

Blaming external forces like the Ukrainian conflict and China's 'zero tolerance' Covid policy leading to supply issues for our current inflation problem, as opposed the lorry loads of 'money printing' known as Quantitative Easing (QE), is much more acceptable for both the BoE and the Government than them taking the blame themselves. However, regardless of where the blame lies, a solution still needs to be found.

Clearly, Liz Truss and Kwasi Kwarteng believe that the solution is to stimulate economic growth. They are hopeful that the £100 billion plus energy costs support scheme for both residential and commercial users, will encourage people to keep spending and for those that are able to, investing. That's important because household consumption is the largest element of expenditure across the UK economy, accounting for 59% of the total in 2021. In Apr-Jun 2022, household consumption was up 0.1% on the quarter, (source: House of Commons Library - 30 Sept 2022).

BONDS YIELDS ARE GOING UP AND TAX IS GOING DOWN! WHY?

The really big story this week was that in addition to the energy support scheme, and without any background data from the Office for Budget Responsibility (OBR) to support it, the Chancellor reduced taxes for millions of individuals and businesses throughout the UK. The result was a sudden devaluation in the Great British Pound (GBP) and a negative reaction from the International Monetary Fund (IMF) who are the lender of last resort for the world's central banks.

It's rare for the IMF to publicly criticise a leading global economy. However, they suggested that the highest rate of income tax should not have been removed as it risked undermining the Bank of England's attempts to reduce inflation. This led to market speculation that the BoE would need to put interest rates up higher than had been expected over the next few months. As a direct result of that speculation, Corporate Bonds and Gilt values went down in value.

Also referred to as 'fixed interest' investments, investing in Gilts and Corporate Bonds is generally considered as 'lower risk' because they are loans to Governments (Gilts) and companies (corporate bonds). In comparison, Stocks and Shares tend to go down and up in value faster than fixed interest investments. However, fixed interest investments are not risk free. It is completely normal for them to go down in value when interest rates rise. I have been warning all of our investment clients about this expected outcome for a long time now.

During the global lockdown, (which led to worldwide interest rates in developed economies reaching all-time lows) it was widely expected that in time, interest rates would start to rise again.

Because of that, Bond and Gilt values have been going down since early 2021. That downturn increased in speed when the US and the UK actually started raising interest rates, towards the end of 2021. However, it's also important for you to know that the opposite is also true. When interest rates are falling, bond values tend to go up in value.

The side effect of bonds falling in value is that the income they produce goes up. This can actually have a positive impact for some investors, particularly big pension funds.

For example, in a statement released by Lisa McCrory, the chief finance officer and chief actuary for the Pension Protection Fund, (PPF) in mid-September 2022, she commented that the increase in bond yields, (income) as a result of interest rate increases was the sharpest since January 2009. The change in value had helped to improve the funding position for PPF pension funds overall by £59.5 billion. The "unprecedented" rise in bond yields "was mainly a result of the Bank of England's forceful approach to tackling inflation, their plans to sell off gilt holdings, and expectations that the new prime minister's program of tax cuts and energy market intervention will cause a material increase in the U.K.'s borrowing," Ms. McCrory said.

So for the PPF, which is the lifeboat scheme for insolvent pension schemes in the UK, rising bond yields (income) were beneficial.

WHY DID THE POUND GO DOWN IN VALUE & WHAT HAPPENED NEXT?

On the back of reducing tax payable for all UK tax payers and the extra borrowing that was announced for the energy support scheme in the recent mini-budget speech, the pound fell in value.

At the same time, this led to market expectations that the Bank of England would need to increase rates faster and higher than they may have originally planned. This then caused the value of both Government and Corporate Bonds to fall further. In addition, because big company sponsored pension funds often have a large exposure to fixed interest investments, there was a concern that the paper losses would have a negative impact on the overall capital value of these schemes.

In response, on Wednesday 28th September 2022, the Bank of England reacted very quickly to the drop in the pound and bond values and committed to potentially purchasing £65 billion of UK Government Bonds. In turn, this action led to some fearful news headlines suggesting that some of the large pension funds were on the brink of collapse.

This was not quite the whole picture and on a positive note the BoE's quick and decisive action led the Corporate Bond Sector to an increase in value of just under 2% in just two days. That's a higher return than most cash based investors are getting in a whole year. Having said that, if interest rates continue to rise in the short term, there may be some very attractive buying opportunities arising in Bond Markets with values getting ever closer to the prices they were before the ultra-low interest rates we experienced prior to the Global Credit Crisis of 2008/09.

Whilst I'm not convinced that we are at the bottom of the Bond market just yet, now that higher interest rates are being factored in and the Bank of England have once again confirmed that they are not adverse to stepping in when needs must, it's very possible that we may, in time, see some positive returns from Bond Markets. Rising bond values could be expected in the event of the UK entering a recession which then leads to the BoE deciding to lower interest rates once again.

If we do find ourselves caught up in either a local or a global recession, all markets are likely to go down in value over the short term.

However, history suggests, that could be the catalyst needed for the Bank of England to reverse their current course of raising interest rates and start to reduce them again, in an effort to stimulate the British economy.

As mentioned above, Bond values go up when interest rates go down. Presuming the BoE get to a point in time where they feel inflation is under control, (moderate inflation can actually be quite good for growth) they won't want to risk pushing the economy in to a deep recession. In order for them to keep growth in the UK economy moving forward and even though the Banks current target for inflation is to keep it under 2%, they may actually be quite comfortable with an inflation rate in the range of 3% to 5%.

However, when interest rates are below 1%, it's really difficult for central bankers to drop them further without going in to a negative interest rate environment.

If the BoE manages to get UK interest rates back up to the longer term 'normal' levels of 5% to 6%, they will have room to reduce interest rates again to hopefully stimulate economic growth when and if they need to.

If we were to move in to a period of deflation, (when prices are going down and people actually put off making purchases because they are waiting for the price to fall) they can also print more money (QE) and potentially give it to the Government to spend on inward investment and infrastructure projects. History has proven that this action normally leads to inflation, the recognised solution to deflation which is potentially much worse than inflation because people just stop buying the goods and services that help to keep the economy in reasonable health.

WHERE MIGHT INWARD INVESTMENT COME FROM?

The Government is hoping to attract investment in to the UK from very large companies from both Europe and the rest of the World. To help them achieve this goal, in June 2021, HM Treasury launched a UK Infrastructure Bank. It was set up to encourage private finance alongside public investment. Its main objective is to support regional and local economic growth whilst also funding projects that help to tackle climate change.

There is evidence that is already happening in light of new projects being secured in the UK. Below is some relevant information about one such project.

The largest wind turbine factory in the world is about to be built in Teesside. The brand new wind turbines will then be shipped out to the North Sea to generate energy for UK households.

https://www.k2consultancy.com/2022/06/16/plans-approved-for-largest-offshore-turbine-base-factory-in-the-world/

https://www.cityam.com/korean-firm-boosts-uk-wind-plans-with-300m-investment-in-teesside-factory/

The UK has been a world leader in offshore wind power for years. It's now enough to produce 10% of Britain's electricity needs. In March 2002, the UK Government promised to triple the nation's offshore wind-generating power to 40 gigawatts by 2030. They hope to increase that to 100 gigawatts by 2050. (source: corporateknnights.com). This new and significant investment in the UK will help the Government to meet its short and long term wind power goals.

WHAT SHOULD INVESTOR'S DO? OR NOT DO?

Most investors will be now be nursing some paper losses. The important thing to remember here is that at present, they are just paper losses. They only become actual losses when investors pull out of their investments.

First things first – don't let your emotions drive your actions….

Sometimes, the general public do the wrong thing for what they feel are the right reasons, especially when markets are going down in value.

Instead of holding on, waiting for the situation to improve, some people may be inclined to encash their investments and turn short term paper losses in to real ones.

Whilst we instinctively know that we should 'buy low' and 'sell high', in difficult market conditions some people will, unfortunately, do the exact opposite. Selling whilst values are low and walking away. Some investors will then wait for the market to rally before reinvesting their money, which is effectively 'selling low' and 'buying high', once the shares that they used to own, or similar ones, have become more expensive again.

This is, of course, the wrong way round.

It is helpful to understand that it is natural human behaviour to be somewhat happy when values rise by 10% and twice as disappointed (as you were happy) when values fall by 10%.

Whilst this feeling is not uncommon, it is also an emotional response. Professional investors do their best to keep their emotions in check because if they don't, it can lead them in to making a decision that they later regret making. They are also always looking for a bargain. When some private investors are letting their emotions rule their head, potentially selling their investment holdings at a loss, opportunities to buy stock at low prices become available that professional investors love to take advantage of.

In the short term, Stocks and Shares could easily take a further downturn, especially whilst inflation is high and there are cost pressures reducing company profits. This is despite increased tax revenues in recent years and the BoE increasing interest rate to curb inflation, (because the economy is running hot). These two factors alone could actually suggest that the UK economy isn't in quite as bad shape as many are suggesting it is right now.

The main reasons for a reduction in company profits are related to the cost of borrowing, wage rises and/or lack of demand. All of these have an adverse effect on a company's share price, whilst at the same time, it can make it harder for the affected company to invest for growth. Companies that are heavily in debt will have more interest to pay on their borrowings and are likely to fair much worse in this type of environment than companies with little or no outstanding debt and manageable production and wage costs.

When interest rates are rising, stocks and shares are normally a better place to invest than Corporate Bonds and Gilts.

Investing in large, blue chip, household name brands can help to fend off high inflation because these companies are more able to increase prices to cover their costs and often pay regular dividends to investors which can be used to provide extra income or reinvested for capital growth.

In a high inflation environment, energy and food based related companies tend to outperform other areas of the market. In addition, companies that are involved in the extraction and supply and distribution of basic materials often do well.

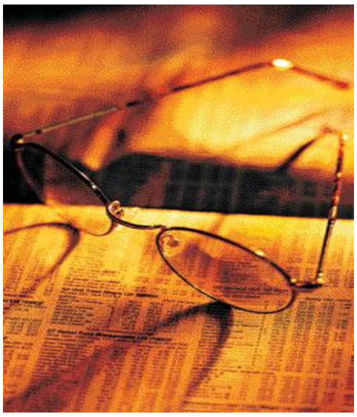
That's because however tough life gets, people still need to eat food, light and heat their homes.

If you have cash to invest, keep an eye out for some bargain share prices that may present themselves in the short term.

Although there are no guarantees, investing when many others are encashing their investments could provide superior returns.

Buying high quality stock in profitable businesses at low prices may potentially provide investors with a rewarding way to offset paper losses over the medium to long term.

Past performance is not a reliable guide to future returns.



Irrespective of whether you are investing for the first time or considering adding to your existing investment portfolio, the statements in bold above are especially helpful to bear in mind in the current economic backdrop.

This document is for general information purposes only. Specific advice should be taken before acting on any of the suggestions made.

We will not accept responsibility for any errors made or actions taken by any readers that have acted on the information contained herein if they have not first received a formal and personalised recommendation from us.

Final Thoughts

In closing, I would like to remind you that ups and downs in the value of stock markets, bond values, property, and commodity prices is completely normal and to be expected. These movements can be traced back over decades, even centuries.

Over the last 25 years we have all experienced both booms and busts in different asset classes. That's very unlikely to change over the next 25 years and in reality, there is very little that any of us can do to avoid them. Having a diversified portfolio that invests in different asset classes and geographical areas of the global economy is a great start. When markets fall in value, don't let your emotions dictate your actions.

Ultimately, it's not all to do with the timing of when you invest in different markets and asset classes, it's the length of time that you are invested in those markets that matters most of all. The longer the term, the better your returns are likely to be, especially if you invest your savings with some of the best fund managers in the world, as we do for the clients that choose to entrust their life savings with Money Minder.

I would also like to take the opportunity to thank everyone who has invested with Money Minder for their continued trust and for regularly recommending our services to friends and family over many years now, especially in these more challenging times. I am hopeful this article is both helpful and reassuring to everyone who gets to read it.

If after reading the article you would like to speak to us about your investments, or any other matter, please do call the office on 01529 300 300.

We'll be pleased to help you in any way we can and we are only ever a phone call away.

financial services
moneyminder

Money Minder Financial Services (UK) Limited
The Old Ale House, 41 Boston Road,
Sleaford, Lincolnshire, NG34 7ER
Tel: 01529 300 300
Fax: 01529 300 400
Email: info@money-minder.com
Web: www.money-minder.com