THE FUTURE HAS CHANGED – CREDIT IS NO LONGER FREE & UNLIMITED

You can see from the shock on people's faces as they leave the supermarket or fill up their fuel tanks, perhaps worrying about keeping the house warm for their children, the concern and worry is palpable. Inflation is everywhere and for many in the world it isn't just a cost-of-living crisis, it is turning into a way of living, or just living, crisis.

For politicians this is the stuff of nightmares, as their impotency and incompetence is exposed, they blame Central Bankers, who blame the politicians, or even the markets, the fact is they are ill prepared. People ask; "why is this happening?" Some simply blame COVID, War in Ukraine or policy disasters over the last few years. In reality the crisis has been decades in the making.

Our self-styled "elites" thought that the global growth prosperity of the last forty years was down to their brilliance, ignoring the deflationary forces of globalisation and technology. Following a false belief, they let interest rates fall. An illusion of wealth was created as asset prices rose on the wave of debt fuelled mal-investment generating the 1999 Dot.Com bubble and the housing and financial bubbles of the Great Financial Crisis in 2008. Policy makers response to these crises was not to change, but to turbo-charge the same failed approach with lower (even negative) interest rates and tens of Trillions in Quantitative Easing.

The result is a fragile economy, which was already struggling before COVID, now riddled with debt, blowing the bubble of all bubbles across various assets, at risk of violent adjustments.

Back to the Future – the proposed new Delorean

Yet the policy response showed our leaders believe the economy is all about money when in fact it's much more about resources, energy, food and people's innovation and creative spark.

Energy is at the real heart of the economy. Yet as we faced environmental crisis our leaders still spoke in platitudes while several more Trillions were spent to prop-up markets, sums that if invested in energy technology could change the world. Long-term planning and investment in energy has faltered and, unsupported by policy and driven by short-term investor demands, companies have had little incentive to invest in resources exploration or energy resilience; supply withered.

Putin was watching, making speeches pointing out how the West was childishly focused on the trivial, drowning in debt, ignoring the important. Putin seized his moment well, hoping to add Ukraine's assets to Russia's already vast resource portfolio. Now he is flailing and has set off a catastrophe of global proportions. Furthermore, just as the West ignored energy he failed to invest in the infrastructure to command Russia's vast resource wealth, meaning he has also become technologically dependent upon those he chose to make enemies.

Through his actions he has accelerated forces already at work and there is no easy way out from these problems. Whether we stimulate (and write-off huge amounts of debt) to keep growth going, or if inflation falls as global recession crushes demand, the only certainty is that a lot of assumptions have been proved to be dangerously misguided.

In this difficult environment, *experience*, *patience* and being well *prepared* are paramount, but so too is having the *investment flexibility* to limit downside and seize *opportunities*. We have all these attributes, providing reassurance for you.

David Scott
Investment Manager

"SAFE AS HOUSES" BUT ARE HOUSE PRICES SET TO ROLL-OVER?

A well-known saying here in the UK, and prices are up c70% over the last decade to stand at £279,000 (for the average new UK house, Nationwide Q1 22), which is over 10x the average salary of c£25K (HMRC, Jan 22). For anyone (not our investors) who saw their share portfolios halve in value in the 2000-3 or 2008-9 bear markets, the apparent reliability of house price growth has been a comforting balance.

This perhaps explains why despite the government trying to discourage Buy-to-Let investors, the sector remains robust, with around 19% of households currently living in privately rented accommodation, up from c10% in 2000 (English Housing Survey 2020, Gov.uk). For many of us the lesson has been to buy the best house affordable, and for landlords it's been to gear up and build the portfolio quickly, prices only go up. But is this true?

It was the collapse in the US housing market and the complex web of financing built off it, that triggered the 2008 Global Financial Crisis and the multiple failures of financial institutions. But it wasn't just in the US, with the UK having to bail out the likes of RBS, Lloyds, and household names like Northern Rock. **UK house prices fell around 19% from their 2007 peak by 2009 (Savills 2018)**. The post 1980's property crash was also uncomfortable as the average house price fell from the 1989 peak of c£63k to c£51k by the end of 1995, a fall of c19%. For many though it was worse, as a flat in London or house in Brighton could have halved in value, failing to recover until the end of the century, meaning deeply negative equity, or repossession.

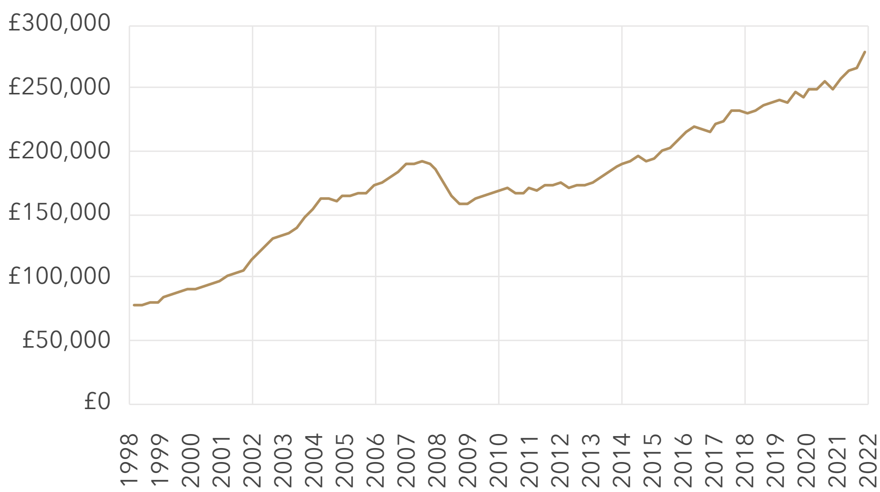
But plenty of pundits will tell us not to worry, because we have been under-building houses for decades and the housing crisis is caused by a 'shortage'. However, this is not entirely supported by the data. Indeed, we are building fewer houses than 50 years ago, but then the country was housing the post-war baby boom and an explosion in the working age population. The current rate of housing completions, around 176k a year (Gov.uk), compares well with the more recent construction peaks in the late 80's / 2000's when, incidentally, prices also peaked due to a "lack of supply". Should we be worried?

In truth, since the early 1970's peak building boom, the average UK household size has fallen from around 2.9 in 1971 to 2.4, suggesting adequate basic housing supply on a historical basis. Recent figures from the Bank of Montreal suggest that UK housing supply is better than the OECD average, better than France, Germany, and Japan. The same is true though of Australia, Canada, New Zealand and the US, all of which have seen house prices go on a record-breaking charge in recent years (Australia/ Canada prices are more extreme than the UK), particularly as interest rates fell to nothing during the pandemic.

So, if there is adequate supply (or even a building boom) why are house prices in these economies so high? The factors that match are low interest rates, a culture of house price appreciation, and more recently government funded stimulus measures to "help" house buyers which (ironically) keeps pushing up prices, no matter how many houses are built.

Many take comfort from low interest rates, after all we don't expect to see double digit mortgage rates anytime soon, but we cannot escape the fact that low interest rates can stimulate risky behaviour, excessive debt and asset bubbles. The history of housing suggests that while it may be less volatile than the stock market, it isn't as safe as people seem to think.

Average UK New House Price 1998-2022



Source: Nationwide Building Society (in current prices, adjusted for RPI)

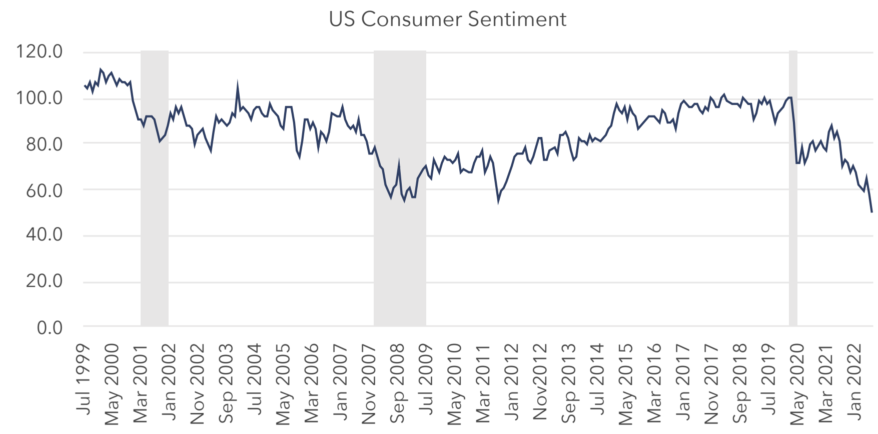
John Paul Thornber
Investment Manager

US SENTIMENT SUGGESTS A RECESSION IS ALREADY HERE

John Paul Thornber
Investment Manager

One of the main complaints about the policy making "elites" is that they seem **disconnected** from the lives of ordinary people. **This disconnect has real consequences, not just for the individual, but for the economy, because if policymakers think things are better than they are, they won't respond until it's too late.**

This is why the US University of Michigan Consumer Sentiment, shown in this chart, has become so important. During the 2000/3 dot.com crash the index low was 82 (Sep 2001 - 9/11), in 2008 June saw 56, November 55, yet **in June 2022 we hit 50, the lowest level on record since the compiling of data in mid-70s**. The correlation? **Inflation**. When people worry about feeding their children, keeping them warm, everything else is secondary, consumers become survivors and that means recession (as depicted by the grey bars in the chart). Indeed, the first 2008 low came **before** the fall of Lehman's, when policy makers thought all was fine, yet later data showed the recession was already real. Now? If the consumer is our guide a US recession is already here.



Source: FRED

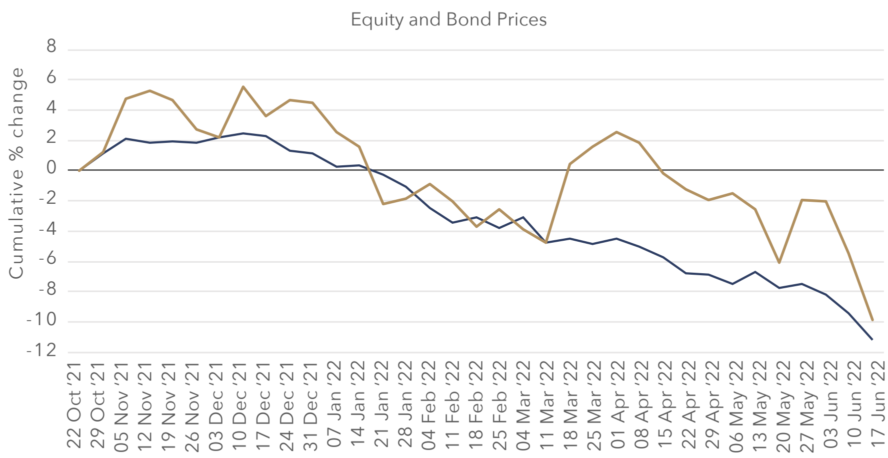
EQUITY AND BOND PRICES HAVE FALLEN IN TANDEM!

Mark Smith
Partner

Putting all your eggs in one basket is risky, so portfolio managers have traditionally blended equities with bonds and property. Trouble is that most private clients have a substantial property exposure, they live in it, while property funds have proved to be illiquid and have fallen out of favour. The result is that most mainstream investor portfolios have a variation of the 60% equity, 40% bond split.

For many decades this worked most of the time, but since the GFC, Central Banks have been actively buying bonds in huge quantities disrupting the traditional relationship often driving both up simultaneously. How about now?

The chart compares the performance in 2022 of equities and bonds, showing how closely correlated they have become. In short **many mainstream investors have no place to hide!** Thankfully we have very little exposure to this type of thinking, placing much more weight on specialist asset classes such as gold, energy (including renewable), infrastructure and so on.



Source: FE fundinfo 2022

THOSE PAYING IHT MAY DOUBLE

Douglas Croft
Partner

No one I know wants to dwell on their longevity, however long or short it might be, but it is increasingly important that we all spend some time thinking about what arrangements are desirable.

We always recommend that a Lasting Power of Attorney for Property and Finance and a properly structured Will are absolutely essential, and we will happily provide guidance and introduce you to appropriate professionals. In a coming issue of Future Insights, we will look at care provision both at home and in a home but, for now, a quick look at one aspect of Inheritance Tax (IHT) is justified.

Every estate gets an allowance of £325,000 (quirkily known as the 'nil rate band') and everything over that could be taxed at 40%. Where on the first death of a married couple or civil partners, everything passes to the survivor, that transfer is not taxable and on the death of the surviving partner the unused nil rate band transfers to the estate of the surviving partner, so at that point the first £650,000 will be charged at nil %.

There is also an allowance called 'Residential nil rate' which is worth a maximum of £175,000 for a single person, £325,000 for a surviving spouse or partner, so some estates might enjoy a nil rate band of £1,000,000 but we are hesitant to rely on this. The rules are complex and hedged about with obscurities, we know that there has been pressure to change this, and Chancellors have a long history of tinkering with IHT!

Here's the rub, the Nil Rate Band was fixed back in 2009 and Rishi Sunak recently announced that this would remain unchanged until at least April 2026, at the same time house prices have continued to grow at a startling rate. The average price nationally (higher in many locations) for a detached house is £441967 (Land Registry March 2022) so for a single person the average detached house already exceeds the allowance, and it does not require much in the way of savings or other assets to take married or civil partners over their allowance. So, no change in the tax rate or the allowance, but substantially more tax payable - when Gordon Brown pulled this stunt it was called 'Stealth Tax'!

If you feel that your arrangements should be reviewed then we will be happy to help.

Other allowances including the annual allowance and small gifts exemptions were set in 1981 and have not changed since. **Small wonder then that the Office For Budget Responsibility recently estimated that the number of estates paying IHT will double by 2027 and the total amount of tax payable in that year will be some £8.3 billion**.

Some might take the view that increased interest rates and a recession will see house prices plummet and solve the problem, that's a big bet! Remembering this is a tax you will not pay but where mitigation will involve some cost to you, you might take the view that it's not your problem. However, if you feel that your arrangements should be reviewed then we will be happy to help.