FUTURE INSIGHTS
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FACTS NOT STORIES

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Central Banks have to raise interest rates to combat inflation. We read this in the papers, are told this by politicians, and of course many 'clever' Investment Bankers agree (you know, those who got us into the 2008/9 Crisis).

Everyone knows what must be done, because everyone knows this is how the policy works and, as it impacts the lives of billions, it must be right? Sadly, the evidence suggests that "everyone" is wrong, which is unsurprising to all philosophers since Plato, but a huge issue when it comes to the global economy.

Our current inflation has been driven by real-world "supply-side" shocks of a global pandemic and the resource crunch resulting from Russian foreign policy, so how does raising interest rates help when we can see it is also dramatically inflating the cost of debt? **"Inflation is always and everywhere a monetary phenomenon"**. Milton Friedman 1963. This is it. This is the reason.

Oddly, as inflation is measured in monetary terms this is, in a simplistic and useless sense, true, yet because of its very simplicity it has been used to establish an easily measured relationship between money supply and inflation. The idea is derived from a narrow (and false) interpretation of a naïve economic equation developed by Irving Fisher, making a simple, and demonstrably shaky, foundation for "economic models". Depressingly once built the models create a prism through which events are necessarily distorted to support (to use a modern idiom) "their own truth", creating an alternate reality. Yet for Central Banks this is a naturally a compelling story in managing their 2% inflation target, although with their model so flawed we should ask is their target itself based upon deep thought?

Unfortunately, the 2% inflation target was first picked, out of thin air, by the Bank of New Zealand in 1990 purely on the basis that periods of high price instability are unwelcome. That's it. That's the solid, inflexible foundation of current policy everywhere. A guess. Coincidentally with the adoption of these policies globalisation galloped ahead while technology, Chinese factories, demographics, and plentiful energy **kept inflation in check.**

This had **little to do with Central Banks**, yet they assumed it was their doing, so their "models" allowed them to keep interest rates too low, starving savers and increasing inequality, while blowing repeated asset bubbles (and crashes). That their policies subsequently forced them to **inject up to $30tn in QE**, to keep the bubbles inflated should, we believe, have caused some reflection.

Some in our industry think we are natural contrarians, but this is not the case. Our frequent differences with the mainstream are a result of hard-won insights and research. So now, as backward looking growth data appears more resilient than the real world might suggest (initially supporting markets) we see this is as an easily explained "money illusion". In short if, collectively, we all spend 20% more on energy and food then, in isolation, this boosts GDP as more money goes into "consumption", even as spending on non-essential, "discretionary" items falls. The secondary negative impact of the collapsing discretionary spending (on jobs, company profits and ultimately the stock market) will usually take several quarters to appear, which we saw in early 2008.

Standing back, analysing the data, doubting what "everyone knows" also helps avoid being drawn into emotionally chasing market madness, like the recent tech bubble, even if it hurts short-term performance. The chart shows the rise and fall of the now infamous US Technology fund, ARK ETF, which quadrupled in value in the space of a year, gathering a huge following and talk of the "exponential age" everyone knew was coming. It invested in glamorous names like Tesla and Peloton before dramatically falling 80%, ending 2022 below its COVID low. The underlying stocks are now much cheaper but until "everyone knows" it was a bubble they may get cheaper still, when the price may fit with some of the genuinely interesting technologies. Then, as an example, our long-term interest in Tech will be fully reinvigorated.

ARK ETF Trust - ARK Innovation ETF 3Y. Source: Koyfin, Andrews Gwynne

A VERY OLD STORY FOR THE DIGITAL AGE

John Paul Thornber
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As the founder of the failed crypto exchange FTX (the absurdly named, Sam Bankman-Fried, known as 'SBF') confronts a long spell in jail, allegedly responsible for truly biblical levels of fraud, we reflect that the bursting of digital excess mixes a very old story with a very new one, with the bursting bubble diverting attention away from rapid progress that could put digital pounds in your metaphorical pocket far sooner than most realise.

If 2022 was tough for many it was terrible for crypto "investors" as many "tokens" became valueless while a series of bankruptcies meant that billions of customer assets literally disappeared into the ether. Already rocked by the collapse of major names such as: 3 Arrows Capital, Celsius, Terra/Luna and Blockfi, the failure of the high profile FTX exchange has crippled the sectors infrastructure, creating a morbid spectator sport among analysts to predict who will be the next casualty.

Thankfully these failures have had little impact on the larger economy, although they are emblematic of the end of a very tired and over-extended cycle, signalling the clear sense of financial nihilism and amorality that captured several celebrities, politicians and even some regulators! But, as with previous bubbles, the scandals may soon be forgotten as the real revolution slowly emerges.

Sam Bankman-Fried

History may not repeat but it definitely rhymes

In 1720, Sir Isaac Newton was the Master of the Royal Mint and had already increased his fortune in the early days of the South Sea Bubble before sensibly exiting. However, he was caught up by the fear of missing out (FOMO – AKA jealousy) and re-entered the market, promptly losing the equivalent of £4.4m as the bubble burst. Then, like now, there were fantastical stories spun by convincing conmen and their deluded acolytes, yet there was also genuine innovation in this and the almost concurrent French Mississippi Bubble when central banks and national debt markets were formalised and both debt and equity became traded like never before.

Most bubbles have very similar characteristics, are usually linked to unusually loose financial conditions (until the inevitable credit crunch) and rapid innovation. One largely forgotten episode is the nineteenth century UK and US railway/railroad bubbles which ultimately left us an infrastructure still heavily in use today, despite bankrupting an army of investors as the easy money stopped and inevitably euphoria shifted to disappointment and then fear, as it always does.

The half-truth forges a new reality

While the New World order of the bitcoin maximalists (whose catchphrase was "have fun staying poor") will not come to pass, development work on Central Bank Digital Currencies (CBDCs) that we first discussed several years ago has been progressing with the Bank of England, US Fed, and the ECB all publishing updates on their own advanced projects to introduce digital pounds, dollars, and euros. Meanwhile the Bank of International Settlements (BIS) has been working with a number of Asian focused central and commercial banks on the mBridge project which has already succeeded in providing seamless CBDC swaps across a number of different banks and territories. This paves the way for a faster and more inclusive global payment system and reducing the power of the US Dollar which, as we discussed last year, has been a serious challenge to the global economy.

While the first crypto enthusiasts often turned out to be either naïve, or on the make, it has long been our contention that the real beneficiaries of the technology would be governments and Central Banks. There are many implications of these innovations we need to consider and are already being seen by some as a dark, Orwellian development. However, we are more constructive and have been investigating the technology for some years (hence why we never believed the hype). Our analysis has suggested for some time our current debt and currency crises are unsolvable without radical change (which may now be facilitated) and although the road will not be smooth it will also offer real opportunity for those who remain informed.

"I can calculate the movement of the stars and not the madness of men"

Isaac Newton

MORTGAGE RATES TO BITE!

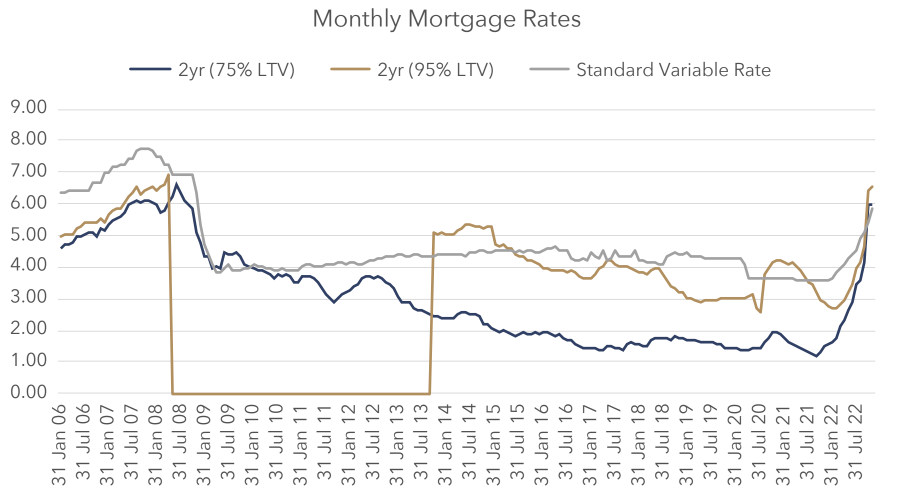
The mortgage data is stark, showing how a 2-year fixed rate mortgage (for 75%-95% Loan-To-Value) fell after the 2008 financial crisis from around 6% to 4% (as risky 95% LTV loans disappeared) before slowly descending to just over 1% following the COVID crisis in 2021.

This fall in borrowing costs helped inflate the ballooning house price to income ratios that we have previously warned were inherently dangerous if interest rates rose, as they have, taking the 2-year fix to around 6%.

In simple monetary terms, this means a £150k, 25-year repayment mortgage, at 1.5%, costs about £603pm, while the same mortgage at 6% costs £978pm, an increase of 62%. By comparison, a shift from around 8% to 12%, which crashed the 1980s housing bubble, would have seen costs increase by under 40%.

What applies to mortgages also applies to company debt and the underlying costs of leases and consumer loans, highlighting our observations that the policy of raising interest rates in a debt dependent economy doesn't bring costs down, just the opposite.

Mark Smith, Partner



Source: Bank of England (stats to Nov 22), Andrews Gwynne

THE BEAR MARKET RULE OF THREE

2022 was a tough year for most stock markets, with the US S&P 500 Index down around 25% at its low, past the Bear market threshold of a 20% fall. Some investors are calling for a rebound, but is this what the past teaches? The table opposite shows the history of US Bear markets, strongly suggesting we should anticipate multiple down waves.

The reality is Bear markets tend not to travel in a straight line, with notable rallies between the dips. Currently we appear to be in such a bounce, even as the market expects company profits to fall significantly. If this is the case then we should still expect further leg downs until 'capitulation', where generally the greatest losses occur. Although potentially dramatic, and a time when most investors do not want to buy, this can be when the most long-term value can be achieved.

	Duration		
Bear Market	1st Third	2nd Third	3rd Third
1929-33	-36%	-25%	-70%
1933-35	-6%	-21%	-11%
1937-38	-12%	-38%	-17%
1938-42	-8%	-22%	-24%
1946-47	-25%	4%	-8%
1948-49	-6%	-9%	-7%
1957-58	-6%	0%	-17%
1961-62	-3%	-3%	-23%
1966	-3%	-5%	-15%
1968-70	-5%	-9%	-25%
1973-75	-12%	-8%	-36%
1981-82	-6%	-12%	-13%
1987	-4%	-24%	-9%
2000-02	-11%	-16%	-34%
2007-09	-15%	-8%	-44%
2020	-13%	-2%	-22%
Mean	**-11%**	**-12%**	**-24%**
Median	**-7%**	**-9%**	**-20%**
Central Tendency	**-9%**	**-11%**	**-20%**

David Scott
Investment Manager

Source:
Andrews Gwynne

MAXIMISING YOUR STATE PENSION

The new State Pension was introduced from the 6th April 2016. To receive the full amount of pension a person must have 35 'qualifying' years, or at least 10 qualifying years to receive a reduced amount. A qualifying year is counted where 52 weeks of National Insurance Contributions have been paid or credited: Class 1 for the employed or Class 2 for the self-employed. These years do not need to be consecutive.

It may be possible to fill in any gaps that have occurred in the last 10 years, i.e. from the 2006/7 tax year onwards, by paying voluntary contributions for those eligible to do so. Once a year is outside this limit, then a permanent gap exists in a person's National Insurance Contribution records. Voluntary contributions currently equate to paying a lump sum of £824.20 to buy 1/35th of the State Pension so that a one off payment of £8242 could buy the full 10 years. This is heavily subsidised by the government and can represent very good value for money.

However, after 6 April 2023, the option to do this is being withdrawn. From this date, the maximum number of years that can be bought is being reduced to six, therefore the payment of voluntary contributions can only cover the years missed from 2017/18 onwards. The years prior to this will be lost. Voluntary contributions must be made by the last day of the tax year.

It is worthwhile checking National Insurance records and also obtaining a State Pension forecast. This can easily be done online at:

www.gov.uk/check-national-insurance-record

www.gov.uk/check-state-pension

The Future Pension Service can also provide information on the payment of voluntary contributions.

Douglas Croft
Partner

PREMIUM BONDS

Premium Bonds offer the equivalent of a tax free 3.15% return, assuming you get your fair share of the prize money. With interest rates on the rise and many savings products now offering significantly better returns than they have done for many years, Government-backed National Savings (NS&I) has again in late January raised rates across its product range.

Premium Bonds, which we actively suggest our clients use for their "rainy day money", has seen the prize fund increase to around £315m for its February draw. The prize rate has been increased to 3.15% on 24th January – the fourth announced increase since early 2022. The odds, however, of each £1 premium bond number winning remains at 24,000 to one. The distribution of prizes is shifting too, with approximately 250,000 of the lowest value £25 prizes moving to between £50 and £100,000. There will still only be two monthly winners of the top £1million prize.

NS&I has also increased interest rates across some of its variable products. More than 570,000 customers holding direct saver accounts and income bonds will benefit from an interest rate of 2.6%, up from 2.3%. The direct saver rate is at its highest level since the account was launched in March 2010, while the income bonds rate is the highest it has been since February 2009.

David Scott, Investment Manager