QUARTERLY NEWSLETTER

Q3 2022

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INTRODUCTION

Welcome to our Q3 newsletter.

The articles have been sourced and written specifically with our clients in mind and we hope that you find them informative.

Alongside an investment update, this edition features articles on the cost of living crisis, cryptocurrencies and the changes to student loans.

We would be delighted to hear your feedback on the content and if you have any questions on the subjects or products discussed in this edition of the newsletter then please don't hesitate to get in contact.

We look forward to seeing you at our next meeting.

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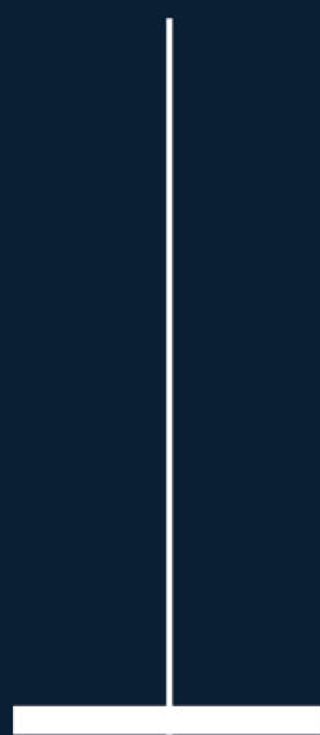


ROCKHOLD

Q2 2022 INVESTMENT UPDATE

INDEX	LEVEL 31 MAY	LEVEL 30 JUNE	CHANGE
S&P 500	4132	3785	-8.4%
FTSE 100	7606	7169	-5.74%
Euro Stoxx 600	443	407	-8.1%
Shanghai	3186	3398	6.65%
US 10 Yr Treasury Yield	2.87%	3.02%	+0.15
UK 10 Yr Gilt Yield	2.1%	2.22%	+0.12
Bund 10 Yr	1.12%	1.36%	+0.24%

Stock markets in June capped off what has been one of the worst six months in equity markets for decades, pushing the S&P 500 into a bear market and, unfortunately, this performance was echoed in bond markets, with some gilt indices producing equity-like negative returns.

Indeed, apart from commodities and cash, all major asset classes exhibited negative returns, as the asset class 'quilt' shows below:

The reasons behind these declines are now well publicised: firstly, loose monetary policy and supply constraints started to push up inflation, then Russia's invasion of Ukraine exacerbated the situation by pushing up energy, fertiliser and agricultural commodity prices.

This in turn led to a complete volte-face on monetary policy by the US Federal Reserve, who rapidly moved to counter decades high inflation by raising interest rates.

They are not alone, with the exception of China and Japan, interest rates have been rising globally, even though some of the factors in play, such as energy and food prices aren't directly in central banks' control through monetary policy alone. There is now upward pressure on wage prices as workers try to maintain a standard of living.

Consequently, Investors are now faced with the possibility, but not certainty, of a recession due to the combination of higher borrowing costs and the cost of basic goods, such as fuel, leading to lower consumer demand.

The net effect of all this has been to put downward pressure on equity prices, particularly previously overpriced growth stocks, and put upward pressure on bond yields, which equates to capital values falling.

However, there was one bright spot as the pound fell significantly against the US dollar, which has reduced the effect of the falls in US assets in portfolios in particular.

Short-term hurdles

Whilst there are some signs emerging which give cause for optimism over the longer term, there are still many factors to play out which may lead to more volatility in the short-term:

- We are about enter earnings season and markets will be sensitive to any signs that the current economic environment is starting to affect corporate earnings. Companies built up inventories due to the supply chain issues whilst customer demand was buoyant, so they are vulnerable to sudden downturn in demand,
- The outcome of the numerous industrial disputes globally over pay still need to be determined.
- Whilst equities are cheaper, they are not cheap on an historical basis, in the US at least (but they are fair value).
- Europe is still struggling with the prospect of gas supplies being cut off by Russia and it remains to see if the Russians reopen the Nordstream 1 pipeline following a closure for planned maintenance in July.

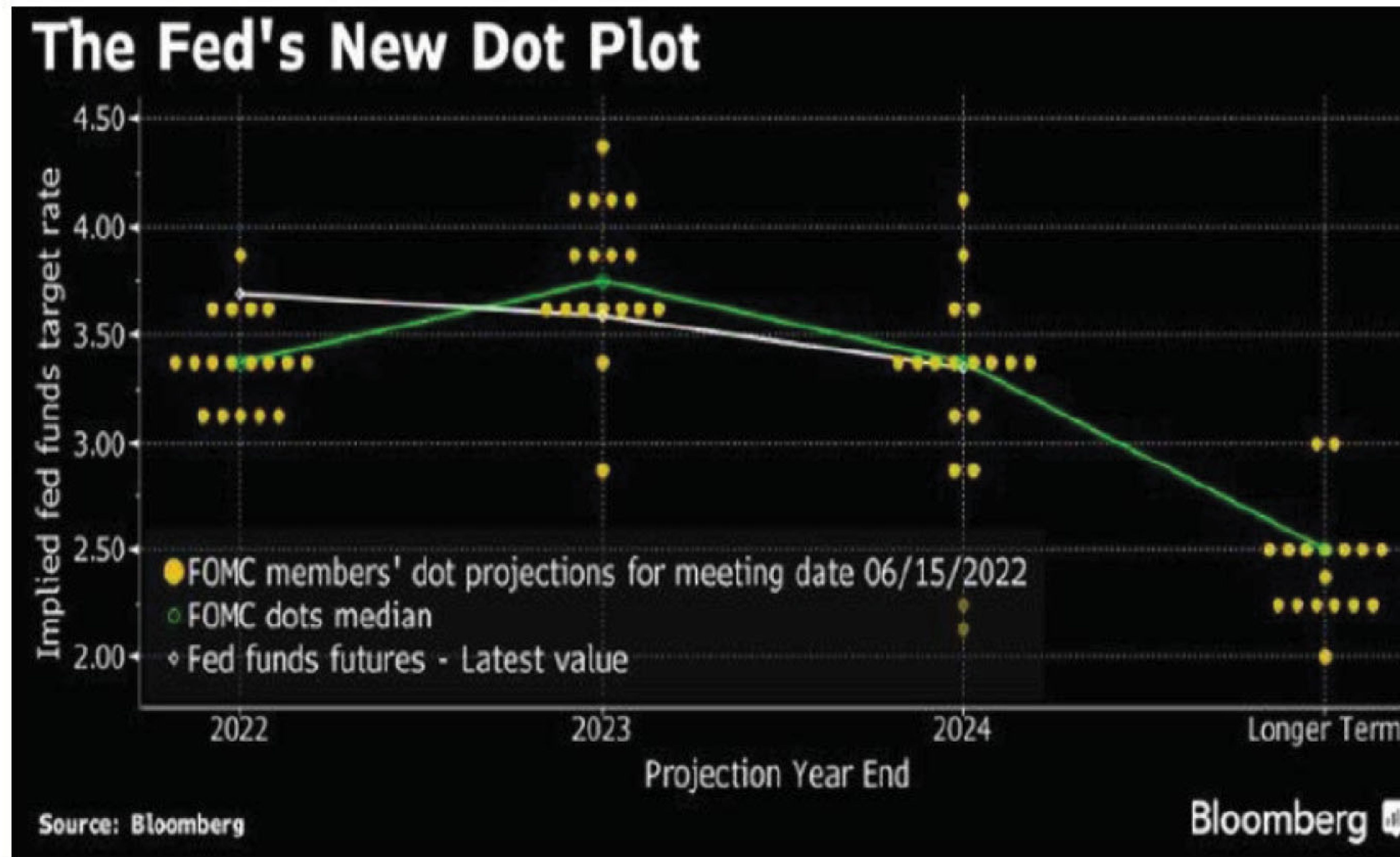
Reasons for optimism

However as mentioned earlier, there are reasons for optimism.

The impact of higher interest rates is being felt by consumers, particularly in the US, where mortgage rates are now at a level not seen since 2008.

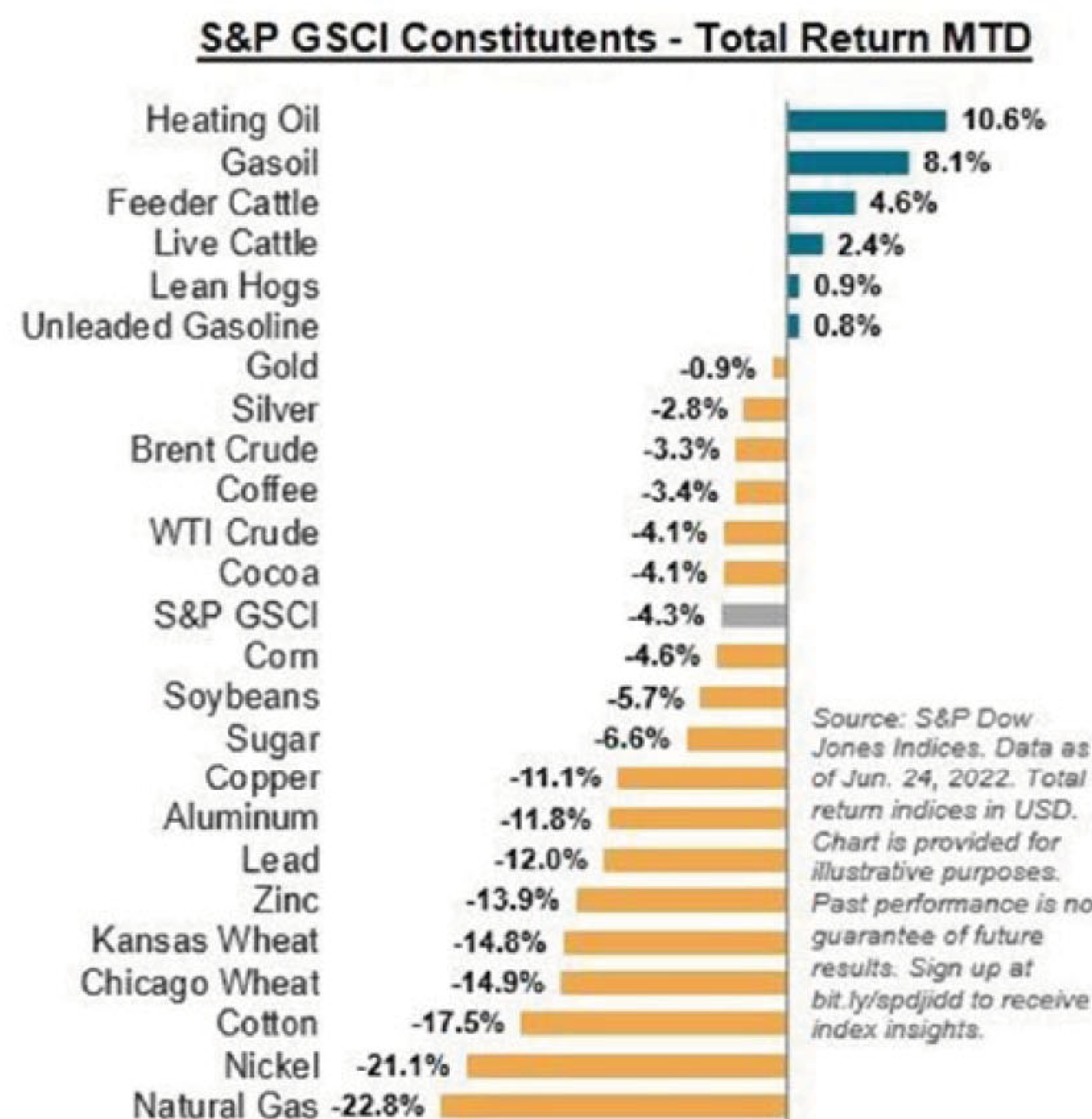
Consumer sentiment is now at a lower point than 2008. The Federal Reserve will be alert to any signs that consumer spending is falling, as they tread the delicate line between controlling inflation and avoiding tipping the US economy into recession.

Weakened consumer demand and lower commodity prices (see below) may stay their hand with regards future interest rate rises. Indeed, the Fed's own 'dot plot' which indicates Federal Reserve Open Market Committee (FOMC -the equivalent of the UK's MPC) members' own projections for the future direction of interest rates, shows a decline in rates from 2023 onwards (each dot represents an individual member of the committee):



This not only tells us that they expect their actions to be effective from this time, but also opens up the possibility to benefit from holding longer dated bonds, which have suffered heavily during rate rises, but which will equally benefit from lowering rates, as will equities.

Many commodity prices have started to decline, due to the anticipated slowdown in economic activity, which will be reflected in future inflation numbers.



The Baltic Dry Index which indicates shipping costs has declined dramatically following the post-COVID supply chain issues:

US 10 Year Bond Yields have been declining since their peak at around 3.5% in mid-June.

Summary

Despite the pall cast on markets in 2022, we need to remind ourselves that we invest in risk assets and, as such, the journey is never one-way. Market corrections and bear markets are features of this, but we know that over the longer-term risk assets outperform cash and inflation. While we may have to wait some months to recover to the previous highs, history tells us that it is likely to happen and that there are longer, more profitable bull phases in markets than there are bear markets.

Markets are forward looking and often looks through any current bad news to the future and we may start to see signs of that emerging sooner than we think. Meanwhile, portfolios and funds continue to maintain a defensive posture until we receive positive confirmation of this.

Rockhold Asset Management, July 2022

CRYPTOCURRENCIES: THE EMPEROR'S NEW CLOTHES?

2022 has not been a good year for holders of cryptocurrencies, as we have witnessed dramatic falls in the prices of most, with Bitcoin, for example, falling by over 60% in sterling terms. With other less well known ones the falls have been worse, affecting even those with supposed pegs to major currencies, such as Terra, which is now effectively untradable.

At the same time crypto exchanges and margin lenders have been closed down. Before we go into the reasons why this happened, it is worth just outlining the basics about 'Crypto':

Digital currencies (Cryptos) were launched post the 2008 Global Financial Crisis (GFC) with the noble intent to reduce reliance on so called Fiat currencies, which are issued by central banks, such as the Bank of England. The GFC caused doubts about the viability of the banking system and thus the currencies around which they were built. As such, digital currencies offered an alternative to, say, the US dollar or Pound.

The security element of these cryptocurrencies was built around Blockchain technology, which in its own right is an excellent technological development that enables secure peer to peer online transactions.

So Crypto was built around this, as a bank did not need to be involved in either the issuing of the currency or transactions in it.

Indeed, Blockchain has been adopted by many corporations and there is talk of central banks employing it, however this article is not about Blockchain, it is about the things using it i.e. Crypto.

Some readers may remember the phrase 'I promise to pay the bearer' on pound notes (note the absence of this now).

This gave users of the currency confidence to trust and use it. The problem with many currencies today is that they are issued by governments who couldn't back a fraction of the currency in issue, but people still have the confidence to use them despite this, probably because they are used to using them and they don't understand or care about the lack of reserves to back them.

Crypto's don't have this advantage, which really aren't that useful for shopping and, aside from so called Stablecoins, they are backed by nothing. Their prices are simply driven by demand (supply is constrained with cryptos such as Bitcoin by people mining them). So, if there are more buyers than sellers, the price will rise and vice versa. Terra, a Stablecoin, crashed because traders in it lost confidence in its ability to track the dollar.

The monetary environment following the GFC was extremely accommodating for financial assets, as QE took low risk assets out of the market and kept interest rates low.

This stimulated investors to chase returns and pushed many into more and more speculative areas. This was evidenced in 2021 by the extremely high valuations of certain technology company shares, the evolution of SPACs (a subject for another day) and the price of Cryptocurerncies.

Since November, we have witnessed the complete turn around in monetary policy, pretty much globally, creating a tighter money supply environment, as evidenced by the end of quantitative easing (QE) and the advent of quantitative tightening (QT).

The removal of the previously accommodating environment has seen bond prices fall, the price of technology stocks crash, the SPAC market dry up and, oh yes, a crash in Crypto prices.

At least bonds pay interest, and many technology stocks have earnings to provide the setting for a recovery in the future.

Crypto does not. It is reliant on confidence that prices will go up, as well as the weight of money circulating around its market and there just isn't as much of either right now.

Hence the analogy of the Emperor's New Clothes – in this fable, the king and his subjects had the confidence to believe he was fully clothed, even though he was naked. It took a small child to make them realise they had been deceived and they realised the truth.

Cryptos are well established now and it may be that talked about government regulation and future involvement by central banks may help to stabilise them – all of which is ironic given the rationale for their creation in the first place. Meanwhile, they are best left to speculators, not investors.

Important information

The FCA have issues with Crypto currency in general and whilst it could be argued that the above is not a promotion per se, they have banned them for retail clients, therefore this needs to be taken into consideration and I would suggest included for the reason they are very high risk.

I am not an expert in Crypto, frankly I really don't understand how they work with the blockchain and security behind so I am not going to try.

However, based upon what the FCA have said we should, if you continue with the article, not paint them in any other way than high risk, very volatile investment where you can lose your money and not as any alternative to other mainstream investments

They are not protected under the regulatory protection in the Uk (FOS or FSCS0

They are not regulated by the FCA

They are not Suitable for the retail consumer

They have a greater potential for fraud/scams

STUDENT FINANCE: THE TREASURY WANTS A GREATER RETURN

The first few months of 2022 produced two important announcements on student finance in England and Wales, both of which were seen as having the Treasury's fingerprints all over them, even if they originated from the Department for Education (DfE).

Students who start(ed) their course between September 2012 and August 2013

Student loan payments operate more as a form of tax than as a conventional loan repayment.

The basis has long been that the payment made is 9% of income above a specific threshold – with no upper limit (other than full repayment). The result is that some lowly paid graduates never pay a penny, while the high earners can clear their debt in a decade or less.

The income threshold is a crucial number and had been subject to increases in line with average regular earnings in recent years, after a freeze in 2017/18. However, early in 2022, the DfE 'announced' in a blog that it would be frozen at the 2021/22 level of £27,295 for 2022/23. Subsequently it emerged that the freeze would last for three years, up to and including 2024/25.

Thereafter the threshold will rise in line with the RPI rather than earnings (which could be expected to grow faster).

As a DfE consultation paper noted, the change '…will generate significant savings for the taxpayer', the corollary being that graduates will be making 'significant' extra loan repayments.

Students who start their course from September 2023

Shortly after the blog appeared, the DfE revealed that students starting their courses in the 2023/24 academic year or later would be subject to a new set of loan terms:

- The good news was that the maximum interest rate would be reduced to the RPI+0%, compared with the RPI+3% which currently applies during the course and to the highest earners when repayment begins.
- The first slice of bad news was, once again, focussed on the repayment threshold. This will be set at £25,000 and held at that level until April 2027 when, in theory, the first of the graduates from the 2023/24 academic year will start to repay their loans. Probably by coincidence rather than design, £25,000 is the same threshold as applied to the current loan scheme in 2018/19, which gives a good idea of how much of a squeeze is being applied. Increases to the threshold from 2027/28 will be linked to the RPI, which is due to move closer to the CPI three years later.

- The second slice of bad news was the harshest: the loan payment term will be extended from 30 years to 40 years, meaning many graduates will be in their early 60s and nearing retirement before they stop making payments to the Student Loans Company.

The difficult question remains…

Whenever the topic of student loans raises its head, the question of whether to repay early is not far behind. There is only an easy answer if the borrower knows:

- The pattern of their earnings over much or all of their working life;
- What the path of inflation will be over the same period; and
- What changes the current and future governments will make to loan conditions before payments end.

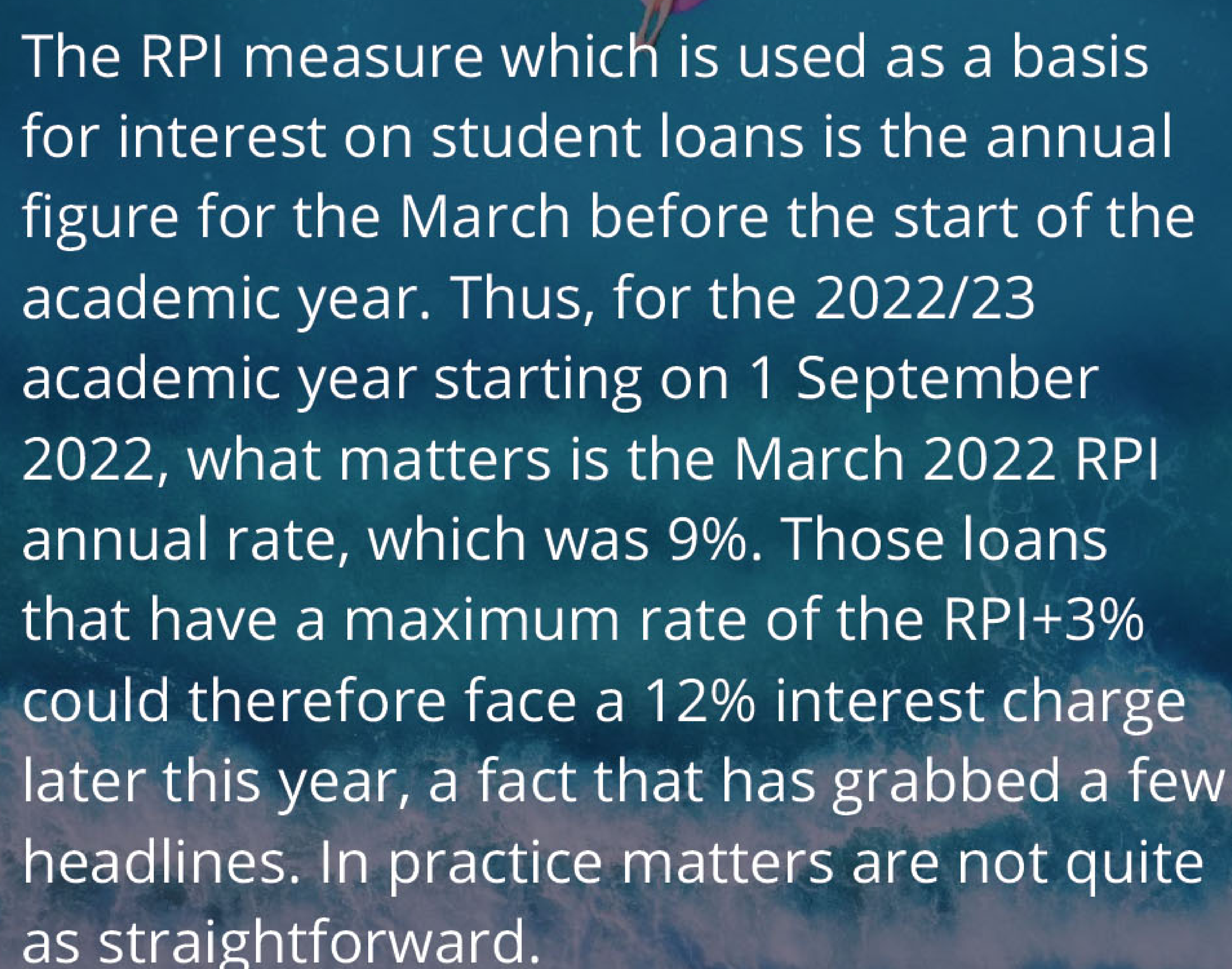
The DfE's own estimates for the entire student population are that even with a 40-year loan term, only about half of borrowers will fully repay their loans.

Under the current 30-year regime, the corresponding proportion is just 25%. In either case, there is an obvious risk that making any payments above that statutory 9% will be nothing more than a gift to the government.

Action

The uncertainty about the merits of early loan reduction or full repayment do not mean that the impact of that effective 9% graduate tax can be ignored.

If you are concerned as a parent or grandparent, talk to us about the options for providing assistance. Making capital available for the deposit on a first home may be a better idea than speeding loan repayment.



Footnote: 12% student loan interest?

The RPI measure which is used as a basis for interest on student loans is the annual figure for the March before the start of the academic year. Thus, for the 2022/23 academic year starting on 1 September 2022, what matters is the March 2022 RPI annual rate, which was 9%. Those loans that have a maximum rate of the RPI+3% could therefore face a 12% interest charge later this year, a fact that has grabbed a few headlines. In practice matters are not quite as straightforward.

All the nations of the UK restrict the maximum student loan interest to commercial rates (on differing bases) if these are lower than the RPI-linked basis. Unfortunately, the process for doing so has inbuilt lags, so interest is likely to be overcharged for six months from September – at 12% in this instance - with compensatory undercharging thereafter to reach an overall commercial rate. All of which further complicates any thoughts of repayment…

Techlink

THE COST-OF-LIVING CRISIS – 6 HINTS AND TIPS TO HELP WITH FINANCES

The surging rate of inflation combined with the growing cost of living crisis, is increasingly placing people's finances under pressure. With times like these, people will be finding it hard to cover the basics, let alone having the extra to spend on enjoyable activities and saving.

Looking at key aspects including the increase in National Living Wage and the rise in the rate of National Insurance, in this article Steven Cameron, Pensions Director, Aegon UK shares 6 hints and tips to help you with your finances and answers 5 key questions about how the cost-of-living crisis could affect you.

With the cost-of-living crisis we find ourselves in, we've gathered 6 hints and tips to help you with your finances.

6 hints and tips

Budgeting methods – consider ways to prioritise your available income, whether you look to the traditional budgeting method or the 50-30-20. The traditional is generally a list of incomings and outgoings and identify where to spend or save.

Or the 50-30-20 budget typically 50% towards needs, 30% towards wants and 20% towards goals but this can be adapted to suit your needs.

Pension basics – research what different types of pensions are available and make sure you are planning towards retirement.

The State Pension – the State Pension is often a main source of income during retirement, but other sources are always helpful to achieving your goals and lifestyle. A retirement pot could consist of workplace savings, personal pensions, ISAs, investments, and the State Pension.

Budget review – you could carry out a budget review. Remember to keep achievable goals by sorting into short, medium and long term – and regularly review any progress and adjust where appropriate.

Pension contributions – consider whether you are saving enough towards achieving the lifestyle and goals you have for retirement.

Pension credit – if you're above State Pension age, check if you're eligible for pension credit as many who are eligible forget to claim this.

END OF THE HELP TO BUY SCHEME – WHAT IS NEXT FOR FIRST TIME BUYERS?

As we move into the summer months, we edge closer to the Help to Buy (HTB) deadline set by Homes England. Recent news states that HTB applications must be submitted by 31st October so that customers can remain eligible for the scheme. Homes England's view is that this should give everyone ample time to make the necessary arrangements to benefit from the scheme before it officially closes in March 2023.

Help to Buy will leave a void in the market, as it has been one of the most successful government schemes in recent times and will undoubtedly have repercussions on the way first time buyers purchase homes in the future. In a rising house price market, it will only become more apparent as buyers come up against deposit and affordability barriers which HTB has helped first-time buyers with.

The mortgage market is very resilient, and the new build sector has gone from strength to strength, and we feel it will continue to do so. We cannot build enough homes in the UK to cope with the demand so builders will play a key part in government policy for some years to come.

So, what is next for the sector, what will happen once HTB is gone?

There are some fantastic schemes in the market for new build customers and there will be more to come as we progress through the next couple of years.

There are some fantastic schemes in the market for new build customers and there will be more to come as we progress through the next couple of years.

1. Shared Ownership continues to be highlighted by brokers as an area that they feel will grow considerably, as Help to Buy ends and the cost of living makes it harder for some to go down the conventional route of home ownership.

   This isn't a new scheme, it's been around since the early 1980's, and it has contributed massively to the housing market by delivering 76,500 homes over the past six years. Our current government have also committed to this sector by confirming that 90,000 shared ownership properties will be built by 2025 through their Affordable Housing Programme.

2. Higher Loan To Value (LTV) Lending is another area which appears to be key, and at TSB we have recently made the move to 90% LTV on new houses and bungalows including Shared Ownership properties.

   In times where we are seeing record house price growth and where the average home in the UK now stands at £289,099 (figures from Halifax Price Index 2022), it is vital that lenders support the market with enhancements to policies to keep the home buying dream alive for all. The delivery times of new homes has also been impacted by labour and material delays as demand outstrips supply.

Paul Thornton, National Account Manager, TSB

Your home maybe repossessed if you do not keep up repayments on your mortgage.

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