Warner Matthews Diaries – Second Quarter 2021

Asset Allocation Musings:

Sitting in my home office thinking about what facets stood out to me during the last quarter it's hard not to ignore the UK's vaccine rollout success. Once derided for her team's efforts to procure sufficient vaccines for UK residents, Kate Bingham, head of the UK Vaccine taskforce, now looks like she has booked her place in medical fokelore with her astute bulk buying vaccine strategy. As the rest of Europe squabbles over who should get which vaccine and why there isn't enough of it, the connection to our new found freedom outside the European Union and the vaccine advantage is more than coincidental. Having said that, in a world where there is a growing chasm between those that have and those that don't, should the UK not be allocating more of our vaccines to those most in need outside our borders….food for thought? Finding a song title that fits in with this dynamic wasn't too challenging – *Freedom* by Wham or indeed Pharrell Williams (who's that I hear you ask..?) were too obvious. So I opted for someone I admire as a songwriter and whose lyrics connects with today's uncertain times – *Chimes of Freedom* by Bob Dylan.

Synopsis of the Chancellor's Budget:

It already feels like a distant memory, however there were some important tax implications within Rishi Sunak's March statement which we have summarized below. As you are now aware, our concern remains the growing debt pile and how it ultimately gets repaid. Rishi also appeared to be concerned highlighting the "huge challenges" in addressing the record levels of borrowing.

Let's start with the good news first - tax thresholds will be increased this year. The personal allowance rises from £12,500 to £12,750 and the higher rate tax threshold rises from £50,000 to £50,270. Corporation tax stays at 19% until 2023. The current furlough scheme is extended beyond the end of April to the end of September, however employers will now have to start contributing in July. Self-employed income support scheme (SEISS) was bolstered and Universal Credit boost extended for another 6 months. Stamp Duty holiday on property purchases was extended until the end of June and first-time buyer mortgage assistance and government loan guarantees introduced. State pensions will rise by 2.5% this year and the triple-lock will remain in place. New plans for green investment were incorporated and the NS&I will launch 'green' savings bonds in response.

And now the not so good news…The Pension Lifetime Allowance remains frozen at £1,073,100 until 2026, so anyone exceeding the threshold over this period will be liable for a tax charge of 25% or 55% depending on how they choose to access their pension. Despite the personal tax thresholds rising this year, they will then freeze these for the next 5 years (as well as National Insurance thresholds). In effect this means many will end up paying more tax on their income than had the thresholds continued to rise over the next 5 years; was this a government sleight of hand manoeuvre? Corporation tax will rise from 19% to 25% after 2023, a rise of almost 25% in one fell swoop. Companies with profits above £50,000 will be impacted, hardly a recipe for sustaining a nascent recovery. The extension of furlough schemes, stamp duty holidays and self-employed support schemes will be tapered away this year, so we have to hope the economic recovery is strong enough to let the patient breathe without the government's infusion of oxygen. Finally, undoubtedly property market schemes have helped the construction industry through the pandemic, but given the headlines on rising property prices, not those trying to get on the property ladder. How is it conceivable that affordability actually declined during the worst pandemic in nearly 100 years?

First quarter stock market quirks and a word of caution from an industry veteran

We were not totally surprised that global stock markets reacted the way they have during the first quarter given the vaccine headlines. Economies are beginning to open up again in the West and in the East, life has almost returned to normal. Consequently, the economic growth statistics look stellar (given the low base effect year-on-year). However, two investment vagaries caught the eye.

GameStop is a bricks and mortar video gaming retailer in the US, listed on the US stock exchange, and like many other offline retailers, has been struggling to grow its revenue based over the last 10 years or so with the advent of online computer gaming. Indeed, its revenue is down over 50% since 2016.

As a result, it became a popular stock to short for the coterie of hedge funds that mimic what others are doing and follow suit. This strategy worked well until last year. Enter, stage right, a new paradigm of retail investors, buoyed with furlough cheques and more time on their hands, acting in cohort to wage a war against the hedge fund community who they believe operate in an elitist manner. The magnitude of their campaign, assisted by social media and platforms such as RobinHood and other online trading platforms, saw GameStop share price rise 10-fold in a matter of months. A frenzy then took hold and the share price eventually peaked over $300, up 100 times in a year, thereby wiping out hedge funds and making a mockery of conventional investing through quasi coordinated manipulation. This happened across a swathe of companies that up until the start of the year were noted only for being the most shorted stocks in the market. As I write this quarterly, GameStop share price has retraced 50% from those highs.

The second vagary is Special Purpose Acquisition Companies (SPACs), which are not a new phenomenon, but have become the must have celebrity endorsement. These are companies set up with no operations, list on the stock market and start with nothing other than funds raised at a listing. The company can then start to acquire other businesses with these listing proceeds and therefore avoid having to go through the arduous process of a traditional stock market float. This has turned into a mega-bubble, with over $80 billion raised this year-to-date versus less than $5bn in a "normal" year in the US. The celebrity sponsors, ranging from rappers to an ex-President's chief economic adviser, have a very different set of economics to retail investors that follow them in. Effectively, they can cash in their chips at their original cost, even if the shares are trading under water; clearly not an even playing field.

What do these quirks tell us about the current state of stock markets generally? Clearly there are pockets of euphoria, undeniably the regulator is behind the curve on responding and finally these are not investment strategies for widows and orphans. But don't just take our word for it, having read the latest missive from Jeremy Grantham, founder of GMO and an investment guru (in this scribe's view), I thought I would share his conclusions. Through his investment lens, "this environment is where investors will truly prove their mettle. Human psychology works towards sucking investors in. But this bubble will burst, no matter how hard the Federal Reserve Committee tries to support it and for the majority of investors today, this could well be the most important event of your investing lives. Time to buckle up!"

So where are we comfortable investing – looking East

The effects of Covid-19 are there for all to see in black and white. Whilst the origins of the pandemic began in Asia, the worlds fastest growing economies appear to have sailed through the crisis with little economic impact. There may be good reason for this. The region has battle scars from previous virus outbreaks and the masses are better equipped to abide by the restrictions to which, us in the West, find harder to adjust. The growth in social media and the Asian Governments' ability to monitor mass movement of people has made it easier to track and trace and respond accordingly.

These are useful tools to administer in times of panic, however there are fundamental reasons why we are growing in confidence regarding allocating more to this part of the world. Using Japan as a reference point, despite not having the structural advantages such as young demographics that many parts of Asia enjoy, there are reasons to be optimistic. As we have highlighted in previous quarterlies, Japanese companies are quick to respond and adapt and therefore lead the way in many industrial and electronic industries.

It's hard not to be impressed with the sheer scale and change in China and India. With supportive demographics in India and South East Asia, there's a growing middle class hungry to jump on the consumption band wagon. From buying a phone or laptop, to transitioning to buying a car and then property, the investment potential is endless. Harnessing this potential used to be full of pitfalls. Too often, Asian management would treat their companies as personal fiefdoms, using the company's bank accounts as their own, buying trophy assets to impress their peer group. However, just like in Western developed markets, a new breed of management and ownership is fostering an improved management philosophy. This is predicated on treating all stakeholders equally, using resources and the environment around it more responsibly, ultimately to create a more sustainable backdrop for the next generation. There is still some way to go, but the foundations are now in place and we are optimistic.