Warner Matthews Diaries – First Quarter 2022

Asset Allocation Musings

As we enter a new year, it's worth pondering what we have left behind. The good news for most of us is that that the fears of food shortages and lack of festive necessities didn't eventuate. So despite most of us being subjected to last minute changes to the Christmas travel plans, the turkey made it onto the kitchen table without much fuss…That said it did feel like Groundhog Day, where every day felt like the day before; reverting to working from home, meeting via Zoom calls, lack of foreign holidays and weekdays and weekends all too similar – one can only hope the missive for next year's first quarter will be loaded with more cheerful reflections on how life finally returned to normal. With this in mind finding a more upbeat musical reference seemed apt. As always the choices were ample, however Billy Bragg's *Tomorrow's Gonna Be A Better Day* won my vote with the lyrics:- Tomorrow's gonna be a better day, no matter what the siren voices say, tomorrow's gonna be a better day, we're going to make it that way…who ever said Billy only filled music halls with tones of despair?

Stock Market Reflections

Every cycle has its own nuances, and the current one is no different. The economic recovery which began at the end of 2020 continues unabated. Equities around the world continue their ascent. Concerns over inflation, climate change and inequality remain at the forefront of investor's minds, however, there has been no tangible consensus on how the end game may look. Politics has never been far from the front pages, and the popularity ratings of the elected leaders both sides of the Atlantic imply challenging times ahead.

The year just passed appeared punctuated by the rotation from growth investing to value investing and back again. However, in the US equity market, growth companies took the prize by a wide margin. It's worth highlighting a few interesting facts to frame the out of kilter nature of the US equity market. The US weighting within the MSCI World index almost touched 70% last year - putting that into perspective - the US accounts for only 25% of World GDP (source World Bank). As a reference point, Japan's weighting topped 40% in the early 1990s before sliding all the way to 6% last year. Despite the benefits of index/passive investing (namely costs) the risks are all too apparent. The largest 8 constituents (by market cap) of the MSCI World Index are all US new economy companies (Apple, Microsoft, Amazon, Tesla and so on).

Thinking about how cycles may unfold occupies a fair amount of our grey matter. In the 1960s, the emergence of growth investing in the US took precedence. The creation of the "Nifty Fifty" ruled the investment universe and its constituents shared many of the same qualities, namely, uber high valuation multiples, which implied that these were sensible investments only if their business advantage could be maintained. Unsurprisingly, many of these elite companies didn't have the impregnable advantage investors first believed and investors who held onto them lost almost all their money from the late 1960s.

There are similarities and differences in the current cycle to that of the 1960s. Drivers of underlying stock markets are again a narrow breadth of high priced, highly valued growth companies. However, the new investment world order as we see it, means the durability and sustainability of today's winners are more susceptible to competition and change. The disrupters are likely to be disrupted, and the risks of putting too much faith in the current leaders are something we are acutely aware of. If the start of 2022 is a portent for things to come, then investors should take note. Changes to Central Bank narrative may be nuanced but it can have dramatic consequences as equity markets have reacted negatively to news that interest rates may be heading higher in the US. Rivian, an electric vehicle start-up that listed in the US last year, has seen its share price fall over 50% from its high; such outcomes are not so isolated. As always, we start with a mindset of capital preservation, and a focus on ensuring no style biases (growth or value) emerge in our client's portfolios – this has served our clients well over time and there's no reason to change our tack…

COP 26 – a fair cop or cop out?

The 26th UN Climate Change Conference of the Parties (COP 26 for short) was different this time, due to the sheer amount of coverage it received. I cannot recall any of the preceding 25 conferences having had any meaningful soundbites from which to recount. Perhaps the fact that policy makers, the financial sector, corporates and even her Majesty in attendance over the two-week period in Glasgow, all armed with the same message, meant that this message was loud and clear. Despite the multiple agendas on offer, a consensus on climate issues was possible. The main consensus point was to reduce average global temperatures from rising below 1.5C and how each country would play their own part in reaching net-zero emissions.

You know that when Greta Thunberg hosted a protest rally outside the conference something's not quite as it seems. Her catch phrase "blah, blah, blah" captured what a lot of the young thought about what the world's leaders inside the conference hall were agreeing to. A lot of pledging and not much action was the common criticism. Phasing out became phasing down as the gap between commitment and reality was too big a gulf.

The so-called successes were well flagged, but as students of behavioural finance we couldn't help agree with Greta on the contradictory actions (private jets the preferred mode of transport for the great and good). As earnest financial practitioners, we see logic in investing time and energy to understand the anti-consensus viewpoint (did you know that whilst the zero-emissions rhetoric hit fever pitch, the best performing sector in the UK stock market last year was oil & gas). With climate change in mind, this means trying to rationalise how the considerable cost, if indeed, this has been realistically calculated, of re-tilting the earth back onto a greener plain might be accomplished and the second derivative impact of taking money out of ordinary folk's pockets, but that's a conversation for another time.

Perhaps these conferences do serve a purpose and provide a discourse for future accountability. We don't have to wait long as COP 27 occurs next year, so the media's appraisal on "the work in progress" will be interesting. The fact that China and the US were able to structure an agreement at a time when hostilities were rising was surprising. The fact that the two largest economies and biggest emitters were able to say that they will work together on this issue was therefore laudable. We hate to sit on the fence on this topic, but it appears the conference was both a fair cop and a cop out, or in the words of the chairman, Alok Sharma, if we are to believe him, it was a "fragile win" for the climate change cohort. The task remains as it was, to get measurable, specific actions to transform our energy, transport and heating infrastructure. This theme will continue to run and run in lieu of any pushback from governments, regulators or corporates. As financial advisers, the key will be to identify which funds are best placed to benefit from this thematic.

ISA & Pension Contributions – don't miss out as the deadline is 5th April 2022

It's that time of the year when the Warner Matthews Team readies themselves for the end of the tax year particulars, namely ISA subscriptions and pension contributions for 2021/22. As you will know, ISAs are "tax free wrappers" where you can place money to earn interest or returns without having to pay the tax man any income or capital gains tax. The maximum subscription is £20,000 for this tax year. Similarly pension contributions come with attractive tax relief. This tax relief is paid on your pension contributions at the highest rate of income tax you pay, so if you are a higher-rate taxpayer you can claim 40% pension tax relief. There is a limit of £40,000 for the tax year 2021/22, so any contributions above this will be subject to tax at your marginal rate. You can carry forward unused allowances from the previous three years as long as you were a member of a pension scheme during those years. For anyone not working or earning less than £3,600, the maximum gross contribution is £3,600 (this includes the government top up, so your personal contribution is limited at £2,880). If you intend to sell assets to fund ISA or pension contributions, remember there may be a CGT implication. Feel free to check with us.

This report is for informational purposes only and should not constitute investment advice. Past performance is not a guide to future performance. No investment is suitable in all cases and if you are in doubt you should contact us. Market and exchange rate movements can cause the value of an investment to fall as well as rise, and you may get back less than originally invested. The views expressed are based on information believed to be accurate at the time of writing but no assurances are given.