Warner Matthews Diaries – Fourth Quarter 2020

Asset Allocation Musings:

With the Coronavirus refusing to take its place in the archives of the first half, and the Chancellor deciding now is not the time for an Autumn Budget statement, your scribe felt that adding to the narrative on the epidemic was unavoidable. Perhaps using their creativity or ingenuity, the Rolling Stones recorded "Ventilator Blues" some 50 years ago. With self-isolation measures now reintroduced the options were endless; two of my favourite songwriters Neil Young and John Lennon have apt song titles in "The Loner" and "Isolation". However, the standout entry was Huey Smith's "Rockin' Pneumonia and Boogie Woogie Flu". In the interests of good taste, I omitted the eponymous Bee Gees song (shame on you I hear you say)…

Some remarkable statistics were realised in the third quarter. We had previously highlighted that a new breed of investors, essentially US retail investors, with government paychecks and Robinhood online trading accounts, had pushed up a narrow cohort of companies to fresh all-time highs. The so-called epidemic winners were largely US listed, online orientated, and conventional measures to determine what a fair value to pay for future earnings streams largely ignored. This frenzy fed on itself, the fear of missing out (FOMO), created panic buying. Consider these facts: Tesla, the US auto manufacturer undertook a stock split in August and the shares rose 16% on the day. The irrational logic being a five pound note split into one pound coins suddenly makes them worth £1.16p each. Tesla may well one day produce more cars than all autos manufacturers combined, but last year it sold less than 5% of Toyota's total auto sales and yet last quarter it surpassed Toyota as the largest by market capitalization. This coming despite reporting quarterly revenues that shrank 5.8% year-on-year. Its revenues have grown $26bn in the last year but its value rose by $64bn, go figure...Our own interpretation is that the playing field advantage they possess is slowly being eroded away in the electric vehicle segment, (their share of the German EV market fell to 8.7% from 18.4% last year). Maybe Elon Musk will put people on Mars, but I wouldn't bet last month's salary on it. Similarly, Apple's market capitalization on August 21st exceeded $2trn, having doubled in price since the low in March. That made it worth almost as much as the entire UK stock market. Call me cynical, but I fail to recall the last killer product launched by the company (was it the iPad in 2010?). Share buy backs and acquisitions can obviously get you more than so far! Like a lot of catalysts in life, you don't always see them before they appear. Many equity bubbles in history have burst on fairly innocuous causes. We aren't necessarily predicting a collapse, but there are certainly areas of the market full of excess, and the helium air that has kept the Apple balloon aloft may begin to lose its efficacy.

Where to park a windfall?

It is an understatement and a cliché to say we live in unusual times. Phone and computer scammers are constantly attacking our trust; in 2018 criminals successfully stole £1.2bn. As advisers we are often asked how and where to place windfalls, therefore we need to know the government's deposit and savings protection levels. Presently the protection limit is up to £85,000 per eligible person, per bank, building society or credit union and up to £170,000 for joint accounts. An important caveat is that it applies to the banking 'authorisation', not each bank account so you need to know who owns the bank where you keep your cash deposited. The Financial Services Compensation Scheme (FSCS) also protects temporary high balances up to £1m for up to 12 months resulting from house sales, redundancy pay or inheritances. Offshore bank accounts often offer better savings rates, but the protection levels differ. Banks in the European Economic Area (EEC) are covered by their own domestic compensation schemes.

So, are their alternatives to deposits and savings that provide some form of protection? All National Savings and Investments (NS&I) are government backed, meaning they are a secure way to store your money. They benefit from having a higher limit on the amount that is protected, such as Direct Saver (£2m) and Investment Accounts (£1m). There are several different products, but not all are readily available (savings certificates/pensioner bonds/growth bonds currently restricted) and upcoming dramatic cuts to the interest they pay on savings (0.01% on Direct Saver and Investment Accounts) have reduced their attractiveness compared to leading high street savings rates.

Premium Bonds, run by National Savings & Investments (NS&I), are investment products and guaranteed by the Treasury. Investors are not paid interest, but the bonds are entered into a monthly prize draw where holders can win between £25 and £1 million tax free. The chances of winning remain slim, with odds of 24,500 to 1 of winning any of the prizes. Again, changes to the prize rate (now 34,500 to 1) has reduced the attractiveness to most savers.

WARNER MATTHEWS
ASSET MANAGEMENT

What's on our Minds?

The alternative to Gold – is it Bitcoin's time to shine?

The role of the dollar, by virtue of its acceptability and stability, is the entrenched global reserve currency, and therefore every other central bank must hold lots of it. A recent study by the IMF revealed that during the second quarter, US dollar denominated exchange reserves (including US Treasuries, US corporate bonds, US mortgage-backed securities etc.) held by foreign central banks rose by almost 2%. This comes at a time when the US has huge trade deficits (the latest monthly print indicating the worst deficit on record), growing budget deficits and significant public and private debt - this appears counter intuitive. Is it therefore possible that its position as the global fiat currency may be under threat?

We have previously written about the role of Gold as a safe haven and its growing position in your portfolios in earlier newsletters. Its performance year-to-date underscores the continued role it should play in volatile and economically uncertain times. However, we have spent some time trying to establish a worthy substitute to Gold. An asset which (like Gold) would provide a diversifying element to portfolios and one which would be less correlated to other assets such as equities, bonds and the US dollar. Could Bitcoin be the answer?

A quick potted history of this digital currency: created in 2008 by an anonymous person(s) using the moniker Satoshi Nakamoto, it began life as a peer-to-peer electronic cash system to solve the age-old issue of transferring value across time and space. It spent its first few years largely unnoticed by the investor masses, however its proof of concept steadily transitioned into wider use, due to the fact that the core tenet was its open sourced software (in layman's terms this meant it was free to use for anyone with access to a computer with sufficient processing power). In addition, it was constructed as a peer-to-peer concept to check transactions with no third-party interference. On May 22nd 2010, the first physical payment for goods was made, someone using 10,000 bitcoins to buy two pizzas costing $25…

We believe its position as the challenger to US dollar hegemony is growing by the day. For a good, a service or currency to maintain its value, it is necessary that the supply of that asset does not increase too dramatically, i.e. there needs to be a mechanism to prevent over production of new units. History is blighted by examples of holders of all forms of assets, such as tulips, being over produced and thereby destroying the underlying value of the asset. This is why Gold has performed so admirably, its supply is limited by the lack of new discovery. Unlike Gold, major currency printing has been used in modern times as a facilitator to lift economic growth or more dramatically to pay for war (as it is seen as far more digestible than raising taxes). In today's backdrop, central banks have embraced the Keynesian edict that the level of spending from newly created money is what matters. Competitive devaluations of almost all major global currencies, supported by record low (and negative) interest rates have reinforced this. If debasement appears structural, is Bitcoin a solution?

In a free market, prices are knowledge and supply and demand dictates prices. Bitcoin's raison d'etre is its finite supply (21m vs 18.5m in current circulation) combined with the ledger basis underpinning all transactions on its platform (confirming a change in ownership of bitcoins). Each entry on the ledger is authorised by its members only. Those providing proof-of-work are the "miners" and they are rewarded through bitcoins. Unlike other assets, the rise in the bitcoin price has not equated to a rise in bitcoins, but only the improvement in processing power required to process more transactions. This is because there is no "board" controlling supply, like central banks. It is not a perfect solution by any stretch of imagination. My initial scepticism was premised on the lack of physical transactions. I suspect none of our readers have purchased a good or service using bitcoins…However it has gone from strength to strength over the last 10 years despite setbacks. We wonder whether Bitcoin will be the millennials equivalent to the baby-boomers gold safe haven trade? Consider this, in today's value those 10,000 coins used to buy 2 pizzas back in 2010 is now worth $100,000,000 (surely the most expensive pizza purchases on record)! Is it therefore worth having a small allocation on the basis that if it's in existence in say another 50 years, the likelihood is it will be more valuable? As always, we are happy to discuss in more detail….