WARNER MATTHEWS
ASSET MANAGEMENT

Newsletter – First Quarter 2024

This quarter nothing really shouted out at me as a possible entry into the newsletter (songs) hall of fame…so I've reverted to my favourite Christmas carol and decided to learn more about its origins.

I love the opening verse of In the Bleak Midwinter, there's something unique about the simplicity of describing the weather at Christmas time.

Created as a poem by Christina Rossetti in 1872, composer Gustav Holst composed the music to accompany the words in 1906.

In 1909, Harold Draker created a methodical similar version that could be sung by a choir with solos as opposed to Holst's congregation only version. As I never was selected for any school choir, Holst's version gets my nod….

The risks attached to making bold predictions

We make no bones about the risks to making predictions, (see the chart above for how the best economists in the US fared in their index return predictions for last year) preferring to extrapolate what has gone before to see if it will chime again. **2023** was an unusual year in many ways; we had the continued war in Ukraine, a new "war" in the Middle East, and yet below these choppy waters some asset classes surged ahead. Despite higher interest rates, a full-blown economic crisis was averted with no signs of major defaults. All the while employment levels in the western world remained robust, providing rising incomes into a backdrop of (now) falling inflation. China promised much post lockdown, but the pent-up demand fizzled out quickly. Japan, forever the bridesmaid in the world of double-digit returns, finally made it to the altar, price inflation finally catching hold after decades of persistent deflation.

Looking towards **2024**, we are moving from an era of low inflation accompanied by low interest rates to something less familiar, so we expect volatility. Complicating matters further, the political landscape is possibly changing and, with it, fiscal policies. The cost of capital will therefore remain vital, and the servicing of the ever growing debt pile more prescient. China's economic path has faltered and the trade war with the US remains impactful, however much of the negatives appear priced in and for those that are superstitious, it is soon to be the year of the dragon. An auspicious zodiac due to the connotations of power and charm. Could this be the tonic required for a renaissance in interest?

The Origin of the Newsletter

Perhaps not the first investment newsletter, but Charles Schwab's first job was to contribute to a regional US investment newsletter, before creating his own weekly alternative. At launch, Schwab charged $60 per annum, hiking this to $72 once subscriptions hit 3,000. After buying out his sponsor, he added a mutual fund arm and changed tack. When he stepped down in 2008 from his eponymous firm his net wealth was estimated at over $10bn. Similarly, US hedge fund manager behemoth, Ray Dalio of Bridgewater Associates, started out writing daily market commentaries, and this caught the attention of McDonald's, who hired him to look at ways to hedge the price of chicken ahead of its launch of the *McNugget*. Even after he set up his hedge fund business, he continued to produce a daily observation for investing clients only. As co-creators of our own newsletter, we find it therapeutic to put into writing all the ideas and things on our mind that help shape the way we think, hopefully you too enjoy our musings…

Twas' the season to be Merry….

Like many, the festive season tends to be one of over-indulgence, leading to a short period of reflection followed by an internal missive to start 2024 with a healthier approach. Global alcohol consumption is however declining year-on-year. Beer sales still dominate the alcohol market. However, a shift to low and zero alcohol beverages targeting the Millennials and Generation Z cohorts, means that brands have had to adapt and change. In 2022, almost half of Gen Z were buying more zero alcohol beverages than the previous year.

I read a recent article to see who the top ten alcohol consuming countries were and was surprised by some omissions – Ireland just missed out on a top ten position (11th), France not far behind at 16, UK a lacklustre 22nd and Russia a woeful 28th. Drum roll the medal winners: in third the Czech Republic (birth place of Pilsner), second place Georgia (wine making post-Soviet country)..and in first place Romania, where per capita consumption of alcohol tops out at 27.3 litres, of over 8 drinks per day per adult. I know little of Romania aside from watching the demise of Ceausecu in the late 1980s, but I suspect the consumption levels may have a connection with a torrid political past combined with an ageing demographic profile.

The case for esoteric assets

A little-known theatre in Cremona (Italy) witnessed a Moldovan violinist play various Vivaldi concertos last month. However, most of the audience was transfixed with the instrument and not the musician. The reason why was the 1772 Stradivarius being used is housed at the museum in Cremona and has stipulations that require it to be used sporadically. Antonio Stradivari lived over 80 years in the 17th century and was best known for his craftmanship in creating violins, of which there were originally 1,100, with fewer than 500 still in existence today. As a result, they rarely change hands. The value of such items has sky-rocketed from a few hundred thousand in the 1980s to a record breaking $15.9 million in 2011. Over the last 40 years Stradivarius violins have consistently yielded an annual return of 4.9-7.7%. "Strads" are normally given nicknames, often after a particular owner (famous owners include Catherine the Great and King Maximillan). The most famous of all is the *Messiah*, which Stradivarius kept in his workshop until death as a yardstick. This is now housed in Oxford's Ashmolean Museum; it is, however, not for sale!

Pension Changes – the evolving playing field

The chancellor attempted to simplify the pension industry by removing the limit on the amount you can save into a pension over your lifetime (this was abolished in March last year). Additionally, you can now contribute up to £60,000 per annum (from £40,000) tax free subject to overall income levels. However, the shadow chancellor has already committed to reinstating the lifetime allowance, if the Labour Party are elected to power later in the year, thus creating uncertainty. Pension savings above the lifetime allowance can be taxed up to 55% so it has created a minefield for those with the option to contribute more. With the tax-free lump sum (PCLS) limit being maintained (£268,275) and the lifetime cap (£1,073,100) for lump sums passed on as inheritance if you die before the age of 75, the playing field doesn't appear that much simplified. The quandary of pushing your pension pot above the old lifetime allowance only for the allowance to be reinstated could be financially damaging. As pensions are a long-term planning vehicle it is important to have a degree of confidence.

With this uncertainty, the alternatives are to take up/top up existing ISAs, VCTs (tax free dividends) or insurance bonds (which allow for tax deferred 5% withdrawals for 20 years). So, if you are a client with multiple investment "wrappers" you could continue to save and switch to whatever investment "wrapper" is most tax efficient at the time. One other element to consider: pension tax relief costs the UK government £50bn per year and some argue it accrues mostly to the highest earners. Could a new government change the amount of tax-free lump sum to a lower value, say £100,000?

Inheritance Tax (IHT) – the missing element in the Autumn Statement…

There was a lot of "noise" in the run up to the Chancellor's Autumn Statement that IHT reform was pending, possibly even to be abolished. In the end any changes were omitted, potentially due to the negative press that could have been ascribed.

With that in mind, we looked at how the IHT allowances differ across developed markets to see if UK citizens are unfairly treated (in the eyes of some). The UK is one of the few nations that levies IHT on the estates of the deceased rather than the recipients of the inheritance. IHT was abolished in Australia in 1979 and 2004 in Sweden (which is known for its high taxes).

In the US the top rate of IHT is the same as the UK's, at 40%. But Americans can inherit more than £10 million before the tax applies. Italians also have a higher allowance at €1m, and anything above this threshold is taxed at 4%. On the other side of the coin, 10% of estates pay the tax in Germany and 48% in Belgium, whilst just 4% do so in the UK, according to the Organisation for Economic Co-Operation and Development (OECD). Even fewer people pay it in the US.

Spare a thought for the French however, where the tax is imposed on the recipient rather than the estate. The rates do depend on the relationship between the deceased and the beneficiaries and the sum being inherited. If you have no direct relationship with the donor, the allowance is €1,594 and the rate can be as high as 60%. For a direct dependent the allowance is €99,820 and then up to 45% above this allowance.

Perhaps a logical way to simplify the UK IHT rules is to scrap the nil rate and residential bands and replace them with a £500,000 allowance with no restrictions for those without children or no direct descendants.

I've been de-banked, get me out of here….

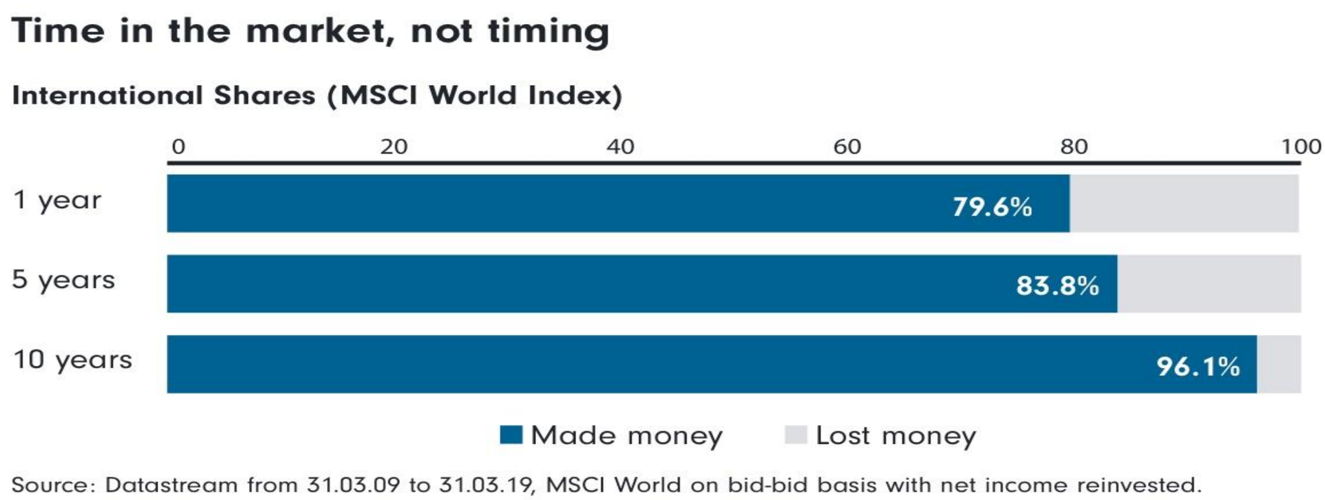
Nigel Farage has had an unusual year, despite eating all manner of Australian insects, he wasn't crowned King of the Jungle, but he did have a more challenging experience with his bank (Coutts) last summer. Farage claimed he had been excommunicated from his account due to his political views. Since this episode, it has come to light that this was not such an isolated episode. A recent Times article suggested that there are thousands of banking customers having their accounts closed down without reason. The regulator (FCA) has now launched an urgent review and the

Treasury have implemented short term measures including a 90-day notice period for any customer whose account is being closed down, with a full explanation as to why the account is being closed down.

So why do banks close down accounts? The most obvious reason is fraud. If a bank suspects a financial crime, it can close an account immediately. This can create a "marker" against your name on the national fraud database (CIFA). This can include unusual transactions, large sums leaving and re-entering an account over a short period, even if it's for legitimate reasons (house sale proceeds). You can also have your account closed down if you have a bad relationship with them (abusive language to bank staff) or if you are not profitable enough for the bank, especially if it's costing the bank to have you as a customer. More likely is if you have a poor financial history (failure to keep up with interest payments, fail to clear overdrafts in a timely manner etc.). However, in 30% of cases, accounts are being wrongly closed, leading to 25% of complaints being upheld by the ombudsman. The first point of call is to speak to your bank, then CIFA is you have a marker against you and then finally the ombudsman.

Why sometimes less can be more:

As we all know, from time-to-time, equity and fixed income markets go through periods of upheaval. This can be because of all manner of reasons: political, economic, war…the sharp falls that accompany these periods can lead investors to alter their long-term goals for near term behavioural reasons. However, more often than not, volatility is short lived and sometimes doing nothing can be the best outcome. By moving too quickly to sell assets, you may run the risk of missing out on seeing your portfolios recover from the falls and even grow in value. As you can see from the table below, the old investment adage: time in the market, not market timing is truly exemplified…



The chart above, when looked at over the longer term, suggests that the optimum strategy for an investor is to buy and hold investments. It also suggests to us that trying to time the opportune entry point into the market is extremely challenging. Sometimes it can be frustrating sitting on your hands, but it can also be the most rewarding over the long term.