McLaren
wealth management

Global Market Strategy – April 2021

Market switchover to value reinforces investment basics

Several events rocked the markets during March: a sudden spike in US 10 year Treasury yields due to the bond market refusing to believe the Federal Reserve can hold interest rates at current levels until 2023; a consequent rapid shift in sentiment from growth (technology with hoped-for earnings) to value (dividend payers with actual earnings and profits); finally, the collapse of a prominent hedge fund.

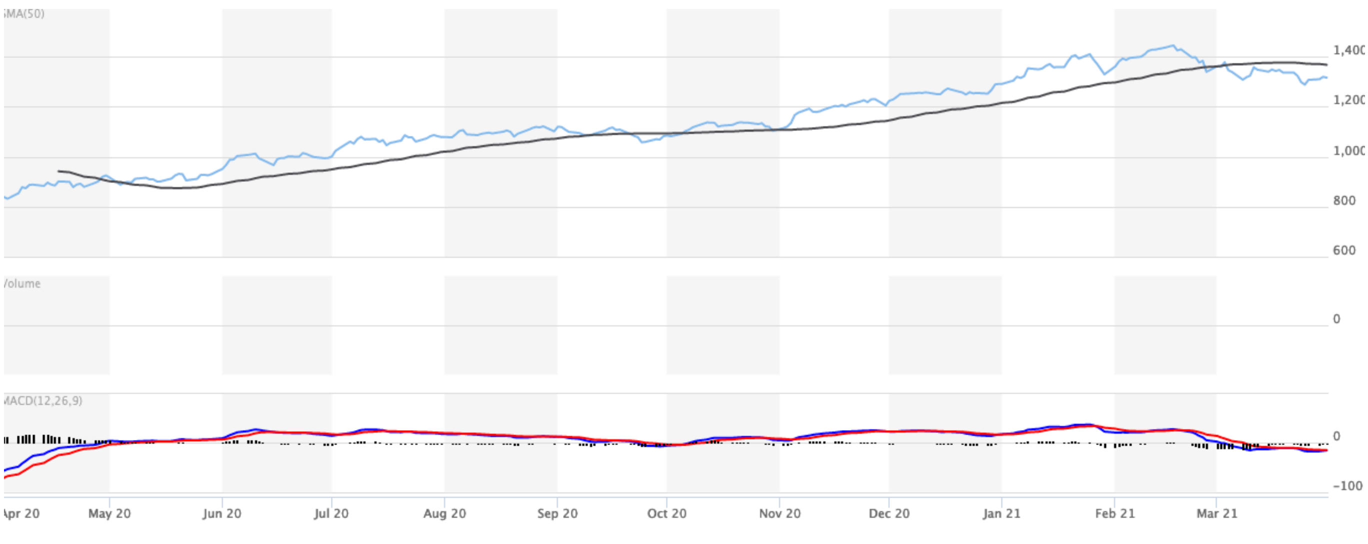
Archegos Capital had to go into liquidation late in the month after it faced margin calls on positions it took on certain Chinese stocks and ViacomCBS, the US media and entertainment company, through derivative trading (where stocks aren't actually owned but borrowed, or lent without owning). Such was the extent of the margin calls, a firesale of assets ensued, and banks Nomura and Credit Suisse which provided brokerage and lending resources to Archegos, have been particularly affected.

The trifecta of increased bond yields, a sell-off in tech stocks and a crisis of confidence caused by the collapse of a major stockmarket trading house, has seen many stocks fall by 10% or more since mid-February. As if the foregoing three factors were not enough, a rise in the dollar index, caused by rising Treasuries, has had an adverse knock-on effect on emerging market stocks.

The impact from Aechegos Capital's misjudged trading should have limited impact on the medium term picture which is: higher yields mean the prospect of faster growth, which should mean less unemployment, which means more consumer spending, which means higher corporate earnings, leading to higher share prices.

As a consequence of the pandemic, there is reckoned by Bank of America to be US$4 trillion in additional private savings because of the inability to spend over the last year. Of this amount $1 trillion is thought to be retained for long-term investment and retirement savings, probably finding its way into the stockmarket, but $3 trillion will be spent over the next 12-24 months across leisure, travel and the purchase of hard goods. The unleashing of capital spend is predicted to result in a US growth rate of 7% this year and 5.5% in 2022, with 99% of all spending via credit or debit card transactions.

The major player in the emerging market sector is China. China's market is heavily tech weighted, so with the dollar strengthening amid a switch from growth stocks to value, it is no surprise China has been hit heavily by the sector turnaround, yet this is another opportunity to buy China for long term growth. China's GDP is expected to grow at 8% this year, despite their central bank trying to move to a slower but steadier rate of growth. Emerging Market indices are down 8.73% since mid February, including China, and the rotation sell-off is providing a chance for investors to reposition ahead of what should be continued stockmarket gains in the second half of 2021 and the first half of 2022.



MSCI Emerging Market USD Index (blue line), plotted against the moving average (black line) - 12 months (Source: marketwatch.com)

The difficulty for investors in the current environment is that there is no safe haven when markets fall. Bonds are being sold in expectation of higher rates, and at the same time stocks are falling amid a fear of overvaluation.

US treasury bonds have had their worst quarter sell-off since 1980, yet 17 times since the start of the year the Dow Jones industrial index has hit all time highs. While the Dow and S&P have recorded new all-time highs during March, an index tracking Special Purpose Acquisition Companies (SPACs) - reverse takeover fund-raising vehicles for promising technology companies - fell 21% from mid-February to the end of March.

Even gold and silver have moved backwards amid a rising dollar. Only Bitcoin has survived [and thrived amid] the current turmoil pervading elsewhere; indeed Bitcoin is now taking trade away from gold.

Bitcoin (BTC) 1 month (Source: coindesk.com)

The UK household saving rate rose to a near record high in the final quarter of 2020, according to the Office for National Statistics (ONS), of 16% of disposable income, only marginally behind the record set during the second quarter of 2020.

As well as lending credence to the belief such pent-up savings will spur the British economy to rebound strongly in 2021 from the largest fall in gross domestic product ever recorded during 2020, the inability to spend their savings is causing something of a dilemma to those in later life with an inheritance tax liability.

Following the budget on March 5th, which had no good cheer for those hoping for a scrapping of **inheritance tax** - or even some relaxation of the nil rate band which has not changed from £325,000 per individual since 2009 - many face the prospect of 40% of their estate being taken by HMRC if they cannot find a way round it.

Few parents now can afford **school fees** out of post taxed income, so grandparents are increasingly stepping forward to make their capital available for their grandchildren's education, yet how best to do it? Frequently the grandparent will want to have an element of control of the releasing of their capital for school fees, rather than simply making a gift of capital to their children for them to manage.

Age	School year	Level	Indexation	Yearly cost	Total cost
5	Year 1	Junior / Primary		£ 13,812.00	£ 13,812.00
6	Year 2	Junior / Primary	3.40%	£ 14,281.61	£ 28,093.61
7	Year 3	Junior / Primary	3.40%	£ 14,767.18	£ 42,860.79
8	Year 4	Junior / Primary	3.40%	£ 15,269.27	£ 58,130.06
9	Year 5	Junior / Primary	3.40%	£ 15,788.42	£ 73,918.48
10	Year 6	Junior / Primary	3.40%	£ 16,325.23	£ 90.243.71
11	Year 7	Senior / Secondary	3.40%	£ 19,241.47	£ 109,485.18
12	Year 8	Senior / Secondary	3.40%	£ 19,895.68	£ 129,380.86
13	Year 9	Senior / Secondary	3.40%	£ 20,572.14	£ 149,953.00
14	Year 10	Senior / Secondary	3.40%	£ 21,271.59	£ 171,224.59
15	Year 11	Senior / Secondary	3.40%	£ 21,994.82	£ 193,219.41
16	Year 12	Sixth Form / Secondary	3.40%	£ 23,492.36	£ 216,711.77
17	Year 13	Sixth Form/ Secondary	3.40%	£ 24,291.10	£ 241,002.87

Average school fees cost if entering private education now (Source: Canada Life)

A gift into trust by the grandparents would be a Potentially Exempt Transfer for inheritance tax (IHT) purposes, requiring the donor to survive seven years from the date of the gift for the full amount to fall outside the estate. The table below shows how a gift of £200,000 could be invested in a 'single premium investment bond' (*not* to be confused with a bond as a debt instrument) which would have the capacity to provide partial payments as required to cover school fee payments, using the child's allowances (personal income tax allowance, the starting rate band for savings and the personal savings allowance, together totalling £18,570). Payments could be made in this way directly to the school from the trust via the trustees.

Year	Value	Fees	Policies required	Surrender value	Realised gain
5	£255,256	£15,634	6,125	£15,635	£3,384
6	£251,603	£16,165	6,032	£16,167	£4,103
7	£247,208	£16,715	5,940	£16,717	£4,836
8	£242,016	£17,283	5,849	£17,283	£5,585
9	£235,969	£17,871	5,760	£17,871	£6,351
10	£229,002	£18,479	5,673	£18,482	£7,136

Example of £200,000 invested @ 5% per annum assumed growth after charges (Source: Canada Life)

After the gift into trust has passed seven years, the saving from IHT would be £80,000 and in addition all growth would be outside the estate.

The Financial Conduct Authority places heavy emphasis on financial advisors to look for vulnerability in consumers. This means vulnerability resulting from bereavement, from divorce, from redundancy, from moving house, from physical or mental ailments, from external [social] pressure, and so on.

While perhaps the first thought is that vulnerability is something to which only older generations are susceptible, the real truth is that we are all potential victims of vulnerability at any stage of life, and in all likelihood it has taken the pandemic to highlight this and remind us that we are not indestructible and there is frailty in everyone. Let's hope the roll-out of vaccines allows us to return to freedom of movement again, albeit in new kind of normal.

Favoured investment plays:

Nil risk:
Cautious risk: Cash
Balanced risk: **Managed / Multi-asset funds**
Market risk: **Multi-asset funds, UK equity**
Adventurous risk: **Asia, Europe, Japan, US equity**,
Speculative risk: **Technology, Healthcare, Platinum, Emerging Markets**

Disclosure:

Nicholas Chappell has the following personal investment exposure (unchanged): Technology (all US, including green energy) 30%, China 11%, Asia 8%, Global Equity 21%, Pharmaceutical 1%, UK Equity 8%, European equity 5%, US Equity 2%, US smaller companies 1%, Emerging Market equity 9%, Platinum 2%, Japan 1%, Cash 1%