INVESTMENTS • ADVICE • PLANNING

Edition 34

Caves Quarterly

Summer 2024 newsletter

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CAVES WEALTH

CEO Welcome

Simon Harvey, CEO

The main focus of the last quarter has been the raft of democratic elections that have taken place across the globe. With the closely watched US election still to come, around 50% of the world population, across 70 nations will have selected their leaders during 2024.

The UK election delivered a landslide win for Labour, who, despite a relatively small share of the overall vote (c37%), now have a sizeable enough majority to deliver significant change. The early days of Kier Starmer's premiership certainly indicate that the pace of change will be rapid.

Despite ruling out several tax rises during this term (income tax, national insurance and VAT are off the table for now), others such as inheritance tax, capital gains tax and pensions could well be in the firing line for a government hoping to increase spending on public services.

Now more than ever, a review of your investment strategy and retirement planning could make financial sense. Our team of highly qualified advisers remain at your disposal.

Best wishes, Simon.

The full list of topics in this edition include:

Market Overview

As we cross the mid-year mark of 2024, the investment landscape proved a testament to resilience and opportunity. At the start of the year, most commentators anticipated rapidly falling inflation and central banks to embark on a series of rate cuts in response to weaker economic data.

However, the economy has defied the forecasts and inflation hasn't declined as quickly as expected. The global economy has remained remarkably robust.

Economists have marked up their 2024 projections for global real GDP growth from approximately 2.5% to 3% and lowered forecasts for the Federal Reserve's rate cuts from 7 to just 2. Policymakers and investors have come to acknowledge that the economy is resilient and over the longer-term, the potential economic impact of artificial intelligence (AI) could be substantial – even transformative.

1 Global Equities

Global equities have continued trending higher in the second quarter of 2024, although at a more measured pace than the first quarter with the MSCI World equity index returning c3%. The index is now up 12% for the first half of this year.

US stocks have performed well, underpinned by strong corporate earnings and the momentum of AI driven industries. The S&P 500 and NASDAQ 100 are up by around 4% and 8% respectively for the quarter (16% and 19% respectively year to date).

US 'mega-cap' technology stocks have led, with the three biggest companies (Nvidia, Microsoft and Apple) making up a staggering 21% of the S&P 500's returns. Intriguingly, US smaller cap and value stocks have performed poorly in contrast; hampered by relatively higher debt levels and lower cash balances in a world of higher bond yields. The US Russell 2000 'small-cap' index is barely changed year to date.

US investors have become increasingly exuberant as prices have risen. However, it is the extreme outperformance of growth versus value, and large cap over small, that has led some commentators to draw parallels to the irrationality of the technology boom of the late 1990's.

The same cannot be said of investor sentiment in Europe, as markets fell following President Macron's decision to call a snap election. Investors are concerned about potential populist spending plans, requiring more borrowing and higher debt. Domestic and politically sensitive equites fell over 10% (the CAC 40 is up just less than 1% year to date) and bond yields have remained elevated relative to those of their German neighbours (the DAX is up approximately 8% year to date). While concerns may be warranted, history suggests that the bond markets will curb any irrational fiscal policy, as was the case for Liz Truss in 2022.

UK stock markets continued to perform well in the second quarter, with the FTSE All-Share up by around 3% since March, making a gain of over 5% year to date. Several factors have helped drive gains, including an improving economy, a revival of M&A activity and a fall in inflation. The FTSE 100 is a truly global index with three quarters of its revenues generated outside of the UK. It has a high representation of commodity orientated sectors and those less sensitive to the domestic economy. Should there be another supply driven inflation problem, as was the case in 2022, we may expect the UK to be a standout global performer again.

Japan appears to be the most compelling proposition in Asia as we head into the second half of the year. The Nikkei 225 is up over 18% year to date. China's economy continues to face headwinds and, as the broader geopolitical backdrop looks increasingly fraught, Japan stands out for its relative stability. Japan appears on the cusp of defeating its entrenched deflationary spiral and its economy looks to be 'normalising' at long last.

It is undergoing corporate governance reform, is less reliant than other Asian economies on Chinese demand and is an important player in the semiconductor supply chain. For the first time in 30 years, Japan's nominal growth has outpaced China's.

2 Fixed Interest

Investors have spent 2024 fixated by the timing of interest rate cuts. This has required a focus on not just the economic situation and inflation data but also on the policy makers themselves.

In clear admission of their lack of clairvoyance, central banks have become highly 'data-dependent' and hence reactionary. Unfortunately, both inflation and employment (key metrics focused upon) are lagging indicators as are central bank policy tools. This approach would appear to be a recipe for a policy mistake if inflation does not behave as expected over the coming months.

Delayed rate cuts have meant an extended opportunity for fixed income investors to lock in some attractive yields. Short-term, low coupon conventional Gilts in the UK have offered higher and additional rate taxpayers an inviting home. Investors are being paid to wait with income yielding above inflation.

Outside the US a global rate-cutting cycle is underway. Rate cuts in emerging markets started in the second half of last year and have gathered pace. In the developed world the Swiss National Bank fired the starting gun in March 2024 and the Bank of Canada and European Central Bank in June. The interest rate backdrop appears to be shifting.

3 Commercial Property

In the UK, we saw mixed updates from REIT's reporting their net asset values (NAV) in May.

Most diversified commercial property funds have seen further portfolio valuation declines, as office exposures have continued to drag on performance. Conversely, UK care homes and social housing assets have increased in value, driven by inflation-linked rental uplifts, whilst industrials/logistics segments remain generally in favour. More positively, May saw the REIT benchmark return 5.5%, compared with 2.4% for the FTSE All-Share and 0.8% for Gilts. There appears to be appetite from investors for current NAV discounts (and prospective dividend yields) and this may support prices going forward.

4 Alternatives

Gold has continued to rally in the second quarter of 2024, up 12% year to date. The precious metal, and its cousin silver, have seen notable gains on the backdrop of increased geopolitical risk, higher inflation expectations and concerning debt dynamics. Given positive real rates and higher bond yields their price appreciation perhaps should be of concern to investors.

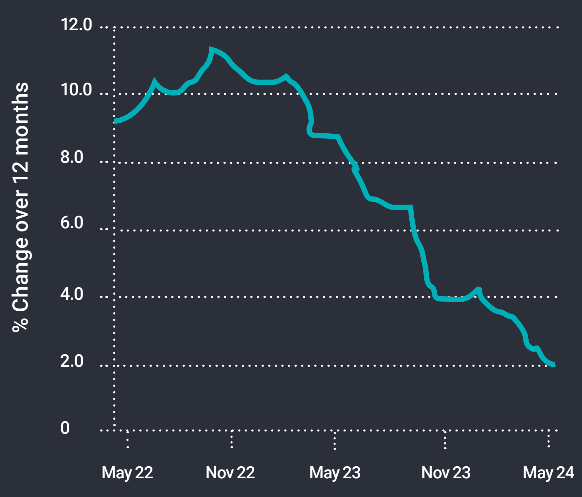
As an asset class, commodities continue to remain a large underweight in most investment portfolios; this despite offering portfolio diversification and a hedge against inflation. A selected basket of both hard and soft commodities has returned close to 9% this year. While the precious metals complex is due a well-earned rest over the coming month, following a strong technical breakout this year, it seems likely that the metals will see higher prices in the second half of the year as geo-political concerns persist.

5 Outlook

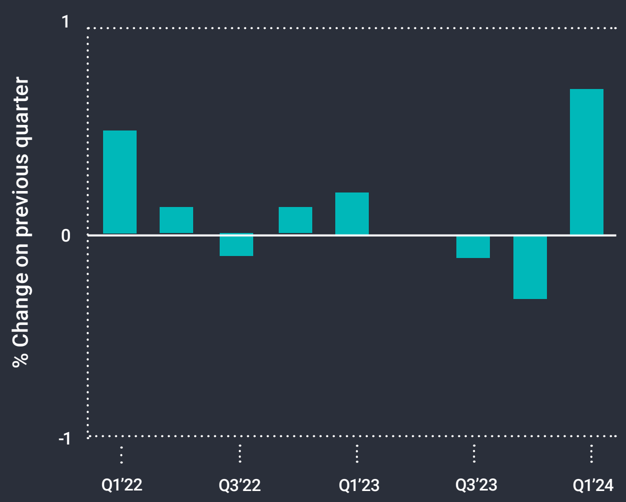
The global economy appears remarkably solid thus far in 2024. Companies have shrugged off higher interest rates, earnings are poised to grow and labour markets appear to have found some equilibrium.

Equities have climbed the proverbial 'wall of worry' since 2023, but it is imperative that we don't become complacent. The world is clearly at an important juncture. Escalating global and regional conflicts have the potential to undermine any economic recovery, as do the outcomes of developed and developing countries' elections in the second half of the year. Yes, we have higher growth, higher equity valuations and bond yields; but we also have higher inflation, geopolitical risks and potentially rising taxes. The key to navigating the remainder of the year appears to be a balanced approach, hedging against potential risks while remaining open to the opportunities that arise.

UK Consumer Prices Index (CPI)

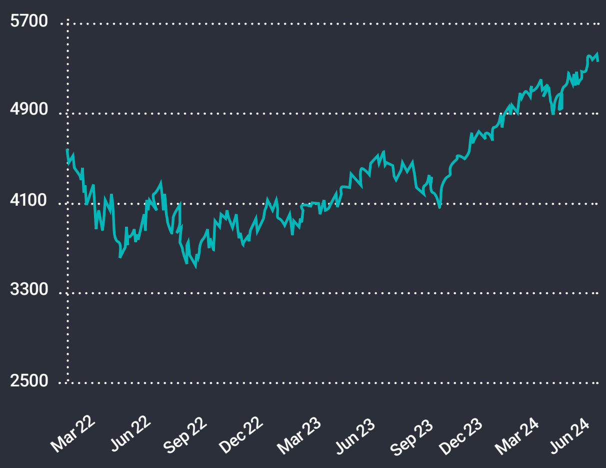


UK Gross Domestic Product



FTSE 100 Index

S&P 500 Index



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Keeping something in reserve?

It pays to expect the unexpected, particularly when it comes to your finances — so a rainy-day savings fund can make all the difference.

Setting aside money can be challenging, but a reserve fund offers long-term benefits in a range of circumstances, from unexpected expenses to a drop in income due to redundancy or ill health. The link between financial well-being and mental health underlines the importance of building some kind of resilience into your planning. A financial cushion lets you manage budget shortfalls without borrowing or tapping into other investments or pension funds.

Private pensions can be accessed from age 55 (rising to 57 from 2028) but withdrawing funds early can have downsides: you might sell investments during a market downturn or incur tax charges, and future pension contributions could be restricted. Having a back-up savings fund means these retirement savings and pensions can stay invested for the longer term, maximising growth opportunities.

Easy access

Rainy-day savings for emergencies should be in an instant access account. Using a cash ISA means all interest is earned tax-free. On ordinary savings accounts basic-rate taxpayers can earn £1,000 in interest a year tax-free, with higher-rate taxpayers' tax-free interest set at £500; beyond this interest is taxed at the saver's marginal rate. With rising interest rates, more savers might face tax on savings interest, making cash ISAs more appealing. The annual ISA allowance is £20,000, shared across all ISA types.

As a rule of thumb, you should aim to build funds through regular savings that would cover your usual expenses for six months.

This Information represents our understanding of current law and HM Revenue & Customs practice as at July 2024. Tax assumptions and reliefs depend upon an investor's particular circumstances and may change if those circumstances, or the law, change. You are recommended to seek professional regulated advice before taking any action. Tax and Estate Planning Services are not regulated by the Financial Conduct Authority.

How comfortably will you be able to retire?

You may need to review your retirement planning after updated figures show some increases of over a quarter for retirement income needs.

Source: Pensions and Lifetime Savings Association, February 2024

How much income do you need in retirement?

If you find yourself struggling to answer this question, you are not alone. It is never easy to calculate as each of us has our own ideas about what we want from retirement. A study by the Pensions and Lifetime Savings Association (PLSA) has shown that 77% of savers did not know how much they would need, while only 16% could provide a figure.

Since 2019, research by Loughborough University for the PLSA has regularly addressed the "how-much?" question by considering three different retirement living standards, defined as:

- **Minimum**: Covers all your needs, with some left over for fun.
- **Moderate**: More financial security and flexibility.
- **Comfortable**: More financial freedom and some luxuries.

These categories are used to review spending across six broad areas, ranging from housing to helping others. They are costed separately for single people and couples and for London residents and those living elsewhere in the UK. For example, under the heading of holidays and leisure, the three standards currently assume:

- **Minimum**: One week-long UK holiday.
- **Moderate**: A fortnight 3* all-inclusive holiday in the Med and one long-weekend break in the UK.
- **Comfortable**: A fortnight 4* holiday in the Med with spending money and three long-weekend breaks in the UK.

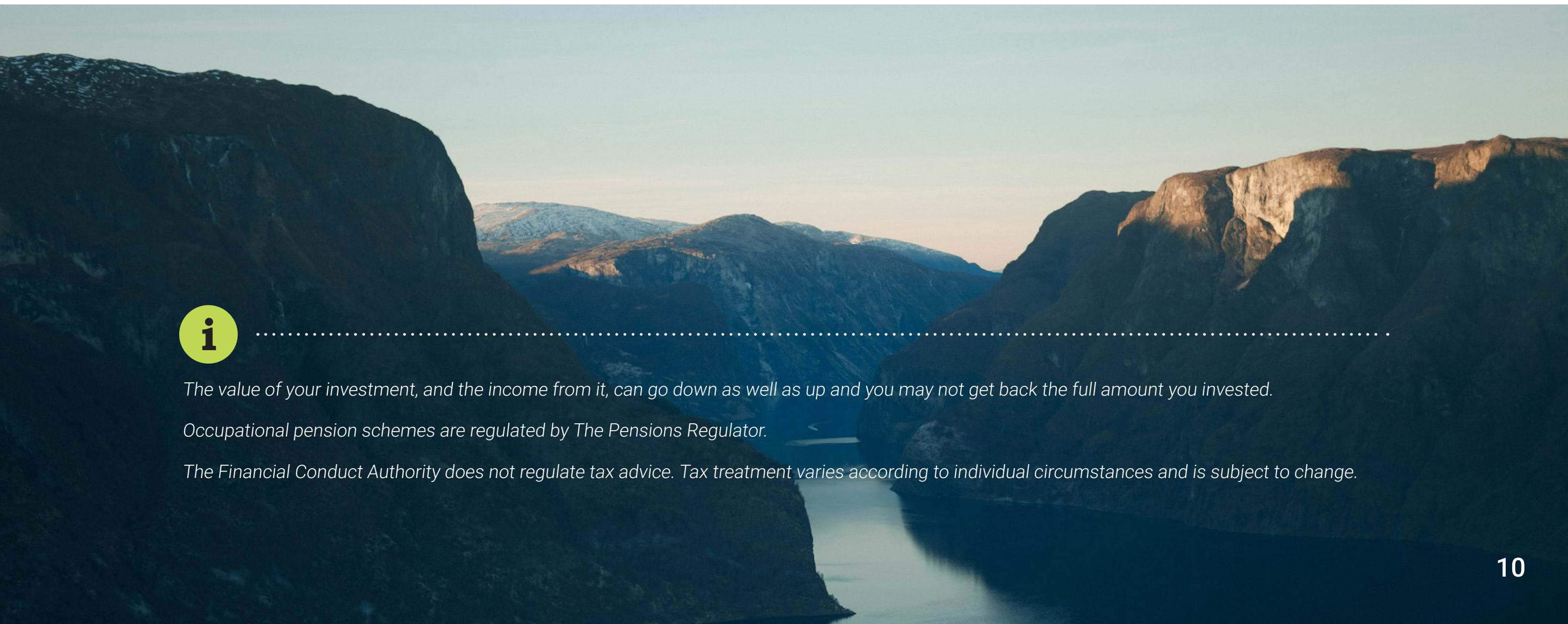
The yearly income requirements for each standard are net, which means at the higher levels tax is a significant factor. For instance, the £45,000 of net income required to provide a comfortable retirement for a single person living in London equates to a pre-tax pension income of over £54,000.

This year's update revealed a 26.8% increase in the income needed for a couple based outside London to enjoy a moderate living standard. For a single person, the rise was even greater – 34.3%. The PLSA attributes the jump to two main factors:

- Disproportionately higher food, household energy and motoring costs.
- What the PLSA described as "changes in the expectations of what should be included".
  For example, the latest research revealed that being able to give financial support to family members has become more important.

The current State pension of £11,502 is not even enough to cover the minimum retirement standard for a single person, although if a couple both have a full entitlement, it might just be sufficient – outside London. And, as has been the source of many complaints from the Women Against State Pension Inequality or WASPI group affected, the State pension does not now start until age 66 (rising to 67 from April 2028).

If you aspire to the Mediterranean fortnight rather than seven days of UK weather; or even hope to finish work before your State pension arrives, you need to accumulate sufficient personal retirement funds. Typically, that begins by assessing what you have already built up and then working out how much extra is required by the time you retire. Like the difficult question about retirement income, it is a set of calculations best left to experts.



The value of your investment, and the income from it, can go down as well as up and you may not get back the full amount you invested.

Occupational pension schemes are regulated by The Pensions Regulator.

The Financial Conduct Authority does not regulate tax advice. Tax treatment varies according to individual circumstances and is subject to change.

Time to check in with HMRC?

Freezes and cuts to tax allowances mean that you may have something to report to HMRC.

Source: HMRC, OBR

A recent report from the National Audit Office (NAO) was highly critical of HMRC, noting that in 2022/23 its 'customers' (that's you) spent the equivalent of 798 years on hold, waiting for an HMRC adviser to answer their call. As bad, only 53% of calls were eventually answered by an adviser.

Unfortunately for HMRC and its 'customers', matters are likely to worsen due to a combination of:

- The continued freeze in the personal allowance and higher rate tax threshold (both unchanged since April 2021).
- The two consecutive reductions in the dividend allowance and capital gains tax annual exempt amount.
- Higher interest rates: a personal savings allowance frozen since April 2016 leaves more savers having to pay tax on their interest.

If you are already within the self-assessment regime, then the extra tax liability will normally be dealt with via your tax return. However, if you (or your accountant) do not file a self-assessment return, things become more complicated.

What you cannot do is ignore the situation and assume that if HMRC does not contact you then you have nothing to worry about. If you have a tax liability, the law says you must pay it. Remember that HMRC automatically receives records of interest paid to you (from onshore accounts and, in nearly all cases, offshore accounts) as well as your earnings if you are an employee.

Stay silent and you may eventually receive a probing letter from HMRC. The end result could be that interest and penalties are added to overdue tax…and HMRC makes you a five-star customer, worthy of close attention!

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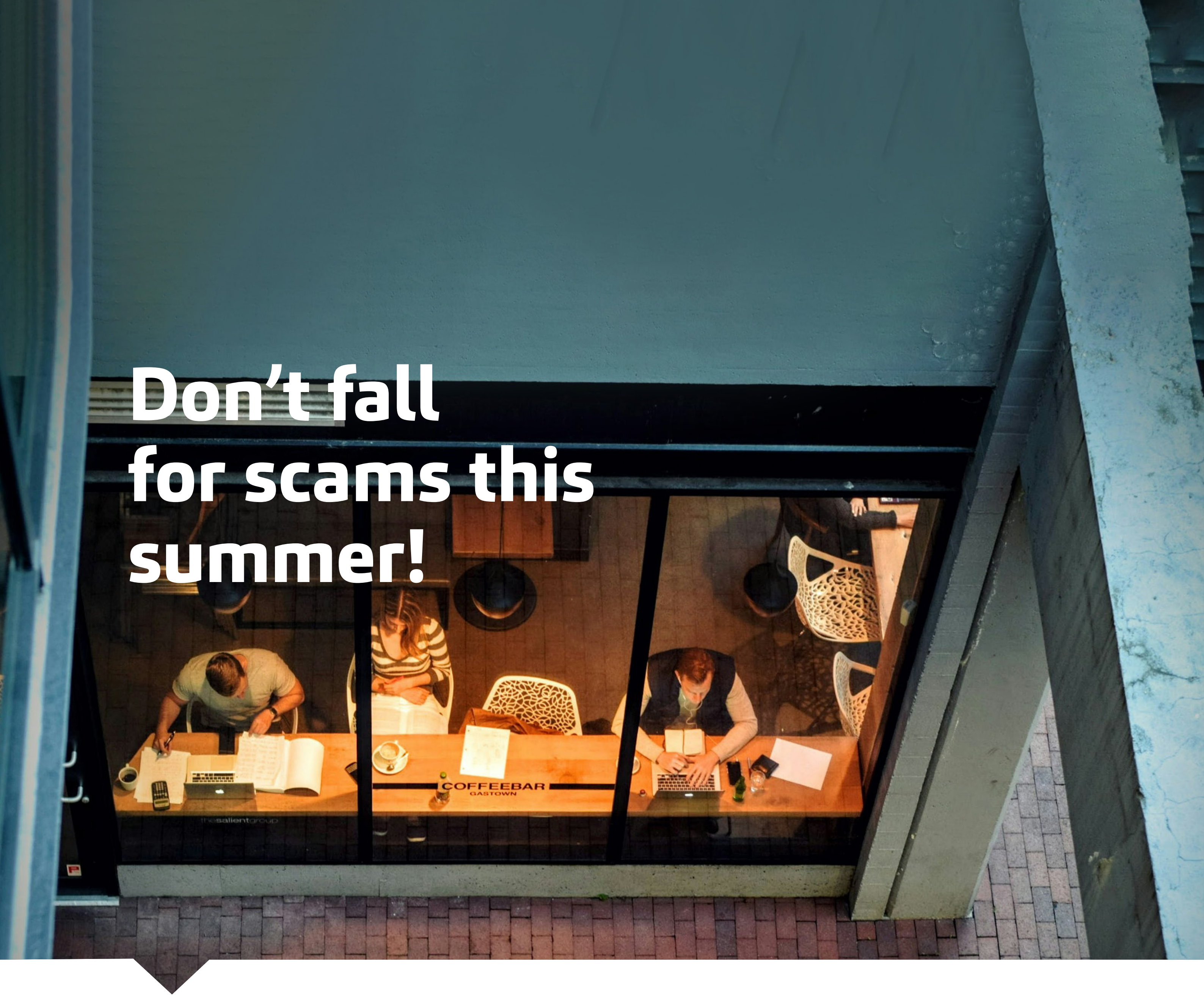

Don't fall for scams this summer!

Make sure your finances don't get burnt this summer, as fraudsters set their sights on unwary holiday makers. Action Fraud, which aims to prevent scams and cyber-crime, says sun-seekers lost £12.3m last year from targeted frauds, with the average loss being £1,851.

It isn't just holidaymakers who need to be on their guard. Financial scams are rife, with fraudsters targeting bank accounts as well as pensions and savings. Phishing scams are among the most prevalent — where emails or texts are sent out, purportedly from a trusted company, encouraging people to disclose personal or financial details, or to visit a website which can download a virus onto their device to harvest further data.

Investment scams are also common; with these fraudsters convincing people to transfer pensions or other savings into schemes promising enticing returns.

Of course, these too-good-to-be-true investments turn out to be just that. At best, they are high-risk, unregulated investments where there's a strong chance that savers will lose money. At worst, they are pyramid schemes, where the money simply lines the bank accounts of the criminals targeting unwary investors.

Hundreds of people fall victim to financial scams every year. Last year over 800 people contacted a dedicated helpline set up by The Money and Pensions Services (MaPS), with losses totaling £13.6m, an average of £16,297 per caller.

There are steps you can take to help protect yourself though. Before putting money into any investment or pension product run the details through "ScamSmart" investment checker. Remember the golden rules: never be rushed into making a financial decision and be extremely wary of any third party contacting you. And finally, don't forget that if a deal looks too good to be true, it probably is.

ScamSmart is an FCA campaign For further information, visit:
fca.org.uk/scamsmart
fca.org.uk/consumers/protect-yourself-scams

The cost of long-term sickness

If you are or become ill, state support remains minimal.

In a speech on welfare in April, the previous Prime Minister attacked the UK's "sick note culture", observing that a record 2.8 million people were off work with long-term illness. He proposed that sick notes (strictly "fitness to work" notes) be replaced with fit notes, issued by health and work specialists rather than doctors.

In the run up to the pandemic, the long-term sick population was fairly stable at 2.0 million. The significant jump since then has added to government expenditure. However, as many people discovered at the time of COVID-19, sickness benefits are far from generous:

1. If you are an employee, statutory sick pay (SSP) is £116.75 a week, payable from day four of sickness for the first 28 weeks off work. Your employer may also provide sick pay but is not required to do so.
2. If you are self-employed, you do not qualify for SSP but must claim Employment and Support Allowance (ESA), which is also available to employees once their SSP payments cease. For a couple, the basic rate is generally £142.25 a week, to which there may be various additions. For a single person, the corresponding figure is £90.50.
3. If either of these payments is insufficient to cover your living expenses, then the next port of call is Universal Credit (UC). However, this is unavailable if you (along with your partner) have savings of more than £16,000. Pass that hurdle and the assessment still takes account of your partner's income.

Were you to become unable to work through illness, would you and your family be able to cope on what the State provides? If the answer is no, or not for long, then talk to us about your income protection options now to put safeguards in place.

Basis year now means tax year

Are you aware of the changes to the way your profits are taxed if you are self-employed or in a partnership?

An old trick of Chancellors who cannot raise tax rates but need more revenue is to accelerate the payment of tax. The latest example was announced in October 2021 with the claimed objective of creating "a simpler, fairer and more transparent set of rules for the allocation of trading income to tax years". As usual, such a promise should be treated with caution.

The change, which has now come into effect, means that for 2024/25, if you are self-employed (or a member of a partnership), you will generally be taxed on the profits made between 6 April 2024 and 5 April 2025. If your business's accounting year is different and its year end is not between 31 March and 4 April (all treated as 5 April), then generally:

- For 2024/25 you (or your accountant) will need to apportion two accounting periods to arrive at profit based on the tax year.
- For 2023/24 you will be taxed on:
  - The profit for your accounting period ending in that tax year plus.
  - The profits you make from the end of that period to 5 April 2024, calculated by apportionment.

The acceleration in 2023/24 is subject to two special treatments for the apportioned profits:

- They can be reduced by any overlap relief you have from earlier years.
- The apportioned profits less the overlap relief can be spread over a period of up to five tax years, with a 20% minimum applying for 2023/24.

Managing a higher tax bill

The extra taxable income could drag you into a higher tax band or mean that your personal allowance becomes subject to tapering. However, you may be able to gain more tax relief by making pension contributions that offset some or all of the additional profit. For more advice on this and other planning opportunities created by the reform, please contact us.

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Elections 2024 – what's next?

Beware of knee-jerk reactions – the dust needs to settle. General elections have been taking place around the world in 2024, from Algeria to Venezuela (via Tuvalu).

Polls defined the UK's vote as a foregone conclusion, though the race in the US seems far from being clear cut, particularly given recent speculation regarding President Biden's health.

There will be no budget before at least mid-September, Labours' Chancellor Rachel Reeves has ruled out a summer budget because she wants a full report from the Office of Budget Responsibility (OBR) first.

The OBR requires ten weeks' notice to crunch the numbers, leaving only a small gap before party conference season begins.

Hold off on big decisions

Labour must also prepare a spending review, theoretically running for three years from April 2025. That review needs to be published by November. It is possible that there could be an interim one-year review, to give the new government more time to settle in and develop its spending plans. Consequently, the significant budget may not be in the autumn, but next spring.

Those timings reinforce a lesson from many past elections: hold off taking rushed investment decisions based on initial results and reactions. The picture should be much clearer later in the year.

New tool for missing NICs

The government has launched a new web tool that allows people to check if there are gaps in their national insurance record, and 'buy back' missing years, to ensure they qualify for the full State pension.

The 'Check your State Pension' tool is available via gov.uk or on HMRC's app. Normally people can only make voluntary payments for the previous six years, but until April next year there is the opportunity to buy back years as far back as April 2006.

Under the new flat-rate State pension, introduced in 2016, people need to have paid NI payments for at least 35 years to get the full amount, currently worth £221.20 a week. The exact number of years depends on age, but this new tool shows people how many years they've paid to date, how many years they have missed, and what effect buying back additional years will have on their future pension entitlement.

News Round Up

"Footsie" reaches new highs

The FTSE 100 index hit a series of new highs in May, all comfortably above the 8,000 level. Nevertheless, by most measures the UK stock market still looks relatively cheap. For example, in mid-May the FTSE 100 had a dividend yield of 3.56% and a price/earnings ratio of 14.36, while the US S&P 500's corresponding numbers were 1.43% and 27.56.

Annuities regain popularity

Data from the Association of British Insurers shows that in 2023, pension annuity sales jumped by 46%, taking them back to the level of 2014 before pension flexibility was introduced. Annuities' new popularity reflects the more attractive rates on offer, thanks to the rise in long-term interest rates.

Interest rate cut hopes recede

At the start of 2024, the expectation was that the Bank of England would cut rates six times (to 3.75%) by the end of the year. By May, the experts were penciling in two cuts by December, although the IMF thinks there could be three. The changed outlook reflects continued inflation risks, even with the CPI inflation yardstick hitting 2% in May. One worrying factor for the Bank of England is earnings growth, still at around 6%.

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