INVESTMENTS • ADVICE • PLANNING

Edition
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Caves Quarterly

Autumn 2024 newsletter

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CAVES WEALTH

CEO Welcome

Simon Harvey, CEO

The last quarter has been dominated by domestic considerations, with the focus having been on the first 100 days of the first Labour administration in nearly 15 years following their landslide election victory, and feverish speculation about a budget presaged to contain its fair share of 'difficult decisions' to help the Treasury plug a supposed £22bn black hole in the public finances.

The next three months, however, are likely to be dominated by more of an international focus. Granted, the 30th October 'Halloween' budget will garner much attention and we cover more on this potentially 'scary story' inside this edition. However, The US election and the escalation of hostilities in the Middle East could also play a significant role in the way global economies and investment markets behave as we run up to the end of the year. Globally, interest rates have also begun to fall, and time will tell if central banks have successfully cooled inflationary pressures without tipping their economies into recession. Thus far the signs are promising, but the 'Goldilocks' economy (not too hot, not too cold) is notoriously difficult to achieve. A full assessment of global investment markets is inside.

Whatever happens to geo-politics, global markets, interest rates and post-budgetary taxation, there is no doubt that professional advice can be invaluable. Our team of highly qualified advisers remain at your disposal.

Best wishes, Simon.

The full list of topics in this edition include:

Falling leaves and rising risks

As the northern hemisphere summer gives way to autumn, the drivers of a rise in hard-landing recession risks remain. The third quarter of 2024 saw a deterioration in the global manufacturing cycle and increasing signs of fragility in the US Labour market.

Leading indicators, such as the new orders components of the ISM manufacturing survey, the Eurozone, and Caixin Chinese PMI's all deteriorated. In Europe, the automotive sector also weakened in what is a macroeconomically significant industry for the region.

Meanwhile, risks increased in the US labour market. The breadth of job growth across sectors narrowed to levels which are of concern. Job openings in the private sector also fell, as did consumer confidence in the labour market.

On September 18th the Federal Reserve (Fed) decided to cut interest rates by 50 basis points. This was the first rate cut since 2020, and was indicative of the weakening data, as well as the easing of inflation, which dropped closer to its 2% target.

In absolute terms the indicators were not disastrous, and so the Fed's decisive move was made with little data backed certainty. However, waiting for further weak data to appear before acting is often too late, so in being proactive rather than reactive, the Fed maybe have staved off unnecessary economic pain.

1 Global Equities

In the first half of 2024 we saw US stock market appreciation but with historical extremes of concentration. 'Large-Cap' technology companies such as Nvidia, Microsoft and Apple made up a notable proportion of overall market returns.

Broadening market participation is often the sign of an evolving bull market, demonstrating underlying strength in the economy, as multiple sectors and industries experience growth simultaneously. More recently we have seen an improvement in market breadth, and this has not just been confined to US stock markets.

Interest rate cuts have prompted investors to seek out smaller companies (due to the cheaper cost of financing growth) and those that offer value relative to some of their more expensive technology peers. At the time of writing the MSCI World Equity Index is up around 0.5% in sterling terms over the last 3 months, and the US Smaller-Cap Index (Russell 2000) is up 2%. Conversely, the US Technology Index (Nasdaq) is down close to 4%.

Of course, an overall appreciation in equities over the period does not mean that all regions have fared well; nor does it mean that the journey has been straightforward.

In early August we saw an aggressive unwinding of the Yen carry trade. Since the 1990's investors have been borrowing Yen cheaply to invest in higher yielding or more attractive growth opportunities abroad. The Bank of Japan's decision to raise interest rates meant that this opportunity became less attractive, and it contributed to a dramatic sell-off in global markets, which were already extended from their averages. Given the size of the positioning in this trade, it is expected that it may unwind over many years and will likely be a big contributor to market volatility going forward.

Japanese equities themselves continued to perform relatively well over the period, returning close to 2%. The Nikkei had an excellent start to the year buoyed by investor optimism over a 'normalising' economy (breaking from its extended deflationary spiral) and corporate governance reform. However, while rising rates are indicative of an improved economic outlook, they can also be detrimental to Japanese exporters who become less competitive or incur higher currency hedging costs.

The UK stock market was a beneficiary of the broadening investor appetite, as investors looked for smaller capitalised, high yielding and cheaper assets to own. The FTSE 250 returned 3% over the quarter.

The UK market has been out of favour for several years, but the combination of strong economic momentum (currently the fastest growing economy in the G7), rate cuts, companies performing well, low valuations and notable M&A activity of late, all hint towards a nascent process of the UK stock market returning from the wilderness.

Investors found little appetite to allocate to asian, specifically Chinese, equities during the period. That is until the end of September when the People's Bank of China (PBOC) decided to launch a series of stimulus measures to bolster the economy. If there had been any doubts as to the lengths Beijing would go to revive its economy, then they were answered. The package involved lower rates, lower reserve requirements for banks and direct support for the stock market and mortgages. The market's reaction showed an investor thirst for any semblance of 'we got this' assurance from the government. The Hang Seng Index rallied by over 4% (the biggest one-day percentage gain in more than 2 years).

European equities dependent on Chinese demand recovered substantially in reaction to the PBOC stimulus measures. Investor appetite for european equities has waned on a relative basis of late due to political uncertainty and a lack of momentum in technological innovation. However, the ECB has lowered rates twice since June and stocks might be attractively valued if earnings recover in line with the economy. The Euro Stoxx 50 has, to date, lost 0.6% over the quarter.

2 Fixed Interest

The high inflation and aggressive rate hikes of 2022 and 2023 negatively impacted fixed income's traditional role in portfolios as a diversifier to equity risk.

However, of late, the focus for bond investors has shifted from high inflation to downside growth risk. Should inflation continue to be more manageable going forward (Fed Chairman, Jay Powell, believes this shift to be multi-year) then fixed income may regain its traditional asset class correlations.

Corporate credit and high yield have continued to outperform government bonds in 2024, contrary to investor expectations. Corporate balance sheets have remained strong, due to refinancing at attractive rates post-COVID, and companies with pricing power have benefited from the inflationary backdrop.

Credit spreads have tightened, reflecting the lower perceived risk of corporate debt and confidence in the economy.

The US yield curve recently steepened and went back into positive territory. The curve inverted in July 2022 and has been a hot topic of debate since. A positive yield curve is what we would expect to see in 'normal' economic environment as investors get paid higher yields to compensate for the increased risk and uncertainty of time. However, it should be noted that inversions of the curve usually lead recessions, suggesting we may not be out of the woods yet.

3 Alternatives

Gold has been one of the best performing asset classes of 2024, and it continued to rally this quarter, finishing up approximately 7% in sterling terms.

Investor appetite for the metal has been unrelenting, fuelled by concerns over the weakening economic data and a backdrop of notable geopolitical risk, with global central banks among the biggest buyers this year.

Over the last 20 years, gold has proven itself to be a genuine diversifier, with extremely low correlations to both equities and fixed income and can be used as an excellent hedge against inflation shocks. As an asset class, commodities continue to remain a large underweight for most investors, but this may not continue to be the case should geopolitical and supply chain risk move to the forefront of investor minds.

4 Commercial Property

The global REIT market has, thus far, had a strong quarter returning 9% in sterling terms.

Surprisingly though, investors remain as underweight the asset class as they were in 2008. The fundamentals appear to be far stronger currently and interest rate rises are seemingly in the rear-view mirror for now. Over recent years, high raw material and financing costs have led to historically low levels of supply and so rental growth could surprise to the upside going forward in sectors such as data centres (digitalisation), residential (generation rent), healthcare (ageing demographics) and logistics (e-commerce).

5 Outlook

The economic data indicates that a soft-landing (where the economy slows down just enough to curb inflation without falling into recession) is most likely.

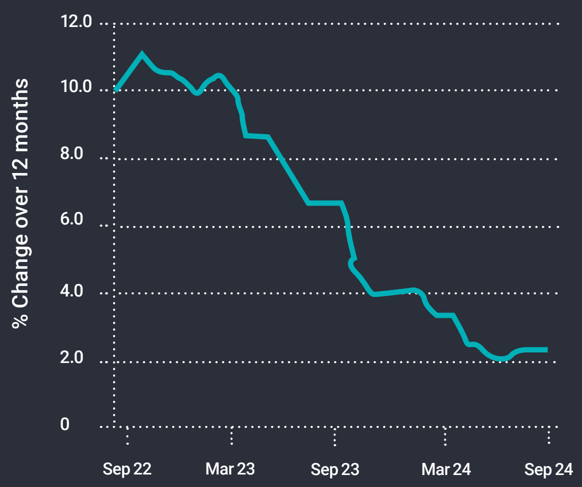
However, as Oasis declared in the title of their 1994 debut album, it's 'Definitely Maybe'. This is because although inflation is declining, recession risks still appear more elevated than normal due to potential lags in the impact of the Fed's 2022-23 rate-hiking campaign.

Importantly, the Fed has started easing before definitive signs of economic stress have emerged. The question for investors, however, is whether the Fed can lower rates back to normal levels while stabilising the economy. This is arguably the most important post-pandemic test for the central bank, and it appears that the labour market will be a key watchpoint going forward.

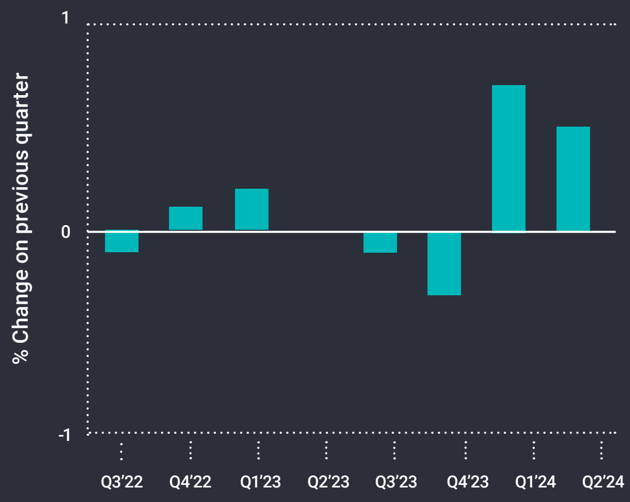
Broadening equity market participation and tightening credit spreads could point to a healthier and more sustained bull market ahead for equity investors. However, risks (both geopolitical and economic) appear to be rising; gold's multi-year breakout has been decisive and might be the "canary in the coalmine."

As evidenced during August's 'flash-crash', equities can go down as well as up and investors should remain alert to the potential for significant volatility during the remainder of 2024.

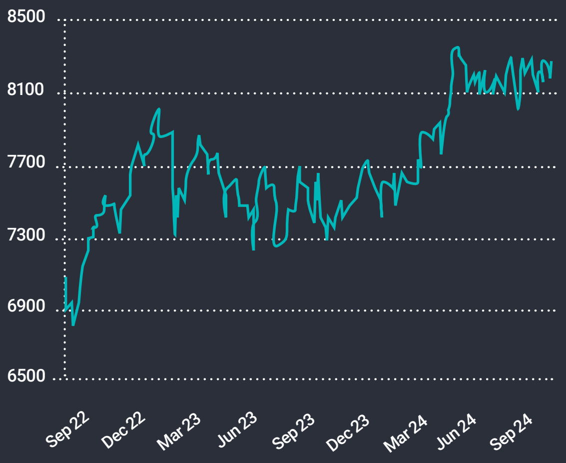
UK Consumer Prices Index (CPI)



UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index

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The missing element in pensions change

Promised adjustments to pension law are missing a key element: increasing minimum contribution levels.

The first King's Speech of the new parliament included a Pension Schemes Bill, largely dealing with administrative matters, such as automatic consolidation of pension pots. What was absent from the bill was increasing the minimum level of automatic enrolment contributions, which would do more to improve retirement prospects.

At present, for an eligible employee, the minimum contribution is set at 8% (3% employer minimum/balance paid by employee) of annual earnings between £6,240 and £50,270. There is widespread agreement among pension experts that current contribution levels are too low. The last government accepted this and introduced legislation giving it powers – so far unused – to reduce both the minimum age and lower level of qualifying earnings.

The Financial Times recently reported that a group of "eight financial services veterans" had sent a letter to Rachel Reeves recommending that the minimum percentage rate should increase by 1% per year until it reaches 15%.

The Chancellor, like her predecessor, is in a bind on contribution increases. Someone will have to pay, which means annoying employers and/or employees when the impact of recent high inflation is still being felt. Raising contributions also hits the Exchequer's coffers because of tax relief given to contributions.

If you want to ensure a comfortable retirement, talk to us now about how much more you could be putting in your pension.

This information represents our understanding of current law and HM Revenue & Customs practice as of October 2024.

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

Occupational pension schemes are regulated by The Pensions Regulator.

A pre-Halloween scare? Looking ahead to the Autumn Budget

Rachel Reeves' first Budget will be on Wednesday 30th October.

"I have to tell the House [the] Budget will involve taking difficult decisions to meet our fiscal rules across spending, welfare and tax."

The Chancellor's 'Public Spending: Inheritance' speech to parliament in late July was designed to prepare taxpayers for changes to come, revealing "a £22bn hole in the public finances." The new Chancellor took immediate action to start filling the hole, including ending road and rail projects and all non-essential spending on consultants.

There were also two notable expenditure-saving measures:

1. An immediate end to Winter Fuel Payments in England and Wales, other than for pensioners receiving certain means-tested benefits. (Scotland subsequently followed suit.)
2. The abandonment of the scheme to cap care home fees in England, previously due to start in October 2025.

The next stage of strengthening the government's finances will be unveiled in October's Budget. So where might the Chancellor find some cash?

The not so usual suspects?

Her party's manifesto said "Labour will not increase taxes on working people, which is why we will not increase National Insurance, the basic, higher, or additional rates of Income Tax, or VAT." That sentence appears to rule out the main revenue sources although, as the previous government demonstrated, a 'rates' pledge leaves scope for creativity elsewhere. The relevance of the manifesto's reference to 'working people' was made clear by the surprising welfare cuts that primarily hit pensioners.

Likely targets appear to be:

Capital Gains Tax (CGT): The Labour manifesto made no mention of CGT. Several think tanks and the now defunct Office of Tax Simplification have floated the idea of bringing CGT rates in line with income tax, meaning that the maximum rate in most circumstances would rise from 20% (24% for residential property) to 45%.

Inheritance Tax (IHT): There are some obvious targets to add to Treasury receipts in this area. Business and Agricultural reliefs mean that the average effective tax rate on the largest estates is lower than that on more modest estates. Scrapping those reliefs, or capping their value, is a possibility which would affect only a few estates, but could produce meaningful extra revenue.

Another exemption that could disappear – and affect many more people – is the current general exclusion of pension pots from IHT calculations.

Tax relief on pension contributions: Right now pension contributions attract tax relief (within limits) at your marginal rate of tax. That can be as high as 60% (67.5% in Scotland) in the income band where the personal allowance is tapered. Replacing the marginal rate relief with a flat rate relief is a commonly suggested reform. If Reeves chose a 30% flat rate, most taxpayers would benefit and the Exchequer would gain an estimated £3 billion a year.

If you would like to discuss your financial position and what impact the changes announced on 30th October 2024 may have on you, please do get in touch.

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Interest rates take a step down

As the Bank of England cut interest rates for the first time in over four years, what are the implications for your investments?

The Bank of England did something this summer unseen since 19th March 2020: it cut the base rate. After nearly a year with the base rate stuck at 5.25%, investors are now pondering two new questions: how fast will rates fall and how far will they drop?

The answer implied (not guaranteed) by the UK money markets is that the base rate will be 3.5% by the third quarter of 2027. Assuming no further global pandemics or escalating international incidents, UK interest rates look set on a downward path, which has several consequences for investors, including:

- New investors will see the return on fixed interest securities, such as government bonds, fall. This move is already underway, as investors buy to lock in current returns.
- Falling long-term bond yields go alongside a drop in annuity rates. If you are thinking about fixing all or part of your retirement income, delay could prove costly.
- Returns on cash deposits will drop as the base rate falls. Inertia is now a serious risk if you are sitting with cash on the investment sidelines. Wait too long before making your move into long-term assets and you could miss investment profits.
- Lower interest rates will benefit companies, particularly smaller companies which tend to have higher borrowing. In the US, which is at a similar stage in the interest rate cycle, there have been signs that investors are switching their attention from the mega cap companies towards smaller companies.

For advice on how you should approach an investment landscape of falling interest rates, talk to us soon – the longer you defer, the lower rates could drop.

Investments do not offer the same level of capital security as deposit accounts.

The value of your investment and any income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Joining the boom in top-rate taxpayers?

New data from HMRC shows there are now more than a million people paying income tax at a rate of at least 45%.

Source: HMRC

Each year HMRC produces an extensive set of tables about income tax, which accounts for about 30% of all tax revenue.

Despite band changes to Scottish taxpayers, these have failed to alter a clear trend in the data: a sharp rise since 2020 in the numbers paying higher- or additional-rate (as HMRC defined) tax. The higher-rate taxpayer population boom is a direct result of the freeze on the higher-rate threshold at the 2021/22 level (throughout the UK), despite the over 20% surge in inflation since April 2021.

The additional-rate tax story is worse, because the previously frozen threshold was cut from £150,000 to £125,140 in 2023/24, followed by the Scottish advanced addition in 2024/25.

At the time of the last Budget, the Office for Budget Responsibility estimated that by 2028/29 nearly 1 in 5 income taxpayers would be paying a higher rate and more than 1 in 30 would be subject to additional rate tax.

If you find yourself in, or heading to, higher- or additional-rate tax, please contact us to find out more about the range of planning options and the tax savings you could make.

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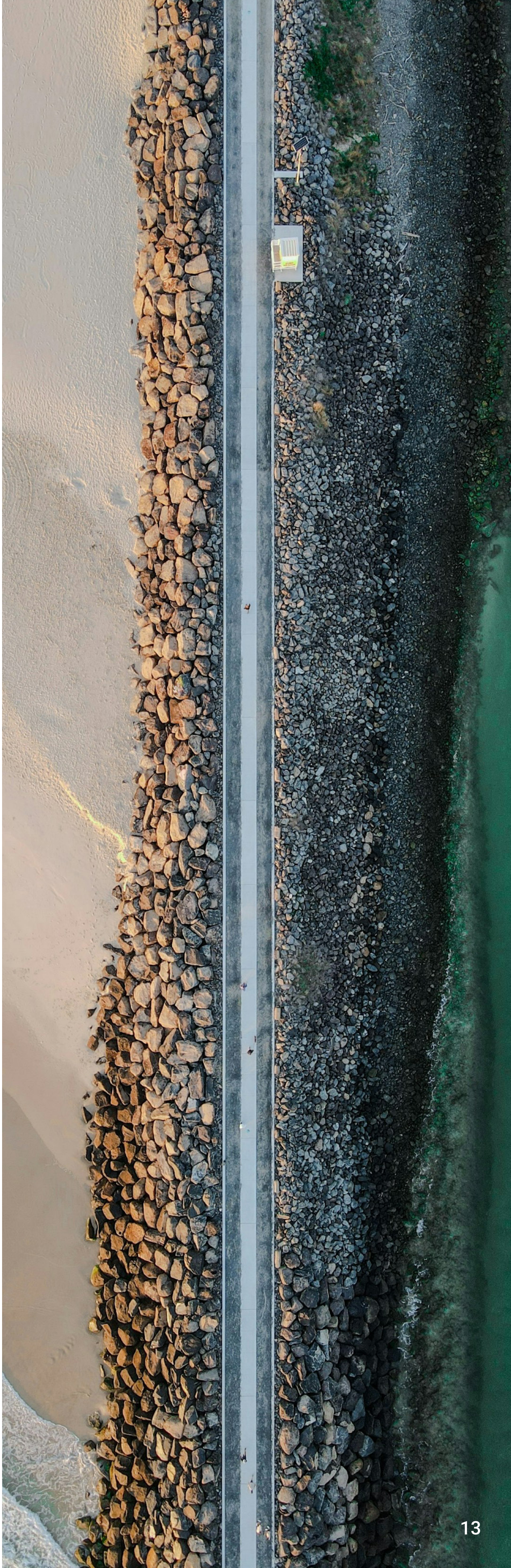

Dividends deliver – behind the headlines

UK companies paid a bumper £36.7 billion in dividends to investors in the second quarter of 2024 — an 11.2% increase from the previous year. But there are some important caveats behind these positive headline figures.

A substantial portion of these dividends came from 'special' one-off payments, which amounted to £4.1 billion. Notably, HSBC contributed £3.1 billion following the sale of its Canadian subsidiary. When excluding these special dividends, the increase in regular dividends was a more modest 1%.

Dividends play a crucial role in enhancing overall investment returns, particularly when reinvested. Over the past 20 years, the FTSE 100 index returned 65% to investors, but including dividends, the total return jumps to 239%, or 6.6% annually.

However, not all companies pay regular dividends. Mature, financially stable companies, such as utility firms, banks or oil companies are more likely to distribute dividends. Whereas companies in rapidly evolving sectors, like technology, often reinvest profits in the business to fuel growth.

In the UK, nearly 90% of dividends come from the largest companies in the FTSE 100. Banks were the strongest contributors in Q2 2024, with many on track for record payouts this year. Healthcare companies also showed strong dividend growth. On the other hand, economic challenges have been reflected in a significant drop in dividends from mining companies and housebuilding firms.

However, excluding the weaker mining sector, the UK market saw dividend growth of 8.6%, indicating that income opportunities remain despite sector-specific slowdowns.

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The truth about student loans

Freshers starting university this autumn face higher costs for their education due to changes in student loan repayment rules in England. (Different rules apply in Scotland, Wales and Northern Ireland.)

Changes took effect last year, so does not impact students who began degrees before September 2023. However, new students are subject to significantly different repayment terms to those who have just graduated.

The average student debt in England is £45,600, with some students owing £60,000, which covers both tuition fees (£9,250 a year except in Scotland) and means-tested maintenance loans. However, student debt is unlike conventional loans because repayments are a fixed percentage of earnings, not tied to the total debt.

For instance, a graduate earning £30,000 annually pays the same amount each month whether they have a student loan of £5,000 or £50,000. Unlike conventional loans, unpaid debts are written off after a set period.

Under the revised system, graduates begin repaying their loans once their earnings exceed £25,000, down from the previous threshold of £27,295. This means that a graduate earning £30,000 will now repay £450 annually, compared to £243.45 under the old system. Additionally, the repayment period has been extended from 30 to 40 years, meaning some graduates could be repaying their loans into their 60s.

Higher earners are more likely to repay their debt within the original 30-year term, leaving those on lower and moderate incomes continuing to pay back for longer.

However, the government has revised how interest is calculated on these loans, capping the maximum interest rate at the Retail Price Index (RPI), a reduction from the previous cap of RPI plus three percentage points.

Regardless of the changes, focusing on paying down these debts does not usually pay off, as it will not reduce monthly repayment or necessarily ensure faster repayment. Even under the new terms, it is still estimated that 48% of graduates won't pay off their debt within the 40-year period, with the loans eventually written off.

Ensuring green means green

Many of us are taking steps to tackle some of the environmental challenges we face. This might be switching to a renewable energy tariff, reducing plastic use or ensuring our money is invested sustainably.

There is now a wide range of 'green' investment products and funds, designed to appeal to the eight out of ten adults who say they would like to see their investments 'do some good' as well as deliver a financial return.

Until now, it has been difficult for ordinary investors to see whether the underlying investment strategy matches environmental claims, leading to industry concerns around 'greenwashing' —misleading advertising or marketing.

The Financial Conduct Authority introduced the new Sustainability Disclosure Requirements (SDR) regime from 31st May 2024 to tackle this problem.

This sets out new product labels and standardised definitions to help investors better understand how their money is being invested, aiding consumer choice.

Financial companies also now need to evidence relevant marketing claims, whether they relate to green credentials, sustainability or having a positive impact on the environment or wider society. This should enable regulators to act against firms who say one thing but do another when it comes to environmental and sustainability claims on funds. As a result, there may be fewer 'green' investment products on the market, but investors should have confidence that those remaining are proven sustainable investment options, that do what they say on the tin.

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Investing in shares should be regarded as a long-term investment and should fit with your overall attitude to risk and financial circumstances.

October tax deadlines

There are two other important tax dates in October, besides the Budget.

The final date for filing your 2023/24 tax return is 31st October 2024 if you do not want to file online (which has a 31st January 2025 deadline). These days, HMRC discourages paper tax returns and will only issue them on request. For 2022/23, over 97% of returns due were filed online.

As the relevance of 31st October has faded, another October tax date has become more important – 5th October. This is the deadline for telling HMRC if you need to file a tax return and have not been sent one before.

For example, a return would be required if you started self-employment in 2023/24 with income exceeding £1,000 or realised capital gains above the annual exempt amount (£6,000 in 2023/24).

HMRC has an **online tool** that allows you to check whether you need a return.

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News Round Up

VAT on school fees from January

Parents educating their children in the independent sector can expect a sharp rise in school fees from 1st January 2025, when the government has confirmed that it will start imposing VAT on these fees. This will be imposed at the standard rate of 20%. Parents cannot avoid the increase by paying the full year's fees early, as VAT will be applied to all payments for the January term made from the end of July this year.

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NS&I certificates

Lower inflation has made NS&I's popular Index-linked Savings Certificates less attractive. Holders should therefore weigh up options at maturity, rather than automatically letting them roll-over into a new term.

Around 300,000 people hold these tax-free accounts, which pay an inflation-linked return for two, three or five years. Returns have been high in recent years, but with inflation expected to linger around the 2% mark there are now better paying accounts elsewhere.

However, it is also important to bear in mind that these certificates are now closed to new investors.

Sterling's high

Sterling has been one of the best-performing currencies in 2024 – good news for holidaymakers who will have found their money going further overseas this summer. But a strong pound does not always help investors holding overseas funds and assets. This is particularly true for Japan investors, with the Yen down against the pound by about 6% this year, negating some of the gains seen in the Japanese stock market for UK investors.

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