IMPACT LENS

Client Update

August 2023

As an investment advice and financial planning firm, we aim to assist clients with making sound investment and financial management decisions. Our principal objective is to help you and your family get the most from the available financial resources so you can do more of what you enjoy.

These newsletters will settle into a quarterly pattern; roughly every three months we will provide you with a brief market summary of how the key asset groups have fared over the past six months. We will also update you on changes to our services and provide more general market and financial planning commentary.

Client Portal Launch

Over the next four months, all of our clients will receive an invitation to use our client portal.

We aim to make communication with us more straightforward and more secure by moving away from email.

The portal will allow you to log in and view your investments, update us with your changes of circumstances and access reports, valuation and taxation information.

This move will be optional, so if you are happy with email, that's fine with us, but the reality is that email is much more vulnerable to attack from hackers and is not a secure service in most cases.

Market Commentary

Investment markets are incredibly complex systems. Offering a summary of what is happening in markets is like trying to hit a constantly moving target, as the news cycle produces something "important" weekly. At present, investment managers and macro-economists (people paid to consider the broader picture) deliberate mainly over:

- Inflation (no change there!) and monetary policy tightening
- Consumer activity and how this impacts corporate earnings
- The opportunities in AI and tech
- Climate change investing

Inflation is becoming more of a good news story than a negative factor.

Central banks and governments within the advanced economies of Europe, North America and Japan have been at war with inflation over the past eighteen months trying to curb economic activity (business and consumer spending) by raising interest rates.

Although typically cautious, most recent comments from Jay Powell at the US Federal Reserve suggest that they view inflationary pressure as less of a threat to economic stability. Falling energy costs point to more modest future increases in interest rates from the present level and potentially an end to the tightening cycle in the US. Federal Reserve rates currently sit at between 5.25% and 5.5%, a 22-year high.

Europe has generally suffered higher inflation than the US, so the European Central Bank lifted rates again to 3.75%. Across the Eurozone, the picture is somewhat mixed, with German inflation at 6.5%, France at 5%, and the Spanish economy suffering inflation of 2.1%[1].

Overall, the inflation story is becoming less of a market "headwind", and markets are looking ahead to much more stable monetary policy and the end of the tightening cycle.

Turning to corporate earnings and consumer activity, most market commentators believe the risk of a recession in the US is reduced.

A recent Bloomberg article on US inflation and consumer activity points to a strong labour market combined with positive consumer spending activity despite increases in interest rates. It suggests the US might stay out of recession and avoid a "hard landing" for the economy.[2]

If the US can avoid a recession, then the current strength in US equity markets is likely to continue.

Over the past six months, technology shares in the NASDAQ 100 have been up 22.51%, with the broader-based S&P 500 returning 7.35%.[3]

Gold (a haven asset for investors concerned about risk) is down, and markets across Europe and the UK have risen, although not as sharply as the US.

In summary, interest rate rises combined with no new shocks to global energy and food markets have rapidly reduced inflation, with most indicators suggesting further slowing in inflation is likely.

Due to the awful year in 2022, share prices have been depressed, creating a strong buying opportunity leading to the present "bull" run in equities.

Robot Wars

The reality is that AI has been with us for a long time. Services such as Uber, Netflix and Amazon have used this technology to enhance consumer experience by matching customer recommendations to behaviour patterns for quite some time.

What has changed is the rise of so-called "generative AI", going beyond spotting behaviour patterns to actually generating original content. This innovation has undoubtedly captured a great deal of investor and public attention. I recently attended a Schroders sponsored conference on this topic and a Google symposium hosted by a US law firm. Talk about AI is booming!

Most of the profits from this interest are currently being accrued by chip manufacturers (NVIDIA: +157% over one year). Per Rathbones IM data, nearly 90% of generative AI systems are "trained" using NVIDIA chips. Cloud computing providers, software vendors and related service providers are also benefitting from this investor interest explosion.

Interestingly, AI is not significantly contributing to corporate earnings yet, despite the hype. Thus, AI took a back seat when it came to earnings figures released by Alphabet (Google), Meta and Microsoft and to investors focused on these companies' primary sources of revenue, which for Alphabet and Google remain advertising.[4]

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[1] https://www.ft.com/content/5dfccc86-f490-4841-9397-7ef399edef57
[2] https://www.bloomberg.com/news/articles/2023-07-28/us-inflation-cooled-while-consumer-spending-picked-up-in-june?srnd=economics-inflation-and-prices
[3] Data from FE Analytics at 28/07/20223
[4] https://www.bloomberg.com/news/newsletters/2023-07-28/tech-investors-love-ai-but-the-core-business-still-drives-shares?cmpid=BBD072923_TECH&utm_medium=email&utm_source=newsletter&utm_term=230729&utm_campaign=tech

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Climate Change Investing

The practical action to address CO2 emissions, along with other emissions contributing to climate change, is falling a long way short of what's required if targets for 1.5 degrees Celsius of warming were to be a reality. Concerted, state-led action is not in evidence; the latest G20 has been marked by schisms and inaction.[5]

The past six months has also been punishing for investors in clean energy infrastructure due to rising interest rates, which negatively impact assets generating fixed yields. Installed renewables are long-term assets often supported by debt, so their returns become less attractive as interest rates rise. For example, Gravis Clean Energy, which invests in installed wind, solar and energy storage assets, fell by 4.91% in June (although, the fund now yields over 5% and has delivered long-term solid returns).

Given the scientific consensus is that 2023 is a year of exceptional and extreme weather events it would appear that a more rapid realisation that climate change is now happening must be inevitable. This adds further weight to the powerful arguments in favor of a rapid decarbonisation of the energy system.

Inheritance Tax

Over the past six months we've had many more initial conversations with clients about estate planning and how a family can pass assets to their intended beneficiaries without a high inheritance tax burden.

Inheritance tax, or IHT, generates around £7.7bn in receipts to HMRC; to put this in context, income from capital gains tax amounted to £18bn.

IHT is paid by a small number of UK estates (around 3%) but given that the threshold currently sits at £1M (assuming a residence nil rate band of £175,000 is available, so £1M is the total exemption for a married couple living in their own home) and allowances have been frozen now since 2021; it has become a consideration for more families.

Pension schemes are exempt from inheritance tax, so many people choose to utilise other assets during retirement and leave pensions untouched.

What steps do families often take to deal with this issue:

- Giving money away to family using the £3,000 per annum gifts allowance
- Investing in assets exempt from inheritance tax- certain types of shares are exempt from inheritance tax under business property rules
- Transfers into trusts
- Contributions to pension schemes
- Gifts made from normal expenditure

Inheritance tax planning is a remarkably complex area, so best to start the conversation sooner rather than later.

[5] https://www.ft.com/content/3c8bab17-5719-4174-9a96-3cf04ef0b968

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We are currently working through our programme of annual reviews with clients and also booking in calls and meetings to discuss portfolios and performance. Please do get in touch if you would like to book a call.

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