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Edition
32

Caves Quarterly

WINTER 2023 NEWSLETTER

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CAVES WEALTH

CEO Welcome

Simon Harvey, CEO

The last quarter has been calmer than at this point last year but has still created interesting headlines. A Cabinet reshuffle just a week before the Autumn Statement safeguarded the Chancellor's place, but the reappearance of former Prime Minister David Cameron as the new Foreign Secretary provided a surprise. With the continuing turmoil in the Middle East, as well the ongoing war in Ukraine, there is still plenty of uncertainty, not least about the date of the next general election and continuing cost of living issues.

One area of extra costs which may sometimes go unnoticed is around the growing numbers of subscription services many of us now use. In the Winter edition of our newsletter, we take the new year as a good opportunity to review which of your subscriptions you are really using and which you might be able to take a break from or cancel.

Our other stories in this edition include:

1

A guaranteed income for life attracts more interest. While the bank of England's Base rate rests at 5.25%, the investment landscape for those nearing retirement broadens as the stability of an annuity, at 7.5% for some, may overtake the appeal of short-term drawdown.

2

Why wills matter – intestacy rules change delay. An unexpected delay to an inflation-linked uplift to intestacy values highlights the importance of having a valid will. For estates in England and Wales, the six month delay by the Ministry of Justice in providing a 15% increase to the value of the mandated share for surviving spouses or civil partners with children created a £52,000 gap in the sum available.

3

Alternative to deposits. While higher interest rates have helped savers, money market funds can provide an alternative choice to traditional high street accounts.

The full list of topics in this edition include:

We will share the next phase of developments with you in April after the next Budget and when the timing of the general election may be clearer. Please do get in touch if we can continue to help or provide you with more information on any of the topics covered.

In the meantime, we hope you had an enjoyable festive period and wish you a healthy and prosperous 2024.

Best wishes, Simon.

It's all about inflation, inflation, inflation

Global equities were boosted this quarter by the continued fall in inflation and reduction in interest rate expectations, as price increases moved closer to central bank target levels.

Developed markets outperformed their emerging market counterparts, with the US stock market leading the gains after a resurgence in the mega-cap constituents of the technology and communication services sectors. Investor concerns over the 'higher for longer' interest rates narrative which developed in late summer have faded, largely as inflation data continued to ease.

The US Federal Reserve held its key interest rate steady over the quarter, citing falling inflation and some signs of slowing economic growth.

The committee has also started pencilling in multiple rate cuts for 2024 and into 2025, as it seeks to strike the right balance between hitting its 2% inflation target and avoiding an economic recession.

The UK economy appears on the brink of a technical recession, after gross domestic product (GDP) was assessed to have fallen by 0.1% in the third quarter of 2023, revised down from a first estimate of no growth. This was largely due to a fall of 0.2% in output from the services sector, with consumer-facing services down by 1% as households cut back on expenditure in real terms.

The Bank of England held interest rates steady over the quarter, with the bank rate maintained at 5.25%, although it is worth noting that three committee members voted to increase rates by 0.25% at the December meeting.

1 Global Equities

Investors' excitement over potential rate cuts saw the S&P500 and Nasdaq indices both rise sharply over the fourth quarter, with these indices posting gains of 11.2% and 14.3% respectively. The mega-cap 'Magnificent Seven' group of stocks including Nvidia, Tesla, Meta, Apple, Amazon, Microsoft and Alphabet finished the year particularly strongly, although the market rally did broaden beyond these stocks in the final months of the year.

Putting this in a broader context, this recovery saw the S&P500 rise by just over 24% (including dividends) over the calendar year 2023, the biggest rally in US stocks since 2019. Roughly two-thirds of these gains can be accounted for by the 'Magnificent Seven' group of stocks, with Nvidia leading the charge, gaining over 200%.

The UK stock market, as measured by the FTSE All-Share index, saw a more subdued performance with a gain of around 2.5% over the quarter. The large weighting to oil producers had a negative impact over the fourth quarter, as oil prices fell sharply on the back of a surprise surge in US oil production to record levels, offsetting production cuts from some OPEC+ countries. Again, on an annual basis, the UK stock market has frustrated investors who remained convinced of its attractiveness on a pure valuation basis, with the FTSE All-Share index up by just 3.9% in capital terms.

In sync with their US and UK counterparts, the European Central Bank (ECB) also decided to maintain the level of interest rates across the fourth quarter, although ECB President, Christine Lagarde, struck a hawkish tone and hinted that rates were likely to be held firm for now to guard against resurgent inflationary pressures. This did not seem to deter investors however, with European stocks rising strongly over the last two months of the year, resulting in an 8.3% quarterly gain for the Euro Stoxx 50.

In China, the Hang Seng index continued its recent malaise, with a further fall of 4.3% over this quarter, as the economy continued to face a myriad of challenges, including rising debt levels and a property crisis, which saw credit ratings agency Moody's downgrade its outlook on China's government debt to negative, from stable.

Uncertainty over China's regulatory regime has also continued to concern investors with, for example, some $80 billion wiped off the market capitalisation of Tencent Holdings and its gaming industry peers in December following the release of proposals to limit the time and money spent using online games. Challenges will no doubt remain as the country continues its multi-year transition to a more domestically driven economy.

After some retracement in the third quarter, Japan's Nikkei 225 index returned to growth in the final three months of the year, with a gain of just over 5%, resulting in an annual increase of just over 28% in 2023. This was its best yearly performance in a decade and came even as data showed a contraction of 2.1% in GDP in the third quarter of 2023 compared to 2022. This forms part of an unstable trend since the start of the Covid-19 pandemic in early 2020 that has seen periods of economic expansion alternating with contraction. A key focus for the Bank of Japan policy is whether we see further improvement in wage growth, which may enable the central bank to target a normalising of monetary policy.

2 Fixed Interest

With global inflation pressures continuing to moderate (in many countries at a greater pace than previously expected), interest expectations were lower, causing global bond yields to fall (yields move inversely to prices) sharply over the quarter.

In the US, the 10-year Government bond fell from 4.6% to 3.9%, while in the UK, an even greater fall from 4.5% to 3.5% was witnessed. Having been a drag on portfolio performance for much of the last 18 months, longer-duration positions were rewarded this quarter, seeing the biggest uplift in prices.

Corporate bonds followed government debt with price increases as yields fell. Although previous hiking cycles would indicate it should not form a base case scenario, economic data continues to remain consistent with a soft landing for the global economy. Expectations for a generally supportive environment for businesses saw spreads remain tight during the quarter.

3 Commercial Property

UK commercial property had a torrid time of it in 2023. Against a backdrop of seemingly endless interest rate hikes putting pressure on valuations, the majority of listed Real Estate Investment Trusts (REITs) moved lower to trade at significant discounts to reported Net Asset Values (NAVs).

Property investment trust discounts have been closely correlated to the movement in UK Gilt yields in recent years, and it was therefore no surprise to see property stocks bounce as as gilt yields fell through the fourth quarter. Some market commentators are citing 2024 as the year of the comeback for the UK real estate sector, with investor sentiment improving on expectations that interest rates have peaked, following better-than-expected inflation prints and both the Bank of England and US Fed holding interest rates steady at recent policy meetings.

4 Alternatives

Investors have long considered the infrastructure asset class as a decent proxy for bonds due to the duration of the underlying cash flows and the fact that most of an investor's return is derived from income payments received.

With hopes for an easing in monetary policy this year, infrastructure investment vehicles could track corporate bond markets higher, benefitting from potential rate cuts and reduced competition from money markets that have recently been providing attractive returns without the associated credit and duration risk.

Concerns over geopolitical instability and the output levels of major oil producers around the world saw Brent crude oil move 10% lower over the course of 2023, to close out the year at $79 a barrel.

Weak global growth forecasts saw OPEC+, which includes OPEC (Organisation of the Petroleum Exporting Countries) oil-exporting nations and allies such as Russia, announce a new round of production cuts for the first quarter of 2024, in an attempt to prop up prices.

Gold had an unexpectedly strong 2023, with pressure of a higher interest rate environment offset by excess central bank demand and the appeal of traditional safe-haven assets in times of rising geopolitical risk. The precious metal closed out the final quarter at $2,071 per ounce.

5 Outlook

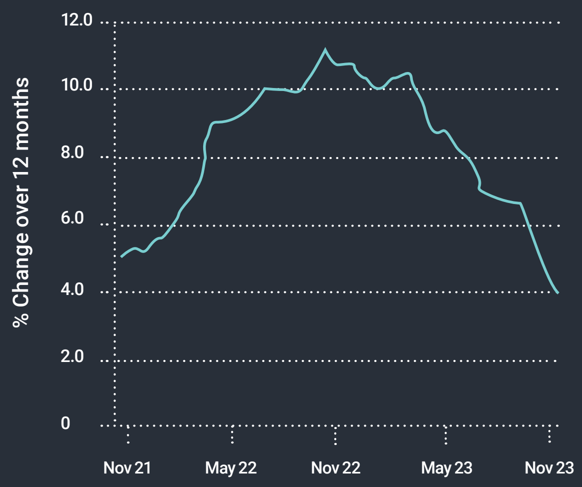
The previous quarter proved a tough period for markets as a 'higher for longer' narrative for interest rates became engrained in investor sentiment. Since that point, the language used by central banks has softened, and it increasingly looks likely that we have reached the peak for interest rates across most of the developed world.

Attention now turns to when we could start to see an easing of conditions, and while we expect to see interest rate cuts as the year progresses, structurally, we believe rates could likely settle at a higher level than the previous decade and more akin to their average levels over longer periods.

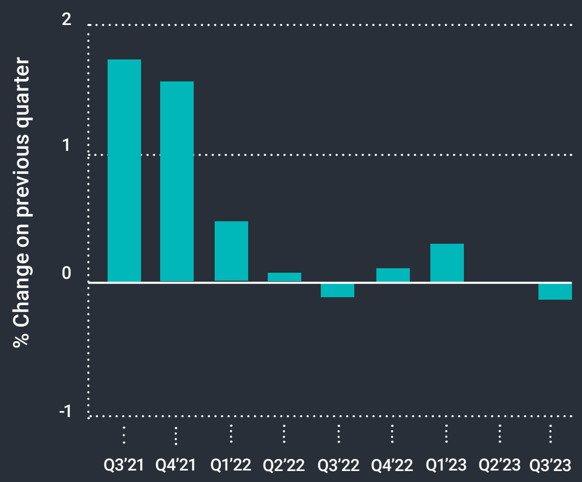
With financial markets pricing in around double the number of interest rate cuts compared to Federal Reserve projections, many areas of the market start the first quarter of 2024 at rich valuations. Investors may need to exercise caution, especially in the context of a busy year in the world of politics, as some of the world's largest nations head to the polls; some 40% of the world population will be subject to a general election this year.

Against this backdrop, we continue to encourage a balanced approach to portfolio construction and believe this is best achieved through a focus on quality and diversification across asset classes.

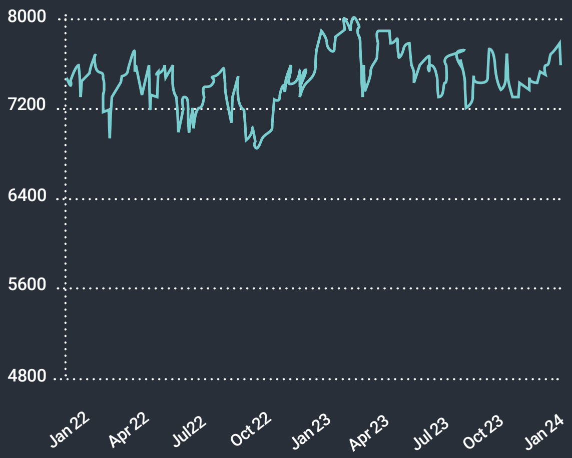
UK Consumer Prices Index (CPI)



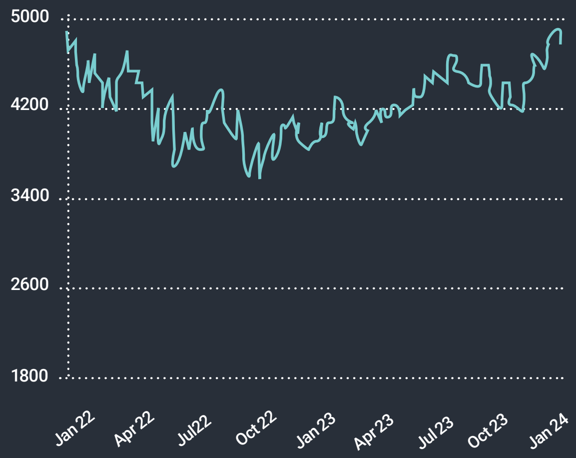
UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index



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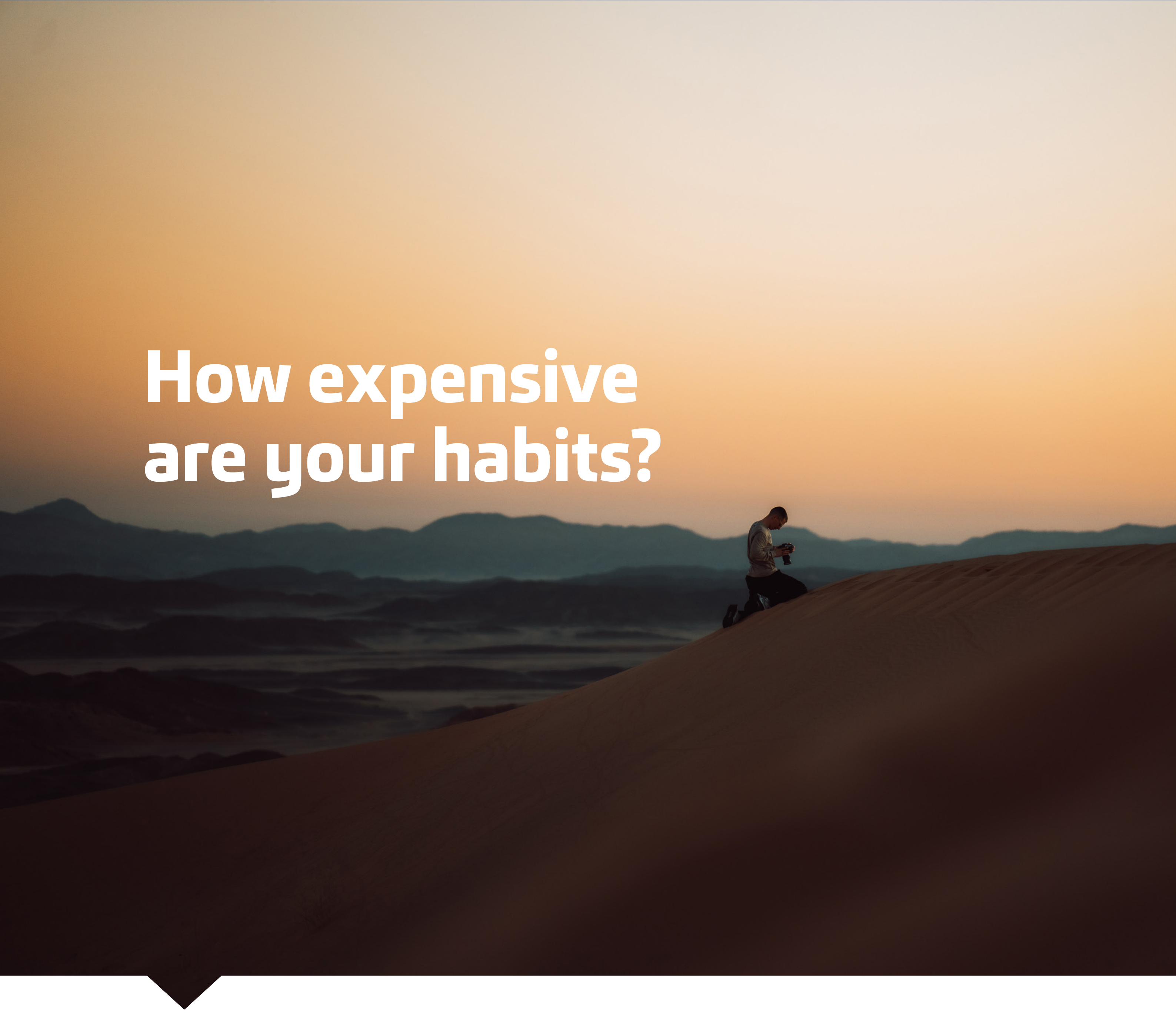

How expensive are your habits?

This new year, make time to review your regular payments such as subscription services – you may be spending more than you think.

Many content providers – from Netflix and Disney+, to Spotify – have increased monthly fees over the past year. However, it's not just entertainment platforms looking to lock consumers into regular payment plans. There are now subscription services for podcasts, audio books, online newspapers, wine deliveries, make-your-own meal boxes and pet food supplies — to name but a few.

Research suggests the average person spends £39 per month on subscriptions, though many will pay significantly more. Collectively, this means UK households spend £1.6bn a month on such services. Yet not everyone is getting value for money, with one in ten claiming they don't use some services at all.

It's not hard to see how this happens. Providers often have low-cost or free introductory offers — knowing many of us forget to unsubscribe within the cancellation period. And while the cost of any single subscription may look modest, once you're paying for a few, the costs quickly mount. A regular review of how often you use these services can pay. There is generally no contract, so it's easy to cancel payments for subscriptions that are just not working for you.

If it's a service you do use regularly, check whether you can 'downgrade' your payment plan. Streaming services, for example, often have cheaper options with advertisements. Family plans can also be cost effective if more than one person in your household pays for the same platform. Don't forget to double check subscriptions that charge annual fees, rather than monthly payments, which can be easy to overlook.

Once you've saved money from raking through regular subscriptions, conduct a more thorough audit of your finances by looking at other regular bills: from gas and electricity contracts to home and car insurance – savings can often be made by switching to better priced deals.

Autumn Statement outcomes – give and take

The Chancellor presented a programme of tax cuts in his Autumn Statement, yet the tax burden continues to increase.

The verdict from the Office for Budget Responsibility (OBR), whose job it is to analyse the financial impact of the Autumn Statement, found:

"… while personal and business tax cuts reduce the tax burden by half a percentage point, it still rises in each of the next five years to a post-war high of 38 per cent of GDP."

While Mr Hunt made some significant tax cuts, they are outweighed by earlier tax increases over the last few years.

National insurance changes

The most notable announcements were cuts made to national insurance contributions (NICs):

1. If you are an employee under State pension age (currently 66), then from 6 January 2024 the main class 1 contribution rate on earnings between £12,570 and £50,270 will be reduced from 12% to 10%. Earnings above £50,270 will remain subject to the current 2% rate. If you are self-employed and under State pension age, from 6 April 2024:
2. Flat rate class 2 NICs (currently £3.45 a week) will no longer be required. However, if your annual profits are below £6,725 you can continue to make voluntary class 2 contributions to secure contributory benefits, such as the State pension.
3. The class 4 contribution rate on profits between £12,570 and £50,270 will be reduced from 9% to 8%. For profits above £50,270 the existing 2% rate remains unchanged.

These changes are worth up to £556 a year if you are self-employed and £754 a year if you are an employee. Their total cost to the Exchequer is about £10 billion a year by 2028/29. However, the freezes to income tax and NIC allowances and thresholds since 2021/22, and this year's lowered additional (top) rate threshold, mean the Treasury will be gaining £27 billion in 2024/25.

For companies, the major news was that the 100% capital allowance for most investments in new plant and machinery, which was due to disappear after March 2026, will be made permanent, at an initial annual cost of around £10.7 billion.

Wave of change?

As with any 'fiscal event', there was a host of other changes, proposals and consultations in the forest of documentation from HMRC and the Treasury – 110 proposals in all. These include:

1. Long overdue simplification of the ISA rules from 6 April 2024.
2. A change to the rules on off-payroll working (IR35) that will avoid the double taxation that can currently arise.
3. A collection of papers on various aspects of pensions, the most noteworthy of which was probably a first step towards allowing individuals to have a single pension pot which moves with them from employer to employer.
4. More changes to Making Tax Digital (MTD), aimed at simplifying the procedures of this much-delayed reform.
5. A 9.8% increase in the National Living Wage to £11.44 an hour from April 2024.

i

For more information on the changes mentioned above or any other aspects of the Autumn Statement, please contact us.

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New takes on retirement planning

At what age did you (or will you) start actively planning for your retirement?

The answer is now 36 years old according to research undertaken by a major pension provider. By contrast, the starting age for today's retirees averaged 49. Over half of that group now wishes that they had begun planning earlier.

There are some good arguments for why a retirement focus now begins in the mid-30s. National Statistics data show that the average age of buying a first home and getting married are now both around 34, so at 36 life should have gained a settled pattern for many. Nearly two thirds of respondents were confident in their abilities to make financial decisions by age 36.

Both today's retirees and the 36-year-olds have experienced the new world of automatic enrolment into workplace pensions. When today's 36-year-olds retire, those pensions will be a much greater proportion of retirement benefits than they are today.

Apart from the longer timeframe, auto-enrolment will also become more significant because of new legislation which paves the way for:

1. an 8% minimum contribution level to cover all earnings (currently it's up to a maximum of £50,270 and excludes the first £6,240); and
2. the auto-enrolment minimum age to drop from 22 to 18.

The lower enrolment age of 18 matters because the sooner pension contributions begin, the better. A contribution made at 18 will enjoy about half a century of investment returns before it starts to be drawn on.

The truth is that whatever your age, your retirement planning should be a primary focus.

A guaranteed income for life attracts more interest

Rising interest rates are changing retirement income perspectives.

Three years ago was another era when it comes to interest rates. The Bank of England's Bank Rate was just 0.1% in December 2020 when a government bond maturing in 2035 delivered a gilt-edged annual return of less than 0.4%. Today's 15-year gilt offers around 5%.

While the change in bank rate received plenty of media coverage, the move in long-term government bond yields has attracted much less attention. Those higher bond yields have pushed up annuity rates significantly across the board. For example, in December 2020, a typical non-smoking 65-year-old (man or woman) could have secured a 4.8% guaranteed income for life by purchasing an annuity. In October 2023, the equivalent 65-year-old buying an annuity would receive a rate of around 7.5%.

Choosing the right option

If you are about to start taking an income from your pension fund or are considering a move away from income withdrawals, look carefully at what today's annuity market can offer you. Annuity tables are at best only a very broad guide for a variety of reasons:

1. Annuity rates are now close to being individually calculated. Where you live, whether you smoke, how much you drink, any medical conditions you have and your relationship status are all factors that can determine your personal annuity rate.
2. Annuities can be set up as level or increasing, either at a pre-determined rate or in line with inflation.
3. Joint life annuities are an option, meaning that a guaranteed income is paid for both your and your partner's lifetimes, or the second person could be a dependent child.

To learn more about all your annuity choices and the latest rates, get in touch.

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Why wills matter: intestacy rules change delay

The intestacy rules for England and Wales have been changed… belatedly and with real consequences for some estates.

If you do not have a valid will then the decisions about what happens to your estate on your death are governed by the laws of intestacy. These may not work as you might hope or expect them to. The rules differ between England and Wales, Scotland and Northern Ireland, but in all three jurisdictions a surviving spouse or civil partner (not cohabitee) receives only a specified share of the estate if there are also children or grandchildren.

For England and Wales, that surviving spouse or civil partner's entitlement consists of personal possessions, assets up to a fixed cash value and half of any remaining estate.

Disparity across jurisdictions

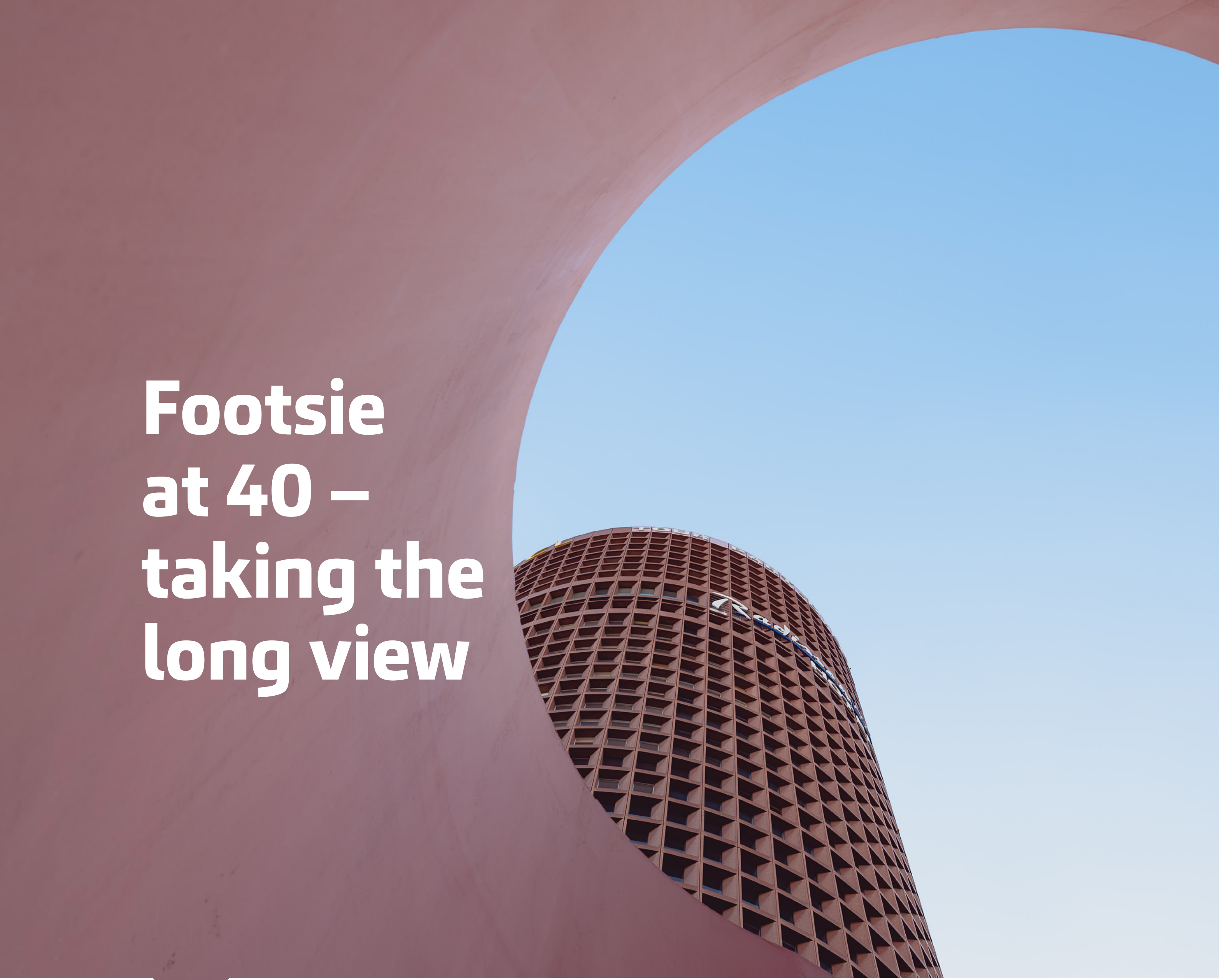
The legislation for England and Wales requires that fixed cash value to be updated once total inflation has exceeded 15% since the last update. No such indexation provision applies to the intestacy laws of Scotland and Northern Ireland.

Unfortunately, although the 15% inflation threshold was triggered in November 2022, the Ministry of Justice did not act until 26 July 2023, by which time the Lord Chancellor's legislated increase raised the cash sum by 19.3% to £322,000.

Throughout the UK, intestacy law is not a subject at the forefront of legislators' minds. But at a personal level, the defaults imposed by intestacy rules can have serious effects. The families of those who died intestate between November 2022 and July 2023 have potentially lost a substantial amount.

Research shows 50% of UK adults do not have a will. If you are among them or your will has not been reviewed for some years, the time to act is now. Procrastination, as the Ministry of Justice showed, can be costly.

The Financial Conduct Authority does not regulate will writing and some forms of estate planning.



Footsie at 40 – taking the long view

This year the FTSE100 turns 40 years old. What can its history reveal about long-term investing?

The FTSE100 includes many of Britain's best-known brands, such as Marks & Spencer, Barclays Bank and Sainsbury's, sitting alongside many large, international corporates. Although the index is rebalanced regularly, just over a quarter of the founding members are still listed.

Tracking how this index has evolved offers some important insights for investors. What's more, since the index launched, just three of the original 100 have gone bust, demonstrating that larger companies can be more stable and less risky than smaller start-ups.

Original investors have received a compound annual return of 5.2% thanks to growth of 660% since its inception (to the end of September 2023). But there has also been significant volatility. Investors need to be able to stay invested for the longer term to ride out the shorter-term price movements.

However, the performance of the FTSE100 shows stock markets don't always deliver positive returns – even over longer periods. This may reflect another key investment lesson: the importance of diversification. Around 40% of the FTSE100 is made up of energy, healthcare and banking stocks – while fewer than 1% are tech companies.

Investors should diversify where possible, by geography, sector and size of company. Investing across different stock market indices can help achieve that.

Is your protection level enough?

Income protection insurance can ensure essential bills will be paid if you are unable to work due to ill-health. But with the cost of living rising significantly over the last 18 months, it is worth checking that any policy you have in place will still cover mortgage or rent, food and energy costs.

Income protection covers a fixed proportion of your salary and typically only pays out after you have been signed off sick from work for several weeks. The longer this deferral period, the lower the starting premium.

If you've insured 50% of your salary, for example, it is worth checking this is sufficient to cover essential bills given the rise in energy costs and interest rates.

If not, you might want to increase the benefit on the policy, although this will result in higher monthly premiums.

Alternatively look to build more substantial rainy day savings, which could be used to cover any shortfalls in an emergency.

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This Information represents our understanding of current law and HM Revenue & Customs practice as at June 2023.

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