A forward view of the global economy and financial markets

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Strikes and Pensions - France VS the UK

"How can anyone govern a nation that has 240 different types of cheese?"
Anatole France (French Poet)

Source: Wikipedia

We have seen a return to unsettled labour relations in the last 12 months with strikes being called from the NHS to Amazon. Just this weekend we had the pleasure of railway workers striking, causing considerable disruption and cost to the public who might have wanted to go the test match at Lords, the FA Cup Final, the Derby and numerous concerts across the country.

In the nineteen seventies, when strikes were almost a part of everyday life the French called strikes the "English Disease". Well in spite of our losing many days to strikes recently we are not in the same league as the French who have had as many as 1.3 million people on strike in a single day. On 31st January this year the CGT Union in France estimated that 2.5 million went on strike and this rose to 3.5 million in March. There were riots and widespread disorder that accompanied these days of action.

Why have the French taken to the streets in such huge numbers? President Macron wanted to force through legislation that would raise the retirement age from 62 to 64; something he said he would do during his last campaign for the presidency and which he has now subsequently done.

I decided to take a look at the French State Pension system and French personal taxes. I can only say that it was like asking a man to find a way through a primary jungle without a machete. I believe that most educated people in this country can fill in their own tax returns without too much trouble. I would challenge most normal human beings to try and do this in France without the help of a tax accountant. There are so many exemptions and different rules along with a bewildering number of different tax rates that it would be well nigh impossible to say what an individual would pay in tax based on a flat salary. There are more rules to French taxes than they have cheeses.

The burden on an individual based on a percentage of GDP is 45% in France as opposed to 33% in the UK. French men retire on average at age 60.4 years and French women at 60.9 years of age and the men are drawing on the State Pension for 23.5 years with the women drawing on the State Pension for 27.1 years. No wonder the French Government's debt to GDP is 113.4% and forecast to rise over the next four years while our debt to GDP is 103.1% and is forecast to fall.

The French Government knows that it can't afford to continue to pay the State Pension under the current rules, while the French worker feels that he or she is paying a lot in taxes and social security contributions and therefore is entitled to a good pension from the State from the age of 62. The reality is that with people living longer in retirement and the birth rate falling it is only a matter of time before the rules have to change or France will have a national debt that is unaffordable.

The next general election in France may well be fought on the issue of restoring a retirement age of 62 which could prove catastrophic for French government finances if the winner comes from this camp.

We can only hope that the recent wave of strikes in the UK will come to an end when inflation falls. This should also mean that interest rates can come down and economic growth can start to improve which will allow the government to at least maintain the state pension at the current rate.

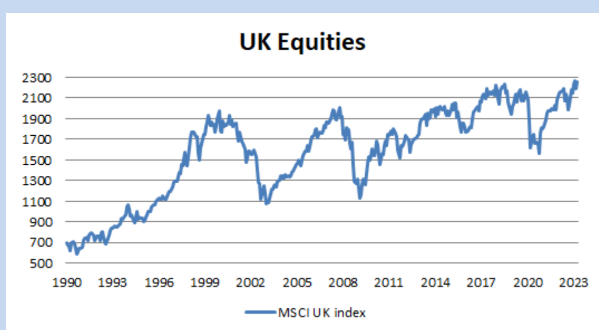
Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

Asset Allocation

In which **Tim Harris**, the Chair of our Asset Allocation Committee, describes the factors influencing our latest Asset Allocation decisions

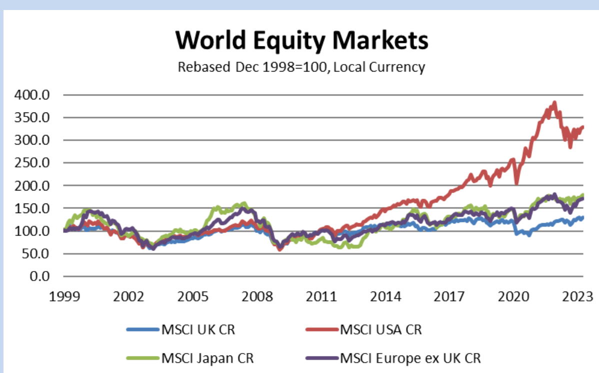
Economic failures have shaken faith in global capitalism	Political failures have undermined trust in liberal democracy and the notion of truth. The ties that ought to bind open markets to free and fair elections are being strained and rejected, even in democracy's notional heartlands of the US and the UK. Around the world, democratic capitalism, which depends on the determined separation of power from wealth, is in crisis. Powerful voices argue that capitalism is better without democracy; others that democracy is better without capitalism. However, a divorce would be an almost unthinkable calamity. For all its recent failings — slowing growth and productivity, increasing inequality, widespread popular disillusion — democratic capitalism remains the best economic system. Such turmoil makes the capitalist's role of wealth creation that much harder.
The world repairs itself from COVID, war, Afghanistan and (in the UK's case) Brexit	The last five years have brought tumultuous risks to global investors. Remarkably, the MSCI All World equity index has risen by 28% over that time – investors should add annual dividends of approximately 3% to that for a heathy annual total return of 7.5% in US dollars. With a return to economic growth across developed countries expected in 2024, we are confident that global equity markets will continue to offer good returns for the patient investor over time.
Our asset allocation is broadly neutral in these uncertain times	This means we are underweight commodities, neutral equity/credit and underweight bonds, with a focus on quality in equities and credit. We are in a late cycle regime - while inflation is normalising, growth is slowing and central banks are still tightening policy, which limits upside to risky assets. While we expect growth to slow alongside inflation for the rest of the year, we remain more optimistic than consensus - despite the incremental credit tightening due to the US bank stress - our perceived recession probability for the next 12 months is not high. However, comparing this late cycle position with relatively low risk premia and investor positioning/ sentiment, we think the asymmetry to add risk to portfolios is relatively poor. Equity volatility has moderated, helped by resilient US growth and a good Q1 2023 earnings reporting season. More bullish positioning from investors increases the vulnerability to shocks, including the US debt ceiling outcomes and renewed financial stability concerns. The growth/inflation mix is likely to remain mixed for the rest of the year, which likely means the late cycle lull continues with equities stuck in a trading range.
We see relatively little upside for global equities in aggregate	We see more upside for non-US than US equities - after a strong performance for European equities YTD we see higher upside for Asia and Japan in particular. Falling inflation as well as upside risk for rates has buffered equities around the recent US banks stress and triggered a material rotation to quality stocks underneath the index level. We retain a high-quality bias within equities, but in most regions we favour a barbell approach by adding selective exposures to cyclical and value areas like banks, energy or basic resources.
Fixed income is becoming more attractive	Higher bond yields and falling rates volatility prevail, with central banks nearing the end of their hiking cycles and less positive equity/bond correlations. However, we expect the US 10-year yield to end the year at 3.9%, German 10-year yields at 2.75% and UK gilts at 4%. Market pricing of Fed rate cuts is likely to diminish into Q2 2024. We expect two or three more 25 bps hikes from the ECB and the BOE and for a peak rate of 3.75% and 5% respectively. Flat to inverted yield curves reduce the attraction of long duration fixed income outside of a recession scenario. For credit spreads, we remain neutral as total return potential is not much above cash. Shorter-duration credit might offer more attractive returns with less drag from duration and inverted yield curves.
We remain overweight commodities	There is structural upside even though, with slowing growth and inflation, commodities, especially cyclical ones, are likely to remain volatile near term. But commodities markets are already discounting a recession, despite supportive fundamentals, which should limit downside risks eventually. We foresee upside to oil prices into the year-end and recent declines are due to excessive recession fears, positioning and excess supply. We also remain bullish of copper and gold prices, which has become a more attractive portfolio diversifier with the weaker dollar and support from central bank buying.

Markets at a glance



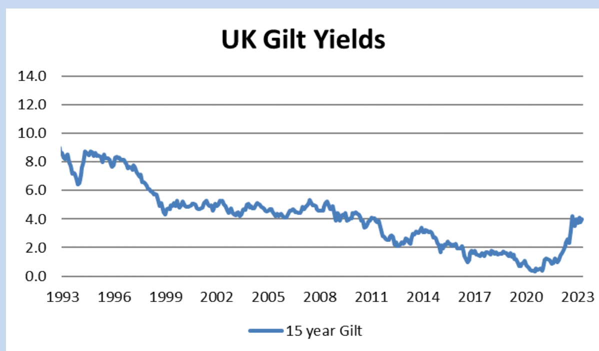
Source: Lipper for Investment Management

The UK benchmark index is driven predominately by commodity prices and global growth. But there are parts of the market impacted by higher bond yields. These mean that the yield offered by equity looks less attractive by comparison. UK large cap dividend yield is 4.1% and has moved below the nominal 10-year gilt yield. The better comparison, of course, is with real bond yields (equities are a real asset as dividends should grow with inflation unlike bond coupons), and while it is true that equity yields remain more attractive than real bond yields, bonds now offer a positive real yield to investors - something not true for most of the past decade. UK equities remain cheap by international standards, but there are not yet significant catalysts to change this state.



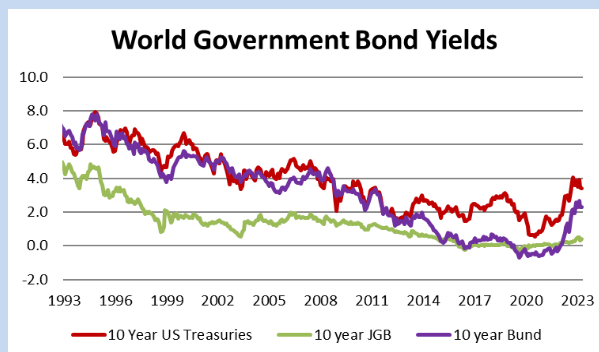
Source: Lipper for Investment Management

Equity volatility has moderated, helped by resilient US growth and a good Q1 2023 earnings reporting season. The growth/inflation mix is likely to remain mixed for the rest of the year, which likely means the late cycle lull continues with equities stuck in a trading range. We see more upside for non-US than US equities - after a strong performance for European equities YTD we see higher upside for Asia and Japan in particular. Falling inflation as well as some upside risk for rates has buffered equities around the recent US banks stress and triggered a rotation to quality stocks. We retain a high quality bias within equities.



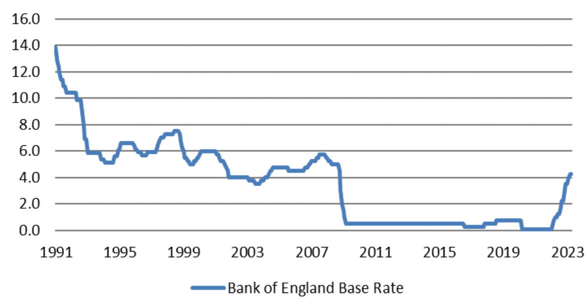
Source: Lipper for Investment Management

The UK 10-year Gilt yield at 4.3% is above similar duration yields even in Greece, and at around the levels last seen in autumn of last year. The spike in yields last year was largely driven by a heightened UK risk premium and concerns about the sustainability of government finances, given large unfinanced tax cuts, while this time the rise in yields appears to be a function of resilient economic growth, higher than expected inflation and an apparent Central Bank reluctance to raise rates. In addition, there has been a high supply of government paper. A flat yield curve may rise further as the Bank of England continues to raise rates.



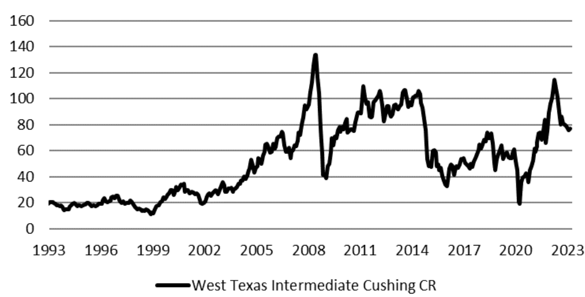
Source: Infront

After a rally heading into the year, government bonds yields have risen sharply on concerns of sticky inflation data and higher rates for longer. We foresee higher rates across developed markets this year and expect them to remain high before potentially declining in 2024. The major European central banks still have work to do because the level of rates remains lower than in the US and the evidence for wage and price deceleration remains less compelling. Rates market participants have been most concerned about the risk that the recent banking turmoil will trigger a near-term recession. But two months after the SVB failure, the evidence for a big impact remains surprisingly limited.



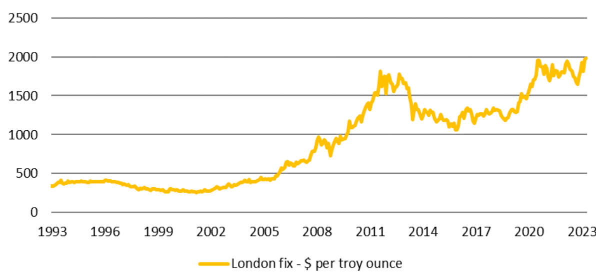
Source: Lipper for Investment Management

We forecast that the Bank of England will raise interest rates to a peak of 5% this year. Public sector strikes and pay demands risk inflation becoming rooted in the UK economy. The Bank of England may need to engineer an economic slowdown at a time of a tight labour market and high input prices. Such action seems to be supported by the Chancellor of the Exchequer. We expect the unemployment rate to remain low, wage growth to be high and the recent increases in prices to prove sticky. These will keep inflation pressures elevated for a while and the Bank of England on a tightening tack.



Source: Lipper for Investment Management

The International Energy Agency (IEA) has slightly tightened its 2023 balance on stronger Emerging Markets ex China and Developed Markets demand and lower North America supply, which more than offset lower China demand and higher Russia supply. We expect a return to oil deficits averaging 2million barrels / day in the second half year. The IEA now projects world oil demand to rise by 2.2mb/d and world oil supply to rise by 1.2mb/d in 2023. We see its report as neutral to slightly bullish for oil prices given the modestly tighter 2023 balance and downward revisions to OECD commercial stocks.



Source: Lipper for Investment Management

With uncertainty elevated, investors are turning to gold. While such a recessionary outlook would normally be good for gold, recently gold prices have stagnated around $2000/oz. The key reason for this is that the situation with the regional banks in the US had proved to be less concerning than originally thought by the market, and recent data even suggest that a small expected hit to US growth may turn out to be pessimistic. Nonetheless, we like gold from here, as we are moving past peak Fed hawkishness since the US is seemingly slowing. That should support a rise in investment demand for gold that has been virtually absent in the last two years. Meanwhile, China and EM central banks continue to rapidly purchase gold, a trend that we expect to continue to dominate gold demand on the back of elevated geopolitical risks and de-dollarisation trends.

Note that where an MSCI Index has been used for illustration. This has been sourced with permission from MSCI Inc.

Quick facts

ISA Allowance 2023/2024	Stocks & Shares ISA Cash ISA Junior ISA	£20,000 £20,000 £9,000
Pension Allowance 2023/2024	The limit is the greater of £3,600 and 100% of salary, subject to the annual allowance of £60,000 (unless money has been accessed through flexi drawdown in which case the annual allowance is limited to £10,000).	

Tax facts

Income Tax	Personal Allowance 2023/2024	Up to £12,570
	Basic Rate @ 20%	£12,571 to £50,270
	Higher Rate @ 40%	£50,271 to £125,140
	Additional Rate @ 45%	Over £125,140
	Married couple's allowance:	Maximum £4,010
	Older spouse born before 6 April 1935	Up to 10% of the appropriate Min/Max
Capital Gains Tax	Annual Exemption - Individuals	£6,000
	Basic Rate tax band (residential property)	18%
	Basic Rate tax band (other assets)	10%
	Higher Rate tax band (residential property)	28%
	Higher Rate tax band (other assets)	20%
	Business Asset Disposal Relief	10%
	Business Asset Disposal Relief limit of gains	£1,000,000
Inheritance Tax	Threshold up to £325,000	Nil
	Over £325,000	40%
Corporation Tax	Full Rate	19%
	Small Companies Rate (SCR)	19%

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