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The Pandemic and Personal Finances

"The greatest wealth is to live content with little".

Plato



Source: Wikipedia

One year on from the first lockdown we will look back on a year that none of us could have foreseen. As we reach the point in the UK where the vaccination programme now looks to be having a real chance of bringing the COVID-19 virus under control we are beginning to imagine what life will be like when we come out of lockdown completely. A lot will depend on the household finances of the vast majority of the population as consumer spending makes up 70% of our GDP.

The impact of lockdowns in the last twelve months has impacted different parts of our society in very different ways. Take for example employment where it has been the 25 to 35 year olds that have seen the highest rate of job losses. This age group now have an average debt per person of £12,819 as reported by a consumer survey. However, average household debt has fallen from £12,910 to £9,246 which is a fall of 33%.

Fintech Times has reported that 9.4 million jobs were furloughed in 2020 and the average debt per furloughed employee was £1,050 in 2020 which amounts to a frightening sum of £9.87 billion. The figure that we don't know is average debt per person who has lost their job or those self-employed people who have not been able to work because of the lockdowns.

Another measure worth looking at is the household savings ratio which was 9.1% in the first quarter of 2020 and rose to an astonishing 29.1% in the second quarter of 2020. A closer look at these numbers reveal that low income families have £95 in savings on average while high income families have savings of over £62,885. This imbalance in society will need to be corrected when we do return to normal but it is going to take a long time as families try to repair their finances. Total household debt in the UK in 2019 was 142% of disposable income and it will be important to see how this statistic has moved during 2020.

The February report from the Bank of England has said that between March and November of 2020 £125 billion in excess savings was accumulated and this figure will certainly rise through the third lockdown. Most of these savings have been made by the over 55 year olds. Average savings per household for the 35 to 44 year olds was £6,000 in 2020 whereas the figure for over 55 year olds was £20,000.

It is clear that when we come out of lockdown there be a recovery in consumer spending. It is forecast that energy, hospitality, entertainment and clothing will see a strong initial recovery as people begin to socialise again and try to make up for a year of restricted living. Sectors that have done well during the Pandemic such as electronics and groceries will probably see a fall in demand. Overall consumer demand is forecast to recover strongly from the fourth quarter of 2021.

The older consumer will have to lead the recovery in consumer spending simply because they have the money and the least amount of debt. We must hope that the older generation will support the hospitality and entertainment sectors when we come out of lockdown but I somehow think that the younger age groups will take on more debt as they will be keen to make up for lost time. One thing that we know for certain is that the wedding business is going to be booming for the next 18 months after we come out of lockdown.

The Chancellor has rightly continued with his support measures well into 2022 so there is every chance that the economy will recover quickly, which will in turn help the employment numbers. On the question of how soon we can address the financial imbalances in our society is another matter altogether but I suspect the Chancellor will opt for increasing taxes on the wealthy and big businesses rather than increase basic rate income tax or national insurance rates for the low paid.

Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

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

Winning the economic recovery

The success story of the global pandemic so far has been one of China's economic outperformance. China has managed to suppress the virus quickly, negating the need for lengthy and widespread lockdowns. In contrast, other countries have struggled to get on top of the virus and have been in a state of intermittent lockdown for most of the past year. China has returned to its pre-virus trend of GDP. Meanwhile, every other major economy is still suffering from large shortfalls in output.

One of the key messages to come from the recent National People's Congress in Beijing was that policy support for China's economy will be withdrawn over the course of this year. The activity data will look extremely strong over the coming months. However, underlying momentum is slowing, and the withdrawal of policy support means that this is likely to show up in the year-on-year growth rates over the second half of the year. The fact that China's economy is now back above its pre-virus path makes a slowdown in growth all but inevitable.

China is still faring far better than any other major economy. If its growth slows over the course of this year, then a more accurate interpretation would be that China's growth rate is normalising rather than underperforming. The response of economic policymakers in China to the crisis was exemplary. Stimulus was large, quick and effective at shoring up aggregate demand. But the old problems that dogged China's economy before the pandemic struck – over-investment, excess capacity and too much state intervention in the allocation of resources – have not gone away. These issues must be managed over time. We have always been wary of investing directly in Chinese equities. However, Asian opportunities have featured large in our portfolios over the years. This has made a valuable contribution to the risk adjusted growth and we remain of the conviction that on a first-in, first-out of the crisis basis, Asia will continue to fuel upside performance across our portfolios.

Meanwhile the US is accelerating

Not only is the size of the Biden \$1.9 trillion fiscal stimulus huge, but it is coming at a time when rising vaccinations and falling virus numbers are allowing many US states to ease restrictions on activity. The result is likely to be an upsurge in economic growth over the coming months and quarters. We expect the economy to expand by 6.5% this year. In the process, US GDP is likely to surpass its pre-virus level by the summer. The fact that the US economy is still below its pre-virus path means there is significant scope for a rebound in output as the economy opens up, particularly with the turbo-charge of additional stimulus. This creates opportunities for the fund managers that we work with – the caveat being that we consider the US equity market to be one of the most expensively valued in the world.

This contains an important lesson for other economies

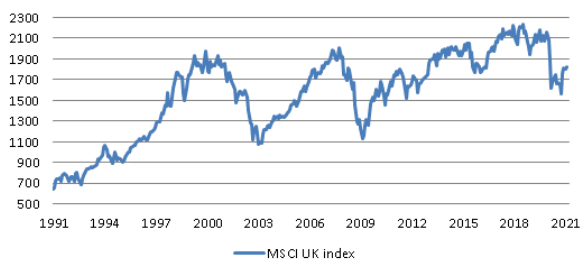
As the effects of the pandemic fade, old problems will start to resurface, particularly across Europe. The biggest challenge facing advanced economies prior to the pandemic was the extremely weak rate of productivity growth across the developed world. This had several causes, including low rates of business investment and the failure of new digital technologies to feed through into broad-based rises in productivity. The pandemic has compounded matters by causing widespread economic scarring and a permanent hit to productivity. We take a more sanguine view of the long-term damage caused by the pandemic, but have stopped short of forecasting a significant boost to future productivity stemming from the pandemic. It is, however, possible that by spurring investment in new technologies and forcing firms to find new ways of working, the pandemic proves to be the spark that ignites a period of faster productivity growth in advanced economies. We continue to invest in assets that reflect improving near-to medium-term growth prospects, such as technology, healthcare and robotics.

Buy the recovery

The above shifts will play out over years, not months, and it will be some time before we can judge the long-term impact of the pandemic. In the meantime, investors should prepare for a shift in the narrative around the recovery. Equities remain the clearest growth orientated asset class to express our optimism for global recovery. We maintain a short duration to our fixed income assets, which has protected portfolios when inflation concerns arose and many government bond markets sold off. We also invest in strategic bond funds, which harness opportunities for rate spread and carry across the world.

Markets at a glance

UK Equities



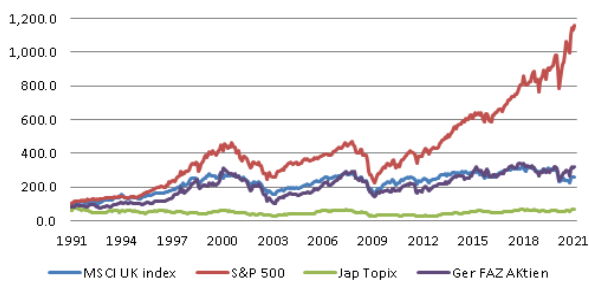
Source: Lipper for Investment Management

Brexit disruption to UK-EU trade and the latest wave of COVID-19 have taken a toll on early year economic growth. However, the signs are that global trade will improve from here and we expect UK equities to continue their 2021 rally. The boost to foreign earnings in sterling terms from a weaker pound would prevent a big fall in the FTSE 100, as it did in the aftermath of the EU referendum. Last year's FTSE 100 underperformance against US and emerging markets in part reflects the high weight within the index of sectors hit hardest by the pandemic: e.g. Energy, Banks and Retail. The latest rally in equities is driven by some recovery of the very sectors that suffered most in the recent downturn.



World Equity Markets

Rebased Jan 1990=100

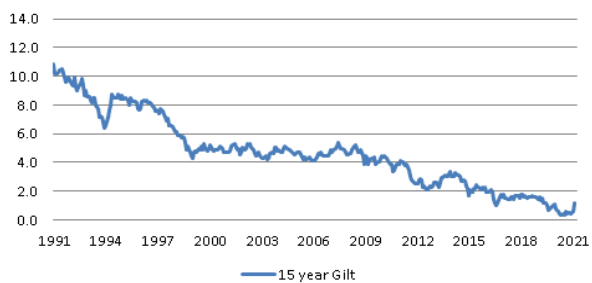


Source: Lipper for Investment Management

We expect global equities to make gains, as the world economy recovers from the effects of the pandemic. We believe that equities in Asia will be the best performers over the next 12-18 months. The recovery in risk appetite will weigh on the US dollar, although uncertainty about the post-virus outlook and the continuing risk of US-China tensions, even with a new US administration, may keep the dollar from falling much further in the near term. Our forecasts rest on the assumption that the major economies manage the coronavirus pandemic without slamming the brakes on activity, even as policymakers debate the inflationary consequences of their actions. Corporate earnings forecasts suggest sizeable recoveries in many countries this year.



UK Gilt Yields

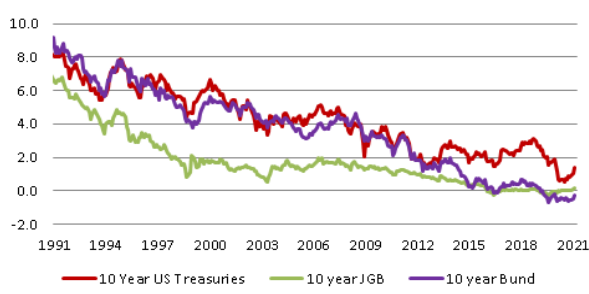


Source: Lipper for Investment Management

There has been some increase in gilt yields in early 2021, as inflation concerns arise and markets look to the Bank of England for possible changes in policy guidance. Extremely low official interest rates and more quantitative easing have kept gilt yields close to their record lows and we believe that a policymaker narrative that no interest rate intervention is imminent will restrict their further rise. 10-year nominal gilt yields have risen to their highest level for a year, widening the gap between 5-year and 30-year borrowing costs to a two-year peak. Even though the Bank is now buying fewer gilts per week than are being issued, we think that a likely further £250 billion expansion of QE to fund government expenditure and continued rock bottom interest rates will keep gilt yields low.



World Government Bond Yields

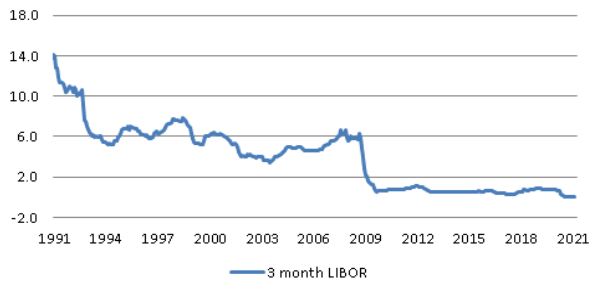


Source: Infront

Government bond yields in the US, Germany, and Japan have picked up from rock bottom levels across their respective curves, as markets scrutinise central banks for clues about interest rate policy in light of concerns that inflation might be creeping up after very expansionist monetary policy. Bond yields in the euro-zone "periphery" have also risen. Policy messages seem to be "wait and see" with respect to growth and inflation risk. We believe that monetary policy will remain extremely loose and that yields will remain very low to end-2021. The yields of investment-grade corporate bonds in the Euro Area, the UK and the US have also risen. As economies reopen, there is more scope for spreads of high-yield bonds to fall than those of investment-grade bonds.



UK Short term Interest Rates

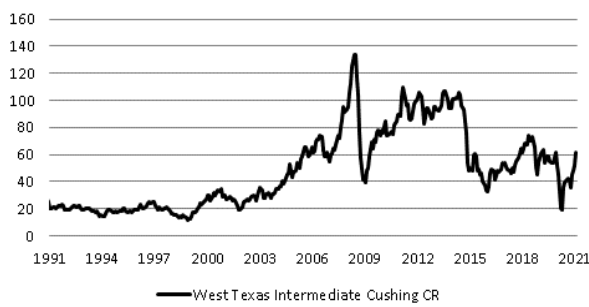


Source: Lipper for Investment Management

Markets have swung from pricing in a chance of negative interest rates to expecting an increase in rates in the medium term. UK rate expectations are between those in the Euro Area, where policy rates are around zero, and those in the US, where the Fed may raise rates by the year-end. Use of LIBOR interest rates is to be replaced by December 2021. For loan agreements, swaps and derivative contracts, the transition to alternative interest rates represents a major change to the financial services industry. Meantime, we expect LIBOR rates to remain close to historic lows, as we doubt the Bank Rate will be raised above the current rate of 0.10%. LIBOR spreads have been stable and low in the UK and the Euro Area, and lower than in the US.



Spot Crude Oil Price

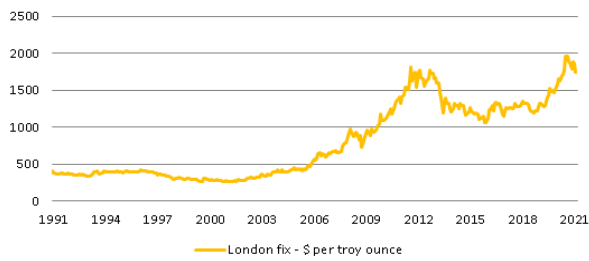


Source: Lipper for Investment Management

Oil prices have risen in the early months of 2021. Brent crude touched a peak of \$70. We think these prices could be supported, as OPEC persists with deep supply cuts and lockdown restrictions start to be eased in developed economies. US crude production has already fallen sharply, given a high production cost base. However, higher oil prices now will start to incentivise supply, which will likely weigh down on prices later in the year. Furthermore, as the gradual withdrawal of stimulus measures leads to slower growth in China's economy, demand may level off.



Gold Bullion Price



Source: Lipper for Investment Management

A further easing in investment demand will weigh on the price of gold, despite ultra-low real bond yields and higher inflation expectations. The prices of all the precious metals, including gold, have drifted lower since the autumn. Prices had been supported by a weaker US dollar and falling real yields, but the gold price has now retreated by 15% from its one-year high. The physical market for gold remains weak. Despite a rebound in India's gold imports, China's gold imports are very weak.



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

Quick facts

ISA Allowance 2020/2021	Stocks & Shares ISA	£20,000
	Cash ISA	£20,000
	Junior ISA	£9,000
Pension Allowance 2020/2021	The limit is the greater of £3,600 and 100% of salary, subject to the annual allowance of £40,000 (unless money has been accessed through flexi drawdown in which case the	

Tax facts

Income Tax	Personal Allowance 2020/2021	Up to £12,500
	Basic Rate @ 20%	£12,501 to £50,000
	Higher Rate @ 40%	£50,001 to £150,000
	Additional Rate @ 45%	Over £150,000
	Married couple's allowance: Older spouse born before 6 April 1935	£8,445
Capital Gains Tax	Annual Exemption - Individuals	£12,300
	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%

GHC Capital Markets Limited · Investment Managers & Stockbrokers · 22-30 Horsefair Street, Leicester LE1 5BD
Telephone 0116 204 5500 · www.ghcl.co.uk

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