Market2Market

A forward view of the global economy and financial markets

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Second Hand Cars

"I went into an electric car dealership and asked them how much they charged".
ANON

Source: Wikipedia

The latest Consumer Price Index (CPI) for November 2021 showed the largest 12 months increase since September 2011 at 5.1%. One of the largest contributors to this rise was in transportation, with used car prices showing the largest contribution to the figures since the start of the National Statistic series in January 2006. Used car prices have risen by an astonishing 31.3% since April 2021.

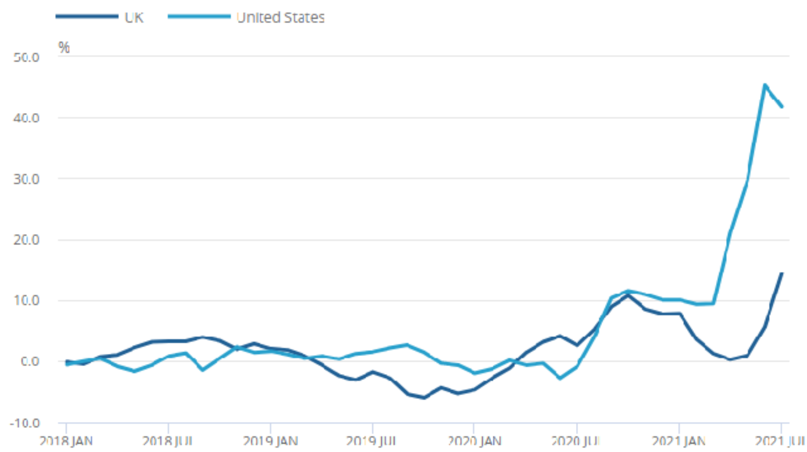
Why has there been such a spike in used car prices I hear you ask? Demand for used cars has been driven by a combination of factors that have all come together to create a dream market for second hand car dealers which in turn has led to a surge in on-line car trading platforms. This has provided work for some television personalities and boosted advertising revenue for the commercial TV stations.

After the lockdowns of the last 18 months many consumers have been able to increase their savings and they either wanted to upgrade their cars or switch to a greener alternative such as a hybrid or all electric car. The problem is that new car production has been drastically reduced by a global shortage of semiconductor chips and labour disruptions which have slowed down production lines. So, fewer one-year-old cars are coming onto the market following the fall in new car registrations last year. This meant that leases have been extended resulting in fewer part exchanges than normal which has been caused by the fall in new-car supplies.

This problem is not peculiar to the UK and the chart below shows that prices have risen even higher in the United States. Prices have also risen steeply in Europe.

Second-hand motor cars 12-month price growth, UK and United States

January 2018 to July 2021



Source: Office for National Statistics – Consumer Price Inflation, U.S. Bureau of Labor Statistics – Consumer Price Index for All Urban

Until new car production returns to normal the market for used cars is going to remain strong. This leads to the question, at what point does one sell the car and downgrade for the short-term, having made a nice profit, before buying a decent motor when the market stabilizes again.

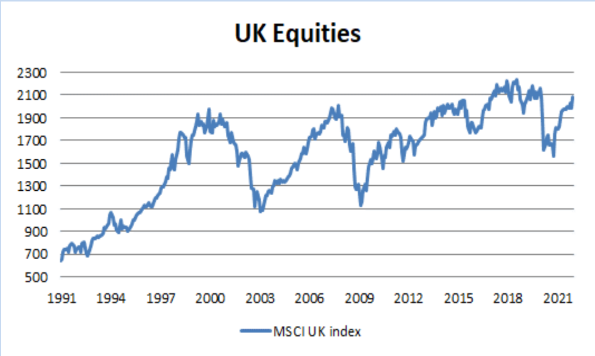
Richard Harper
Head of Asset Allocation
GHC Capital Markets Limited

Asset Allocation

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

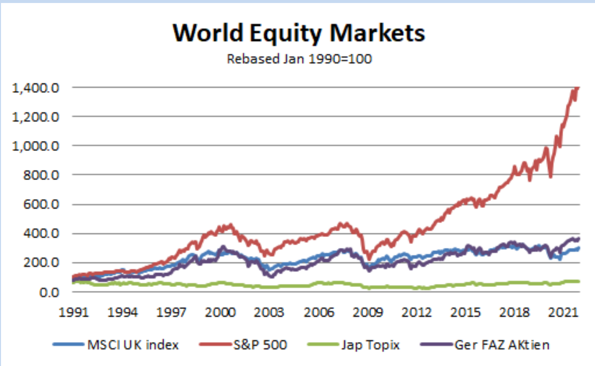
Risk Markets on Alert as Rates Spike	The initial days of 2022 already appear to be testing the resolve of the bulls. Alarm bells are ringing in the bond market as the Federal Reserve's pivot away from the transitory inflation narrative begins to sink in, and investors assess the implications of possible Fed actions to stem inflationary over-heating on portfolios. Bond yields have spiked: the rise in the US 10-year Treasury yield to 1.76% takes the market to a level last seen in March 2021. On two previous occasions in 2021, the market had a brush with 1.75%, but on both occasions yields receded. The absence of a breakout to higher levels on those occasions was partly a result of the Fed's patient view on inflationary pressures building in the system.
Technology stocks have retreated as bond yields have crossed last year's high	Tech stocks have had a difficult start to the year, following a sharp downtrend that reflects markets' distaste for the notion of higher rates and tighter policy. It has also been the case of stretched valuations – for more than a year now global technology stocks are trading at high earnings multiples. The MSCI World Information Technology Index is trading at a trailing PE ratio of 36x even now, down from 38x in December. However, that still constitutes a huge expansion in the earnings multiple, which was at 21x immediately after the first COVID-induced dip in March 2020. Technology may be vulnerable into a Fed tightening cycle and as yields spike.
Credit markets find buyers	On the other hand, US high yield bonds had a very solid December, with spreads reaching multi-year lows. Although the start of the year has seen some consolidation, there has been no serious sell-off. The HY spread to government bonds is at 383 basis points in the broad market, compared with 429 basis points at the beginning of December, based on JP Morgan indices. Some tech names have faced selling at a more granular level, offset by gains elsewhere, including the volatile energy sector. A particular standout in the sub-investment grade market has been leveraged loans, where the appeal of low-duration credit exposure has been a trigger for greater investment demand. While the outlook for good total returns for high yield could be challenged by the Fed's rate stance and policy course, loans could prove to be a more resilient performer this year in relative terms.
The Federal Reserve has signalled that it will take inflation threats seriously	This time might very well be different: no longer can the market view the Fed as on the side-lines. The minutes of the latest FOMC meeting make it clear that the Fed means business. We know that its tapering process will end by March, implying there will be no further purchases after that. We also know that the lift-off in rates could begin at much the same time, with three or maybe even more during the year. Another policy action that will have a tightening effect will be a balance sheet run-off, estimated by JP Morgan to be around $100 billion per month phased in from July onwards.
Labour market conditions are getting tighter	Don't be fooled if inflation cools off: after the serious lift-off in inflation in H2 2021, it would be wrong to assume that level of 5-6% and higher in CPI will be maintained. Statistical base effects make that very unlikely, as does the moderation in input costs that will slowly permeate through the price surveys from now onwards. However, a theme for 2022 will be the tight labour market. There is little evidence to suggest that labour market shortages are about to ease. While much of the chatter about the "great resignation" is still just that, at the margin, evidence is emerging that wages globally are starting to edge up in favour of workers. Inflation pricing is still hinting at a higher post-COVID level: it is worth noting that long-term inflation breakeven interest rates appear to have stabilised in the 2.5% to 2.6% range. Such a level is high by historical standards, but is much lower than the prevailing level. That chimes well with the view that while inflation should moderate from here, nominal bond yields are at risk of further increases, to adjust to the reality of tighter policy.
Last year was kind to our portfolio across risk grades from cautious to high risk.	In general, we remain cautious investors, backing better value developed market equities and commodity plays and minimising emerging market exposure. In bond markets, we maintain short duration in portfolios.

Markets at a glance



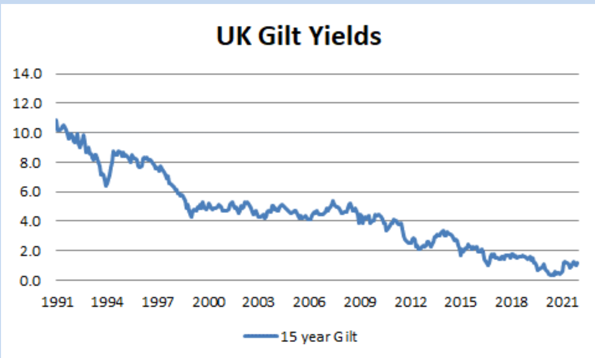
Source: Lipper for Investment Management

The UK equity market is becoming more popular with international investors after a period of post Brexit doldrums. Its relatively modest valuation and the resilience of leading international companies has alerted fund managers to its attractions. However, the 18% rise in FTSE 100 last year still lagged the US and many European markets, so we expect more catch up to play out. Despite a strong earnings and cashflow recovery from the lows of the COVID crisis, signs of rising inflation pressure with a risk that monetary policy may become less accommodative are concerns. We are moving into a phase of rising domestic interest rates, as the Bank of England addresses inflation imbalances.



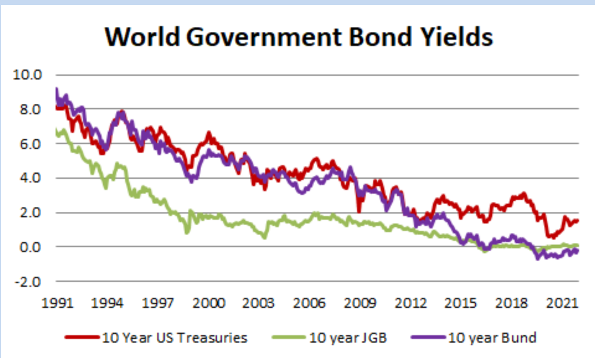
Source: Lipper for Investment Management

While there have been sporadic setbacks with COVID-19 variants, this needs to be seen in the context of higher natural and vaccine-acquired immunity, lower mortality and new antiviral treatments. Key risks to a bullish outlook are a hawkish shift in central bank policy, delay in China reopening or continued supply chain issues. We expect further upside in the S&P 500 on continued robust earnings growth, labour market recovery, consumers remaining flush with cash, supply chain issues easing, and the inventory cycle accelerating off historic lows. The outlook for European equities is positive, as central bank policy remains accommodative and another year of expected positive earnings is foreseen. Japanese stocks should also have moderate upside in 2022 and we expect recovery from EM equities.



Source: Lipper for Investment Management

Gilt yields have continued to rise at both the short and long end of the curve – the 10-year gilt currently yields 1.19% to redemption, which compares to a low of 0.62% in July. Inflation concerns reflect shortages of materials and wage pressures, given labour shortages in sectors, such as retail and hospitality. Low absolute yields reflect extremely low official interest rates, but real gilt yields are very negative. Policymakers are now signalling their concern about inflation risks and have started a rate rising phase. Markets will be looking closely at the risks of policy error, given the need to balance economic recovery and housing affordability against significant inflation risk. Any spike in gilt yields could be costly for the economy.



Source: Infront

The Federal Open Market Committee is laying out the path for the removal of accommodation and announced the tapering of asset purchases in November. We expect the Fed to finish tapering by mid-2022 and to start hiking by 25bp quarterly in the summer. Thus, we expect Treasury yields to rise, with the intermediate sector (bonds with a maturity of 2-10 years) leading the way. With markets pricing a July hike, we project 2-year yields rising to 1.20% by year end. Meanwhile, given the resilient economic environment, the yield curve has room to steepen for a short period in early 2022 and 10-year yields are projected to rise to 2.25% by the end of 2022. The European Central Bank will likely deliver asset purchases beyond its pandemic emergency purchase programme, implicitly pushing back any rate lift-off to late 2022.

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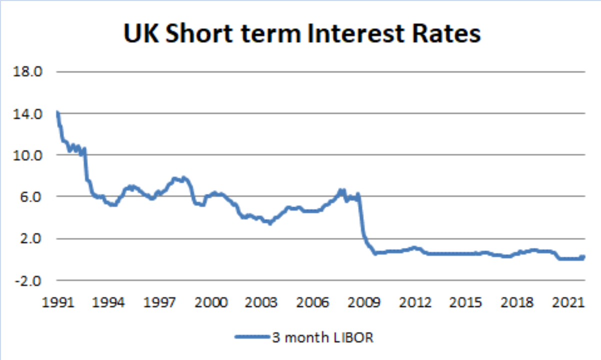
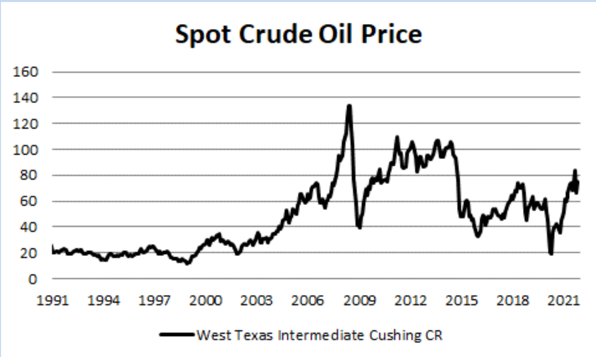


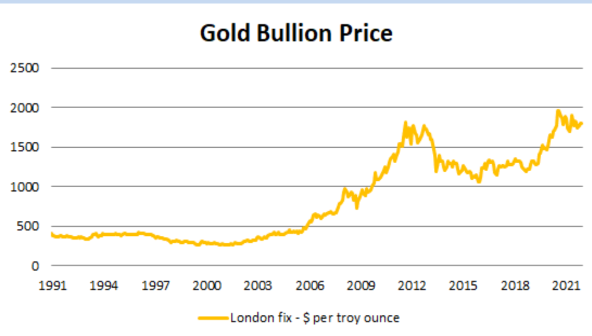
Source: Lipper for Investment Management

In 2022, strong growth momentum is expected to continue with gradually declining inflation pressure triggering different responses across central banks. Further vaccine success and booster deployment will help break the link between the virus and mobility restrictions, with a gradual adjustment on the monetary policy side as central banks focus on labour markets and wage pressures. The Bank of England has already signalled its concern over inflation with a rate hike of 15 basis points in December. We expect a series of 3-4 further interest rate rises through 2022 to address inflation.



Source: Lipper for Investment Management

Brent crude oil spot prices have continued to rise to $84/ barrel from a low of $36/barrel from August 2020. Rises over the past year have resulted from steady draws on global oil inventories, which averaged 1.8 million barrels per day. Strong underlying fundamentals sustaining above-potential global GDP growth in both 2022 and 2023 with pro-growth fiscal policies continue to support the ongoing recovery. Oil looks set to remain a major beneficiary of a continued global economic reopening over the course of 2022. The last time consumption was as high as we expect, US shale drillers were pumping flat out and the Organization of the Petroleum Exporting Countries and its allies were locked in a battle for market share.



Source: Lipper for Investment Management

With the lift off in inflation it is a surprise that the gold price ended 2022 nursing annual losses of 4% in dollars. Physical demand for gold has remained strong, however investors have only had limited interest in paper gold. ETF buying has been subdued. The attractions of cryptocurrencies to investors looking for an inflation hedge explains some of the poor performance of precious metals. Ironically, central banks' gold purchases have remained strong on their view that gold is a valid asset for reserve management of inflation risk. Despite a rebound in India's gold imports, China's gold imports are weak. We expect gold demand to be driven by central bank policy and investor fears of inflation risks. Gold is a real asset, which is the optimum hedge in inflationary times.

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

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Quick facts

ISA Allowance 2021/2022	Stocks & Shares ISA Cash ISA Junior ISA	£20,000 £20,000 £9,000
Pension Allowance 2021/2022	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 annual allowance is limited to £4,000).	

Tax facts

Income Tax	Personal Allowance 2021/2022 Basic Rate @ 20% Higher Rate @ 40% Additional Rate @ 45%	Up to £12,570 £12,571 to £50,270 £50,271 to £150,000 Over £150,000
	Married couple's allowance: Older spouse born before 6 April 1935	Minimum £3,530 Maximum £9,125 Up to 10% of the appropriate Min/Max
Capital Gains Tax	Annual Exemption - Individuals Basic Rate tax band (residential property) Basic Rate tax band (other assets) Higher Rate tax band (residential property) Higher Rate tax band (other assets) Business Asset Disposal Relief Business Asset Disposal Relief limit of gains	 £12,300 18% 10% 28% 20% 10% £1,000,000
Inheritance Tax	Threshold up to £325,000 Over £325,000	 Nil 40%
Corporation Tax	Full Rate Small Companies Rate (SCR)	 19% 19%

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The information given is of the opinion of GHC Capital Markets Limited, the opinions constitute our judgment which are subject to change.

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