BROOM IFA
IMAGINATIVE FINANCIAL ADVICE

Monthly Investment Update
November 2022

Contents:

Performance Update

Global stock markets rebounded in October, with the FTSE 100, Euro Stoxx and S&P 500 gaining 2.99%, 5.63% and 4.81% respectively.

Rishi Sunak becoming Prime Minister was well received by financial markets. UK Government Bond yields fell sharply and are below where they were before the mini-budget. UK interest rates are now expected to peak at below 5% in 2023, down from as high as 6.3% just after the mini-budget. This led to UK Government Bonds growing by 3.82% in October, but they are still down 22.27% over the last year.

Sterling also rebounded against the Dollar by 4% on the news and is now at $1.14. Whilst this provided a headwind to portfolios, Sterling is still near historic lows and has fallen significantly over the last year. UK assets remain in the doldrums with the FTSE 250 down 20.34% over the last year and one of the world's worst performers.

China's party congress confirmed that leader Xi Jinping will stay in power indefinitely. This news, coupled with the continuing Covid lockdowns, has meant that overseas investors have been selling out of Chinese stocks. The MSCI China Index fell 18.73% in October and is down 37.40% over the year. By contrast, the MSCI India index is up 11.42% and Brazil is up 44.16%.

UK inflation rose to 10.1% and it is this September figure (the data is released in October) that is crucial as it is the one used to uprate pension and benefits for the following April. Whilst inflation rose higher than expected, the price of many commodities remains stable, and it is looking likely that inflation will fall over the next few months.

Big technology companies such as Alphabet (Google), Meta (Facebook), Microsoft and Amazon have seen their values fall significantly over the last 3 months, with October continuing the decline. Whilst big technology has fallen, we saw gains in other technology-related sectors such as Biotech, Cyber Security and Robotics.

The performance of the main markets we invest in over the last month, 6 months and 1 year is shown below:

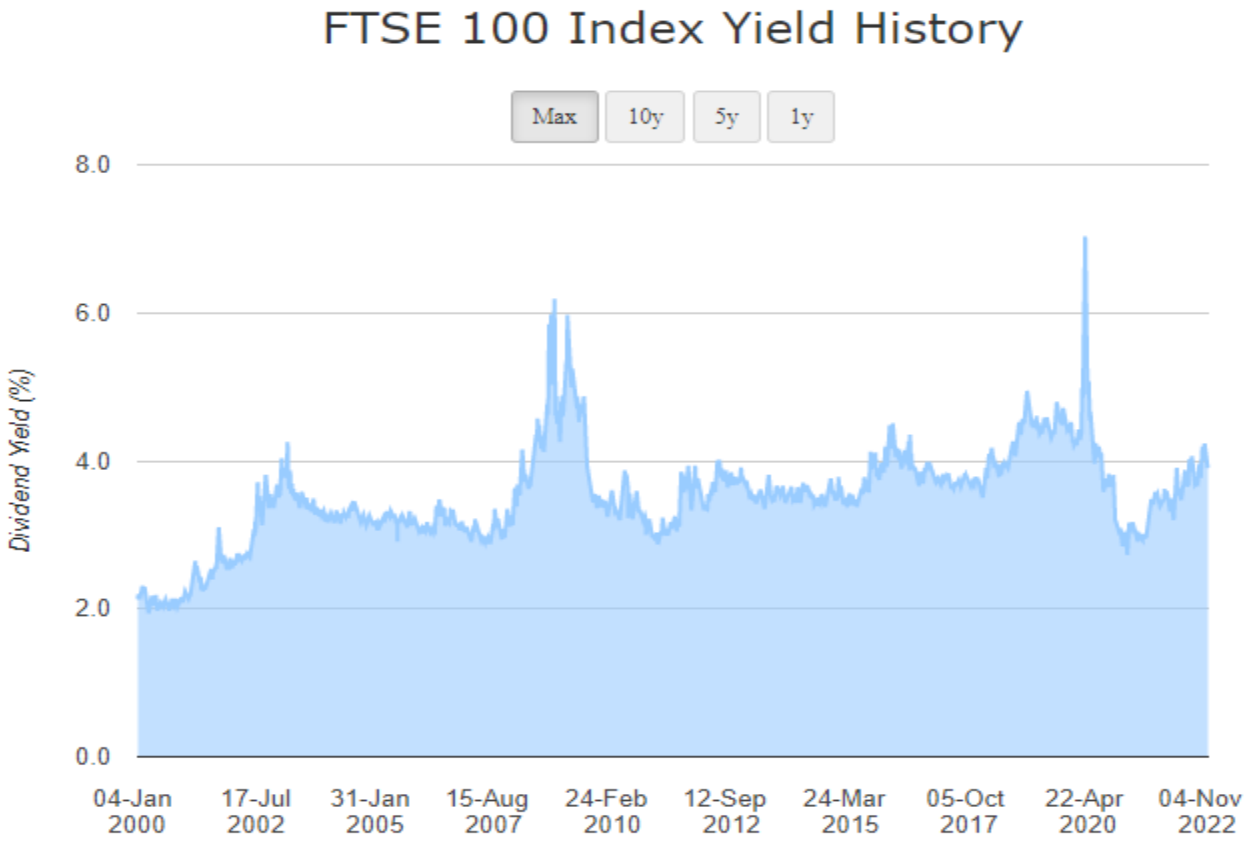
Markets	Performance % 1 month	Performance % 6 months	Performance % 1 year
FTSE 100	2.99	-4.28	1.68
MSCI World	3.94	0.48	-2.48
S&P 500	4.81	3.05	1.66
Euro Stoxx	5.63	-3.62	-12.59
Nikkei 225	0.43	-2.14	-12.79
Emerging Market Equities	-6.04	-12.12	-17.53
UK Corporate Bonds	4.12	-11.00	-18.49
UK Gilts	3.83	-14.53	-22.19
Gold	-4.98	-6.67	9.87

*All figures are sourced from Financial Express to 31.10.2022 and converted into Sterling.

Investment Overview

We must remember that markets have already priced in the "doom and gloom" that we are reading about in the media every day. Whilst bonds have crashed this year and are set to have their worst year ever on record, there comes a point in time when they offer great value and will start to recover. This will happen when inflation first starts to fall and then interest rates will not have to go up as high as expected. We could be very close to this point. The same will happen in equity markets and, with the yield on the FTSE 100 over 4%, we could be very close to the equity recovery as well. In the meantime, we remain in a very volatile period.

The chart below shows the FTSE 100 dividend yield history. The yield is currently 3.89% but if we add in the special dividends (one offs) that have been paid this year, it increases to 4.09%. You can see how 4% is a level that it doesn't go above often and when it does, it is normally due to a crash in the index which makes yields spike higher temporarily.



Asset Class Review

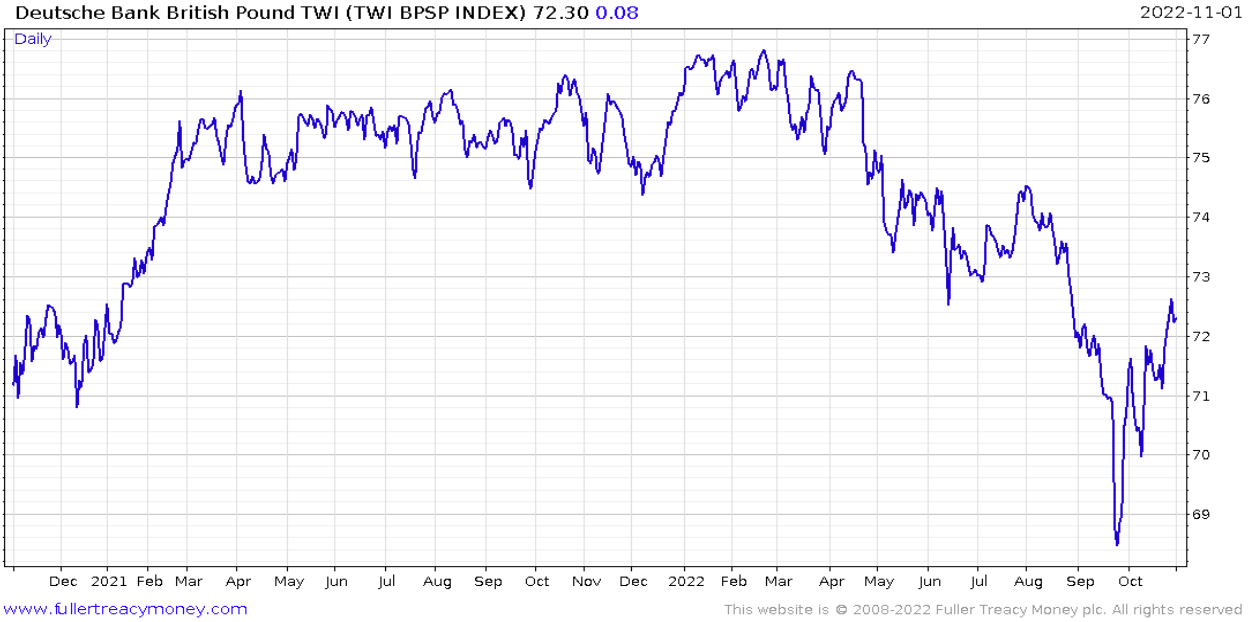
This section will give you an insight into our current thinking. This month we look at the most important charts affecting our wealth.

UK Gas–remains highly volatile

UK gas prices remain highly volatile, and it is this volatility that arguably brought down Liz Truss as her mini-budget would have given the UK Government an unlimited two-year liability for paying for gas/energy costs. If the price spiked again then UK Government borrowing would have been horrendous but if the price fell, then the cap would have potentially not cost anything. The limiting of the price cap to 6 months certainly helped restore economic stability. But what happens if the price remains very high over the next 2 years? Putin knows that he can bring economies to their knees, cause deep recessions and governments to be changed.

Sterling recovers

The chart below shows the value of Sterling against a basket of other major currencies. You can see how far it fell during Liz Truss's term as Prime Minister and how it has recovered somewhat after she resigned.



US Treasury yields-continue to rise

The chart below shows the yield that you can receive from investing in US Government Bonds over the next 10 years and it has broken above 4%, a level not seen since 2008. By contrast the equivalent UK bonds hit 4.5% under Liz Truss but have now fallen back to 3.5%. Higher borrowing costs have hurt growth companies over the last year, particularly technology related ones.

Stock markets at a pivotal point

Global stock markets recovered somewhat in October but still remain in downtrends generally. The chart below is of the Euro STOXX 50 (Europe's 50 largest companies), and you can see how since 2022 each recovery high has been lower than the previous high and each new low is below the previous low including the recent September low. However, it has advanced higher, and this move could be strong enough to break this sequence. The chart below is similar to many other global markets.

In Summary

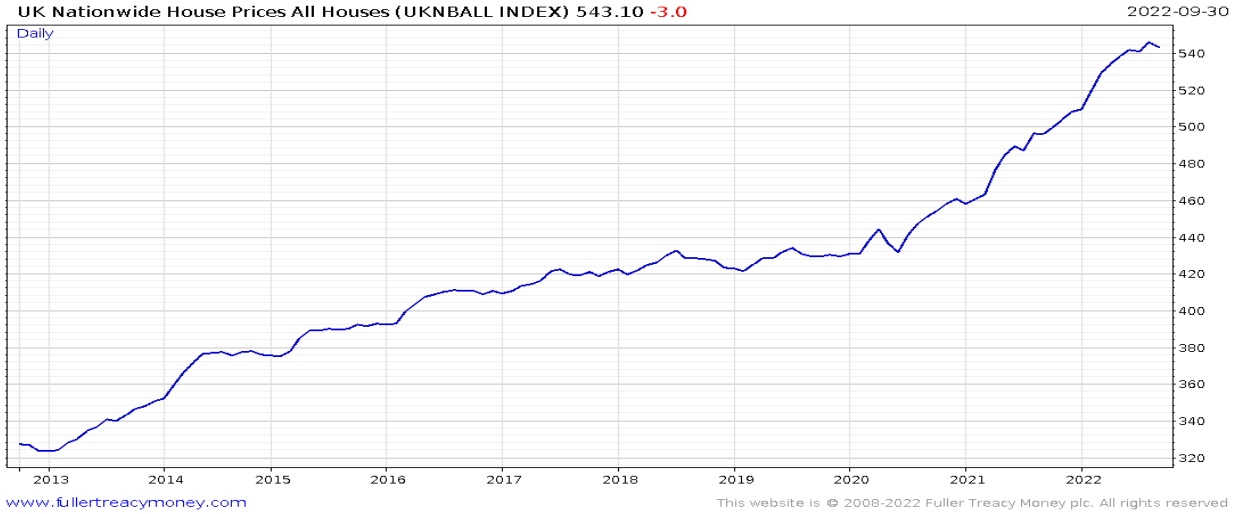
The price of gas has fallen, and most other commodities remain stable. This bodes well for inflation to start to fall and interest rates to peak lower than expected. The panic in the UK following the mini-budget has subsided and bond yields have fallen whilst Sterling has recovered somewhat. However, they remain high in the US and show no signs of falling. Equities are at a pivotal point, and could we be about to experience a Santa Rally?

House Price Crash?

Lloyds bank made headlines last month forecasting the UK economy to shrink by 1% next year and by as much as 4.5% in a worst-case scenario. They also predict that due to rising interest rates we will experience a 7.9% drop in house prices, but at worst they could crash by almost 18%, with commercial property falling by as much as 36%. However, the historical figures are still positive with the Halifax stating that house prices in September 2022 were 9.9% higher than the same month a year earlier; Rightmove has seen average asking prices rise 0.9% to a new record of £371,158, and Nationwide has said that there has only been a modest slowing in UK house price growth to 9.5% in September from 10% in August. So, are we going to experience a house price "crash"?

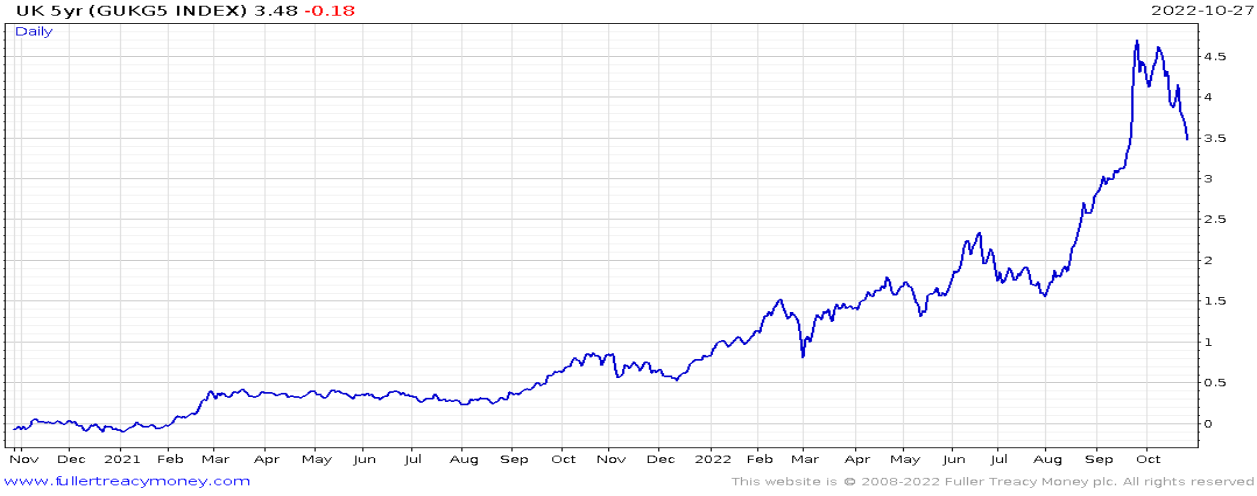
Historic House Price Growth

House prices have been racing ahead since Covid, but the rate of growth appears to be slowing a little. This makes sense as house prices will nearly double every 7 years if we get 10% per annum growth. From the Nationwide house price chart below, it is clear that the rate of advance increased since January 2020 and a fall of 7.9% would take the chart below to around 500 and still much higher than pre-Covid:



Mortgage Rates

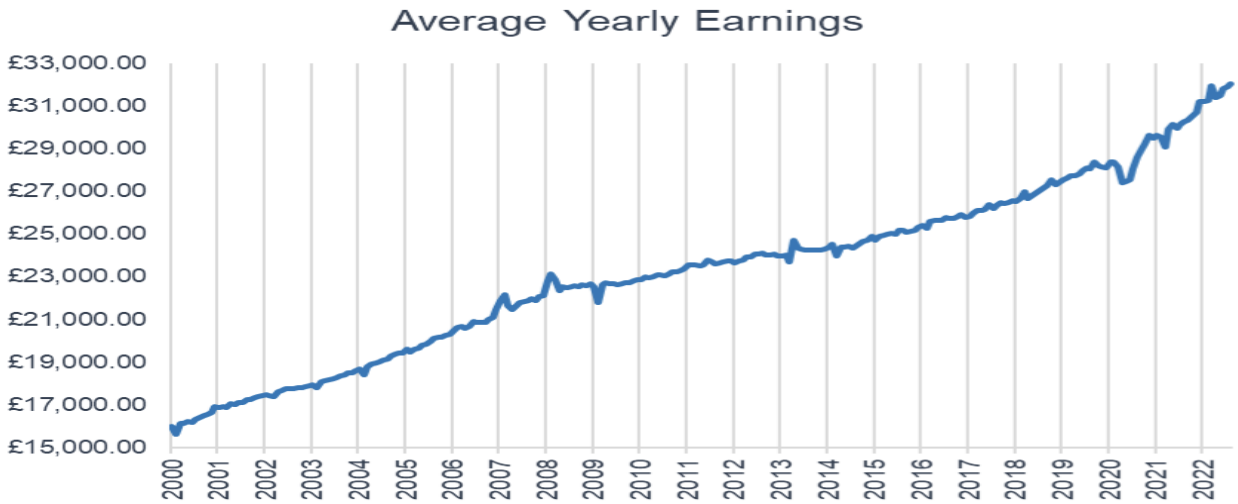
Central banks globally are raising interest rates to combat inflation. The UK is more susceptible to rising interest rates as our mortgages are predominantly short-term fixed-rate mortgages or variable ones. Our longest fixed-rate mortgage tends to be 5 years, whereas the USA has fixed rates of up to 30 years. Our 5-year fixed rates have just hit 6% but were around 2% not so long ago. Banks price 5-year fixed rates off the 5-year gilt chart below.



As you can see the yield on gilts rose to just over 3% before the mini-budget, but the chaos after the budget caused the yield to go above 4.5%. This is what caused the panic and jump in mortgage rates. Subsequently, the rate has come down and mortgage rates should follow a similar path, although banks are always keener to increase mortgage rates than reduce them.

Salaries are rising

According to the Office for National Statistics (ONS), the average earnings in August 2022 was £32,084 per annum. Whilst pay decreased early on in Covid, we have seen earnings rise significantly recently with average total pay now growing by 6%. Banks generally lend as a multiple of a person's salary (income) and if we experience strong growth in salaries then house price falls should be small and temporary. You can see how the rate of growth has started to accelerate higher:



Real Incomes Decreasing

Whilst rising salaries bode well for house prices, real incomes are falling due to inflation of over 10% and wages rising at only 6%. The price of important necessities like food and heating are going up the most and it is easy to see how households, especially lower-income ones, are being squeezed. If unemployment rises from here then we could experience a lot of families unable to pay their mortgages and many more forced sellers entering the housing market, potentially pushing down prices. However, we are not experiencing rising unemployment yet.

Summary

The price of a typical UK home is now 7.1 times average earnings, which is the highest level ever seen, making houses unaffordable to many potential first-time buyers. Perhaps we have seen prices rise too quickly recently and it could be argued that a small correction of below 10% is what we need. We do have catalysts for a correction - rising interest rates and a squeeze on incomes. But with average earnings rising rapidly, unemployment low and mortgage rates perhaps peaking, any fall should be small, and of short duration. Perhaps the Halifax is correct in its prediction.

Final Comment

After the resignation of Liz Truss, we have some stability again in the UK economy. Sterling has recovered somewhat, and bond yields have fallen back. However, tax rises are on the way and, coupled with high inflation, could cause house prices to fall. The media will highlight every small bit of bad news and we must expect dramatic headlines over the next few months. As investors, we must remember that this bad news is already priced into asset prices, and if the bad news gets slightly better then we could start to see a rebound in both equities and bonds.

If inflation starts to fall due to commodities remaining stable, and interest rates peak lower than expected, we should start to experience a rebound in both bonds and equities. Could markets be set for a good year-end and a traditional 'Santa Rally'?

Broom Consultants Limited
Sterling Court, 4 Gresham Road, Brentwood, Essex.
CM14 4HN

Tel No. 01277 202222

www.broomconsultants.com