ISSUE 22: NOVEMBER 2023

technical news

Knightsbridge Wealth

For professionals working with international clients

Global property prices falling

Each year UBS (The Union Bank of Switzerland) carries out its Global Real Estate Bubble Index. This year, it concludes that the risk of a real-estate bubble has shrunk. It puts only two cities – Zurich and Tokyo – in 'bubble risk' territory out of the 25 global cities analysed. That compares with nine last year. London is classified as 'overvalued', but not in a bubble.

There was an average real terms price drop of 5% across the 25 cities between mid-2022 and mid-2023. The biggest declines came in Frankfurt and Toronto, where prices fell back by 15%. The rankings use data such as prices to rent, prices to buy relative to average incomes, and prices compared with a city's own history to determine bubble risk.

The big surprise is how many European, especially German, cities come near the top of the rankings. Eight European cities are classed as overvalued – including Munich, Frankfurt and Geneva – compared with just two American ones (Miami and Los Angeles). New York and San Francisco are deemed "fair value".

German house prices are already down by 14% since their March 2022 peak, but further pain is likely as rising interest rates push up mortgage costs. Some 15% of German households spend more than 40% of disposable income on housing, double the share in Spain and Italy.

Those looking for cheaper European housing should head for Milan, Madrid and Warsaw. Average mortgage rates have roughly tripled since 2021 in most markets. In many places that has triggered a sharp decline in housing market imbalances, although affordability remains historically stretched.

Although the post-pandemic house-buying frenzy has cooled, housing remains undersupplied in most cities. Work-from-home has not, as once predicted, durably dented demand for city-living. What's more, falling prices have caused a slump in new construction in many urban centres. The seeds for the next property price boom have already been planted.

Some economists had been predicting a significant fall in house prices this year. A huge pandemic era boom meant that by March 2022, the average value of a house in a rich country was 41% higher than five years earlier. Clearly, this leaves lots of downside potential. Yet after modest declines, house prices are rising again in key markets such as Australia and the US.

Why? Firstly, high net migration has kept demand strong. Secondly, strong household finances – high prices have locked poorer people out of homeownership, so today's homeowners are richer on average and can meet rising mortgage payments more easily than in previous slumps. Finally, the pandemic changed buyers' preferences, causing people to demand more space for things such as home offices.

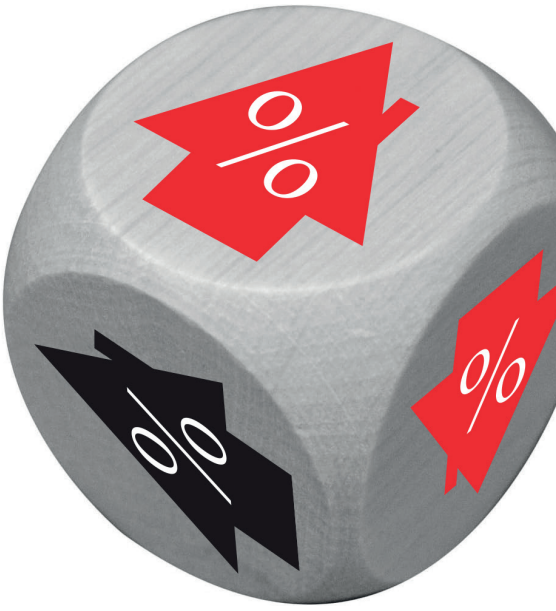
A surprise rise in UK house prices

UK house prices rose last month, but there is likely to be more pain ahead.

House prices had fallen for six consecutive months as rising interest rates squeezed buyers. But they staged a 1.1% month-on-month rally in October. Prices remained down 3.2% for the year to October, but that also marked an improvement from the 4.5% annual decline to September. The Halifax figures echo similar data from Nationwide, which reported that UK house prices rose 0.9% in October.

The upturn may reflect low transaction volumes. Prospective sellers are taking a cautious attitude, leading to a low supply of homes for sale. This is likely to have strengthened prices in the short term, rather than prices being driven by demand from buyers, which remains weak overall. Another tailwind is that average mortgage costs have fallen modestly amid signs that the Bank of England is done raising interest rates.

The worst isn't over. Affordability remains stretched. The average two-earner household must now be willing to devote 29% of their income to mortgage payments, much higher than the steady 20% average over the 2010s. The decline is likely to continue.



Bond bust bodes well for equities

Rising yields on government debt herald the end of the free-money era – good news for investors.

Since March 2000, ten-year US Treasuries have lost 46% of their value (in nominal terms) and 30-year bonds 53%. The bear market may now enjoy a respite, but it is probably not over. The supply of bonds has increased thanks to the extravagance of governments.

Meanwhile, demand has decreased as banks have stopped raising their holdings and central banks are selling (at a loss) in a reversal of quantitative easing. The question is whether the rise in yields is enough to attract enough demand.

Bond yields have been below inflation for years and although they are now above it in the US, real yields of 1.5% are not tempting. In the UK, real yields are still negative.

Stock markets, meanwhile, have been held back by the need for earnings multiples to fall as bond yields rise, but corporate earnings have held up well and are now poised to rise again. In the longer term, the absence of ultra-cheap loans should discourage speculation and low-quality investment, but encourage higher returns on capital.

This trend, along with the reining in of government spending, should result in higher productivity, higher economic growth and higher corporate profits. Investors have nothing to fear from the bond-market crash – they just need to be patient.

There have, though, been some real winners from the bond-market crash. Defined-benefit pension schemes were so keen to control future liabilities that they offered very generous terms to 64-year-old members, often 25-30 times their current pension entitlement, to those who wanted to transfer out. Those who did so will have done well, provided they didn't invest in gilts.

The terms offered will now have deteriorated to around 15 times, but opting out may still make sense: who can now trust the actuaries, trustees, managers, and regulators of these pension schemes to deliver? It might be better to exit now and weight a self-invested pension fund much more towards equities.

The government appears to have persuaded the big pension funds to invest more in equities, but the agreement hardly inspires confidence. The government wants the investment to be in Britain, preferably in the infrastructure projects that it can no longer afford. The pension funds have lost so much money in bonds that they are discredited in investment decision-making and have much less to invest. This does not augur well for the members of their schemes.

This shows the benefit of accountability and proper supervision in the management of pension funds, as in all investments. The suddenness of the change has unnerved many who had come to believe that a world of free money was normal. But it paves the way for a much more rational landscape – one that favours risk-taking and equities.

Squeeze continues on Buy-to-Lets

Could there be a crisis in the UK rental market? There does appear to be a massive mismatch between supply and demand. Focusing on London, Rightmove reports that there are an average of 25 requests to view per available property.

The number of lets are down by 60% from the period between 2017 and 2019. Average rents are now more than 30% higher over the same period, with an 8% increase this year up to August. There are now 41% more tenants looking for 35% fewer properties. Though the rate of increase has slowed slightly in London this year, the trajectory is still upwards.

As rent (and mortgage payments) are the main monthly outgoing for most people, the effect on the consumer is dramatic. No wonder travel agents, bars and restaurants are reporting tough times.

This process has been going on for some time and has two main causes. The first was the withdrawal of the ability to put interest costs against rental income for tax purposes. This was phased out in 2020, and made the returns from residential property distinctly less attractive. This only applied to residential property, not commercial, the logic of which is not immediately apparent. At the same time, government regulation has made life as a landlord more difficult. The latest Renters (Reform) Bill, among other things, outlaws no-fault evictions. In 2016, a 3% surcharge was added to stamp duty for anyone purchasing a buy-to-let.

The other key factor is the rise in interest rates. This has had two effects. For any landlords who were wondering if the returns made up for the hassle, it made up their minds for them, and they have exited the market. For those thinking of going in, the income sums didn't add up and the prospect of capital gains (which has fuelled the market for the last 30 years) has turned into a prospective capital loss in a falling market. On the other side of the fence, interest rates have dealt a blow to prospective buyers who can no longer afford to buy and are now thrown back on the rental market, adding to the ranks of too many tenants chasing too few properties. A perfect storm on both sides of the rental divide.

The reality is that being a residential landlord is hard work, and the circumstances that drew investors to this market have changed. Both main UK political parties need to accept that, while one side of the market needs protection, the other needs to be made profitable enough to make the sweat worthwhile.

Insurance costs rising

Most of our clients have a need for general insurance in the UK – particularly home insurance either for properties that are lived in, or rented out. It is noticeable that home insurance premiums are on the rise. The cost of protecting a home is expected to rise by 36% over the next two years, according to accountancy firm EY, with an increase of 17% this year.

Insurance firms point out that the huge increase in premiums is due to supply-chain difficulties, which have driven up construction costs for fire and flood-damaged homes. On top of this, major weather events are becoming increasingly common – and mean more claims for insurers to cover. Last year three named storms – Dudley, Eunice and Franklin – caused 170,000 properties to make insurance claims costing £473m. As a result, premiums are on the rise for all, but particularly for those who have properties in a flood-plain, or somewhere likely to be affected by bad weather.

So, what can you do to fight increased premiums? Don't be tempted to cut back your cover. While cancelling home insurance may seem like a quick way to save on costs, the risk of having to pay out for damage without it can be more expensive. The good news is there are lots of ways to trim your premiums. One option is to combine policies.

Most insurers will give you a discount if you go for a home insurance policy that covers both the building and contents. Another good option is to pay for insurance annually rather than monthly. Many people choose to pay monthly, but you will pay more in the long run. On average, a home insurance policy costs 18% more if you pay monthly.

Clients may also want to consider spending a little money now to save money on premiums in the years ahead. For example, upgrading the home security could save money in the long run. A safer lock can drastically lower the cost of your policy, as it demonstrates you are proactively reducing the risk of a break-in and needing to make a claim.

We often recommend our clients fit a five-lever mortice deadlock that conforms to British Standard 3621. This is considered the most secure type of lock not just by insurers, but by police as well. If you have one on your front door, insurers are likely to provide a cheaper policy. Lock manufacturer Yale believe upgrading your home security could shave up to 10% off your premiums.

You could also join – or set up – a local Neighbourhood Watch scheme. It is very easy and these schemes reduce local crime. Insurers love them, typically reducing premiums by 5% for scheme members.

Next, consider what you are paying for. There are several extras you can add to your policy that will increase the cost, but you may not really need them. Emergency home protection (relating to heating, plumbing and drainage crises) usually adds around £40 a year to your insurance bill. Accidental damage cover bumps premiums up by an average 10%. Another way to cut your premiums is to increase your excess. If you are happy to pay more in the event you do make a claim, your premiums will fall substantially. For example, putting your excess up to £400 from nothing could reduce your premiums by around 25%.

Finally, don't forget your no-claims bonus. Insurers love customers who pay their premiums but don't make a claim. So, they will give you a no-claims bonus. Even a one-year no claims bonus could cut your insurance by 10%, rising to as much as 50% if you have five years or more without claims.

Knightsbridge Wealth works with a panel of expert independent insurance brokers to ensure its clients have access to the best advice for their unique circumstances.

Don't count on lower interest rates

Interest rates will need to stay high and flat for some time in order to bring inflation under control. Whatever happens, for central bankers the descent from high rates will be more dangerous than the climb up.

Whilst the US Federal Reserve held interest rates at between 5.25% and 5.5% at its September meeting, it surprised markets by projecting that rates will need to stay high until well into next year. With annual US inflation down to 3.7%, investors had been hoping that rate cuts were coming into view, but a strong jobs market and an oil price spike have dashed those bets.

The Fed's own projections show that it might even raise rates one more time before the end of 2023.

Leaving open the possibility of more rate rises distracts traders from speculating on when cuts will come. It is all part of the delicate game of deception that central banks must play with markets to stop them from going bananas on bets of easy money ahead.

So far, the plan is working, with US ten-year Treasury bond yields topping 4.5% for the first time since the eve of the financial crisis in 2007. Bond yields have moved higher for the past two years, inflicting losses on bondholders (bond prices move inversely to yields). Investors had been hoping that 2023 would finally be the "year of the bond", but instead US Treasury investors are on course for a third consecutive year of losses. Traders think US interest rates will still be around 4.75% by the end of next year. That would mark a reversion to the long-term norm before the exceptionally loose policies that followed the global financial crisis.

In the UK, the Bank of England also held rates steady at 5.25%. Annual core inflation (which strips out volatile food and energy prices) fell significantly this autumn. That may mark a turning point. Inflation is now down to 4.5%, less than half where it began 2023.

London's undervalued stock-market

London is Europe's stock market champion again. The combined market capitalisation of primary listings in London is now $2,888.4bn, edging ahead of the $2.887.5bn figure for Paris, which has been hit by sliding luxury share prices.

London has been helped by its greater weighting towards energy as oil prices have spiked. The FTSE has also been boosted by the Bank of England's decision to hold interest rates steady. That weakened the pound, which increase the overseas earnings of multinational British blue-chip firms in sterling terms.

France's CAC 40 has fallen by 9% since its April peak, although the index remains up by 4% this year. That compares with a 2.5% fall on the FTSE 100. The FTSE 250, down 11% so far this year, has done even worse. Unlike the more international FTSE 100, the mid-cap index's rout has been driven by gloom about prospects for the UK's domestic economy.

London's leapfrogging of Paris isn't much to celebrate. It reflects flagging designer handbag sales in China (which have hit French luxury stocks), not a flood of high-growth tech businesses listing in London. A spate of acquisitions have caused £700bn in delisting's from the London market over the past decade, over six times the amount raised by new issues. Indeed, the UK is the only developed equity market to have shrunk relative to GDP over the past 20 years.

Since 1997, the number of companies on the London market has virtually halved, falling from almost 3,000 to 1,619 last year. Between 1997 and 2007, the UK market averaged 300 new share issues annually. Since 2010 that figure has been closer to 100, thanks in large part to a decline in activity by smaller companies. Another key factor has been divestment by UK pension funds, which have opted for gilts instead.

The London market, which has shrunk to make up less than 4% of the global developed markets universe, is increasingly regarded as irrelevant by big US fund managers. Many big British firms trade at almost half the valuations of their US peers. Medical-devices maker Smith & Nephew, for example, is on a forward price/earnings (p/e) ratio of 14.3, compared with 26.1 for US competitor Stryker. Similarly, US bank JPMorgan trades on a forward price-to-book ratio of 1.7, compared with 0.4 for Barclays.

Many British companies are doing much better than their share prices would suggest. London's shares are plainly undervalued, which is why there has been so much foreign private-equity interest in them of late. And while floats are thin on the ground, that has been a problem across global markets this year.

Which European stock exchange raised the most money for existing clients this year? London. By miles.

Contact us

If you require further information about our services and how we can assist your clients, then please call us or send us an email about how and when we can contact you.

+44 (0)20 7407 3032

info@knightsbridgewealth.co.uk
www.knightsbridgewealth.co.uk

Knightsbridge Wealth Ltd
45 Pont Street
London
SW1X 0BD
United Kingdom