ISSUE 15: NOVEMBER 2020

Knightsbridge Wealth

technical news

For professionals working with international clients

Could Trump pull it off?

With the US election just over a week away, President Donald Trump has returned to the campaign trail, beginning with a large rally in the swing state of Florida. As well as rallying his support, Trump is eager to use the events to demonstrate to the American people that he is healthy and has recovered from the virus, which he contracted in early October. His decision to hold large campaign rallies comes despite criticism from top US government scientist Anthony Fauci that such events are "asking for trouble" due to the risk of spreading Covid-19.

Trump may be back on the campaign trail, but his re-election chances don't look good. Challenger Joe Biden is now up to 9.5% ahead nationally and 'must-win' states such as Pennsylvania, Michigan and Wisconsin are appearing safe for Biden. Even Republican strongholds, such as Texas and Georgia, are looking competitive. With the White House lurching from crisis to disaster, Democrats are daring to hope they can put the nightmare of the election four years ago behind them.

Tax revelations, a poor debate performance and Trump's Covid-19 infection have all led to brutal polling for Trump.

However, Biden's leads may not be as big as the polls suggest. Polls might be underestimating Trump's support since his supporters refuse to answer pollsters' calls. This could boost Trump's results, assuming that they will ultimately get out and vote for him. Still, even if true, that polling error would have to be massive – considerably larger than in 2016 – for Trump to pull off another victory.

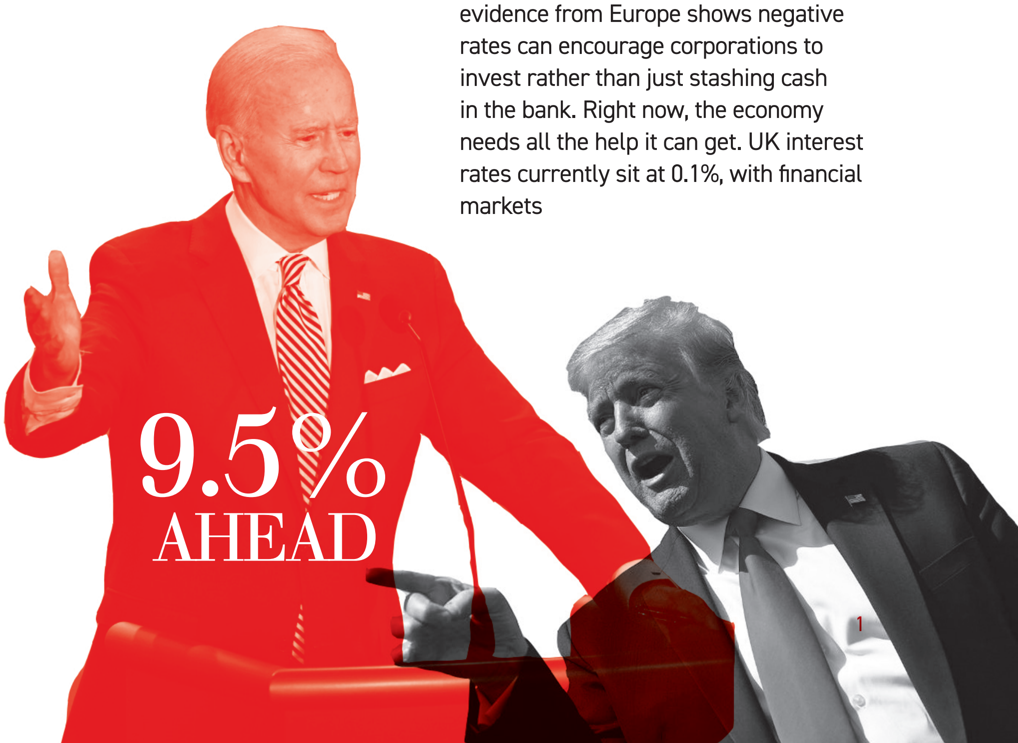
Trump is also running short of cash. Thanks to the support of outside groups, including one run by former presidential candidate Michael Bloomberg, Biden's campaign and its supporters have around $85m more to spend than Republicans in the final weeks of the campaign, enabling them to book nearly double the number of television slots. Indeed, Trump's campaign has already been forced to pull advertisements from several states in the Midwest in order to conserve cash. Faced with the possibility of a bloodbath in the Senate, many senior Republicans are starting to back away from Trump.

If the polls are correct and Biden does win by a clear margin, then the contest could be all over by election night. Up until now it was assumed that the large number of postal votes would mean that many of the key states would not be decided until several days after the election, increasing the chance of disputes. While some states, such as Michigan and Pennsylvania, will take days to count the result fully, some other marginal states, such as Florida and North Carolina, are now confident that they should have most of the vote counted on election night. That should make it next to impossible for Trump to challenge the result if Biden wins.

Interest rates to go negative?

The Bank of England (BoE) has pumped £300bn of quantitative easing into the system this year, but as the second wave of Covid-19 gathers pace, all the signs are that it is not enough. UK consumer price inflation was just 0.2% in August and banks have tightened lending criteria. That means that it's time for negative interest rates.

The BoE governor, Andrew Bailey, says evidence from Europe shows negative rates can encourage corporations to invest rather than just stashing cash in the bank. Right now, the economy needs all the help it can get. UK interest rates currently sit at 0.1%, with financial markets



pricing in a shift into negative territory next year. The BoE is conducting preparatory work, with Bailey describing the policy as being in the toolbox.

The BoE would use the rate to penalise commercial banks that deposit excess reserves with the central bank. It wants them to lend the money instead. Banks would probably avoid passing on negative rates directly to depositors and those with mortgages should not anticipate a payday.

The policy would probably be a mistake. Lenders want their money back and, in a steep downturn, there are fewer creditworthy borrowers around. When the economy is weak no amount of interest-rate prodding will make the banks lend more. These are bad times to be a saver. America's one-year Treasury bill, a traditional way of storing cash, yields just 0.13%. It would take more than 530 years to double your money by reinvesting that interest. Today's savers have three options: save less and spend more; save more to compensate for lower returns; or put their cash into riskier investments, such as shares. Central bankers generally assume that lower interest rates cause the first reaction, but the data is much less clear. As is already happening in Japan, the old increasingly risk running out of money before they die.

Negative interest rates may be a terrible idea, smacking of desperation. They are deeply counter-productive. Pension funds are forced into risky, speculative investments in a desperate hunt for yield. The experience on the continent shows that banks avoid cutting interest rates on deposits, thus weakening their balance sheets and making the whole financial system more fragile. The winners are those with a vested interest in seeing bloated stock and bond markets surge even higher.

Potential in commercial property

New York's commercial property is in trouble. Last month, only 10% of office workers in Manhattan had returned to their desks. London property is also in crisis, but these comatose days for offices will not last forever. Post-pandemic, people will probably still head go to the office at least a few days a week. Canny private-equity groups such as KKR are swooping on London's property companies, which trade on steep discounts to net asset value. Yet their focus is limited to firms with office exposure. The outlook for retail space is much grimmer.

London's offices are suffering from unprecedented uncertainty because of the rise of homeworking. But big companies may end up reducing their requirements for space less than expected.

Commercial property is a simple asset class. In an expansion, we need more space. Currently, we are in a thumping great recession. Property investment was 43% below the five-year average in the first half of 2020. But it was 51% down in 2008 and the recovery will be better this time. In the office market, vacancy rates are rising, there is downward pressure on rents and development starts are being delayed, but we are not at the end of the cycle: the medium-term fundamentals remain good.

Less development will reduce vacancy rates and the pressure on rents.

Home-working is suitable for some tasks (reading documents, focused work and video or phone calls), but a lot of things work better in an office so offices won't disappear. Offices are better suited to team management, meetings and the informal chats or chance encounters that can spark fruitful new ideas and strategies for the

Property investment

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company, a key factor in services and creative businesses. Surveys show a marked swing in favour of working from home, but from one day a week or less to two or three days a week – not to full-time.

Retail parks have been more defensive than shopping centres, with weekly footfall down 20% rather than 60%. Retail parks are well suited to 'click and collect' services and returns, while they also offer social distancing. In the industrial market, the take-up of logistics space in the first half was the highest for 15 years, but this type of property is not as safe as it seems. When vacancy rates rise above 12%, as they did in 2009, rents fall.

Within the UK, favoured areas are beds, meds and sheds: student accommodation, healthcare property and self-storage.

London Residential Market

The prime markets of London have continued to defy gravity over the summer months, a period which is generally known to be much quieter.

The number of properties worth £1 million or more marked as sold subject to contract across the capital was 87% higher in the third quarter of 2020, compared to the same period last year. But strong demand is being matched with supply. New for sale instructions in the three months to September were 77% higher than in Q3 2019.

Buyer and seller expectations on price also appear to be aligning. Half of our London agents reported that vendors' price expectations of the property they are selling had reduced, while 44% said buyers' budgets had decreased. Similarly, 35% and 29% of agents reported an increase in vendors' and buyers' expectations on pricing, respectively.

All of this suggests that there is a balanced market and, at a headline level, there has been little movement in prices. Indeed, across prime London as a whole, prices remained flat in the third quarter of 2020, leaving them 1.0% higher than a year ago. But these overall figures do hide some disparity across the market that has been triggered by a recent shift in lifestyle trends. Across all five prime London regions, the value of houses held up more strongly than that of flats. The best performing markets over the past three months have been Victoria Park, Richmond and Putney, which are well known for having a strong family house market.

The top end of the market continues to look good value after suffering the most over the past six years because of successive stamp duty changes and political uncertainty.

Economic uncertainty will make it difficult for the current momentum to be sustained. Prices will depend on the extent of economic recovery, where we stand with Covid-19 and the search for a vaccine. The wider tax environment may act as a drag on future price growth, particularly as the government is going to need a strong focus on tax revenues once the economic recovery has gained some momentum. Easing of international travel restrictions will be particularly important for central London and other markets more reliant on overseas demand.

Londongrad

The long-delayed report on Russian influence on public life in the UK was finally published by the government since our last issue of Technical News. It found no smoking gun of evidence to show that Russian efforts to influence the result of the 2014 Scottish referendum, or the 2016 Brexit referendum, were successful. But its worrying main conclusion was that the UK has left it too late to untangle the web of Russian influence that permeates the country's political and business elite. "Russian influence in the UK is 'the new normal'," the report says. "There are a lot of Russians with very close links to Putin who are well integrated into the UK business and social scene, and accepted because of their wealth. This level of integration – in 'Londongrad' in particular – means that any measures now being taken by the government are not preventative but rather constitute damage limitation."

Not all Russians are, of course undersirable and it emphasises the importance of firms such as Knightsbridge Wealth who work hard to understand a client's background and source of wealth – regardless of complexity.

The report highlighted that "there is as much to fear from licit flows put to illicit use as there is from the flow of illicit funds alone". This is not just an economic crime question; it's a matter of Russian expatriates using their wealth (whether illicitly gained or not) to buy influence via, for example, donations to academic institutions, charities, or – crucially – political parties.

According to The Times, some 14 government ministers, including six cabinet ministers, have received donations from individuals or companies linked to Russia. In addition, so have two of the Tory MPs recently appointed by Johnson to the intelligence committee, Theresa Villiers and Mark Pritchard. The Conservatives' leading donor is Lubov Chernukhin, a Russian-born businesswoman, who has donated more than £1.7m since 2011. Alexander Temerko, who told The Guardian that he is no "friend of Putin's", is not far behind with gifts of £1.3m; he runs a company, Aquind, hoping to be granted the right to build an electricity interconnector between Britain and France.

The scale of illicit activity is hard to assess, the figure is probably in the tens of billions annually. In 2016, the Home Affairs Select Committee concluded that the London property market was the primary avenue for the laundering of £100bn of illicit money a year, of which Russia accounted for a significant slice (though a much smaller one now than ten years ago). In 2017, an investigation by a consortium of international newspapers, including The Guardian, found that, between 2010 and 2014, British-registered firms and British-based banks helped move at least $20bn of the proceeds of criminal activities out of Russia via Latvia and Moldova.

Unexplained wealth orders are supposed to be a key plank of the UK's fightback against money-laundering. But when the National Crime Agency recently lost its attempt to impose an order on a wealthy Kazakh family, it was landed with a £1.5m legal bill. Not surprisingly, it is now reconsidering its use of the orders. The government is likely to address the weakness of the UK's corporate registry system and enact the Registration of Overseas Entities Bill. The UK government has said that "tackling illicit finance and driving dirty money and money launderers out of the UK is a priority". Financial professionals working in this market are likely to be increasingly in the front-line to ensure the legitimacy of investments and fund flows into London.

Golden Visa schemes remain in spotlight

The vice president of the European Commission, Maroš Šefčovič, has said the bloc is setting out plans to start an "infringement procedure" against Malta and Cyprus because of their citizenship-by-investment (CBI) schemes.

The programmes allow foreign nationals to acquire a Maltese or Cypriot passport in exchange of a significant investment in the country, which often entails buying a property. Since its introduction, Cyprus has raised €7bn (£6.3bn, $8.2bn) through its CBI scheme. Last year, the EU took aim at the various CBIs offered by some of the 27 member states and ordered the countries to "phase them out" as quickly as possible, as they pose security risks to the bloc.

Maltese prime minister Robert Abela has defended the investment programme because of its economic contribution to the country. Shortly after unveiling the country's 2021 Budget, Abela said: "We will be defending Malta. Had it not been for the contributions from that programme, which we are in the process of winding down, we would probably not have been in a position to present a budget of this scale."

Malta has been debating changing its Individual Investor Programme, potentially requiring applicants to live on the island for at least a year before investment, committing to become residents for at least three years and increased investment amount and philanthropic donation.

Buy British

Jitters over a no-deal Brexit, the economic downturn and the shambolic response to Covid-19 have been key reasons why British stocks – tracked by the MSCI UK index – are trading at their biggest valuation discount to their global counterparts on record.

The discount to the MSCI World index's valuation has reached around 42%, while the historical average is 17.5%. The discount to the MSCI Europe ex-UK index is almost 30%. The last time the gap with the rest of the world reached similar levels was in the early 1990s when Margaret Thatcher resigned and a recession began; before that the chaos of the 1970s produced a huge gulf.

The UK stockmarket's performance relative to the global average over the past 12 months has been the worst in over 40 years. The macroeconomic backdrop isn't the only reason sentiment towards Britain has soured. The key issue is the FTSE's sector mix. This has been the year of the technology stock, but out of 15 major world markets, only Australia and Switzerland have a lower technology weighting than the UK. UK indices are heavy on unfashionable commodities and financial stocks. The FTSE 250 is down by 18% so far this year, while the FTSE 100 has shed 21%.

UK stocks are approaching pariah status. But they are now trading at the greatest discount to global equities for 50 years.

All this bodes well for long-term investors. With the market yielding an impressive 4% and endless gloom and doom in the headlines, the bad news seems to be largely in the price. Stock that should be able to weather the Covid-19 storm could therefore recover very strongly once the fog clears.

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.

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