UPDATE

Knightsbridge Wealth

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The Knightsbridge Wealth magazine for international clients

Special feature: Defence

Why the West must invest in defence

Page 6

Other features:

Welcome note from Knightsbridge Wealth
Page 4

India's Bull run ends
Page 18

Market report
Page 19

Your Knightsbridge Team
Page 20

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Special feature: Defence
Why the West must invest in defence
Why modern wareface is about to change radically.
6

Hong Kongs precarious future
Is the territory's new chief executive another step to dismantling of the 'one country, two systems' principle?
10

Britain: 70 years on
How has Britain faired during the reign of Queen Elizabeth II?
14

House prices falling
Is the UK housing market about to falter?
16

A welcome note from Knightsbridge Wealth

"Buy on the sound of cannons" is a famous investment adage, but it's not well supported by history. Yes, a look back at 13 geopolitical crises, starting with the Cuban missile crisis in 1962, shows that stocks have on average tended to do better after the onset of a global crisis and s afe-haven assets have tended to do worse. But that average disguises a lot of variation.

There have been times when markets bounced back emphatically and times when they haven't. Overall, non-crisis- related factors were the biggest drivers of performance in each case – such as the end of a US recession (the Iraq War in 1991), or the onset of a financial crisis (the invasion of Georgia in 2008). Investors should make their decisions to buy or sell based on the health of the overall economy and the outlook for industries and earnings.

There's certainly no point in trying to price in worst-case scenarios. The likelihood of nuclear war may now be higher than it was, which is discomforting, but that's not the kind of risk that one can usefully take into account when building a portfolio. Thus it's logically consistent to say: "The risk of Armageddon has risen dramatically. Stay bullish on stocks".

Still, even setting aside existential risks, the world economy is facing a triple shock. The uncertainty caused by the collapse of the post-Cold War geopolitical order, along with the risk of further escalation is just one threat. Another is disruption to international trade, especially in commodities, such as embargoes and export controls. The third is a financial shock, with potential defaults by Russian and Ukranian entities, and contagion risks to other countries. Thus the world faces a growing risk of stagflation – an economic slowdown coupled with high inflation.

Conditions are certainly starting to look reminiscent of the 1970. Oil has topped $120 per barrel. The change is not as big in percentage terms as the oil embargo of 1973-1974, but natural gas – which is far more important to the economy today than it was five decades ago – has increased even more, implying a massive energy-price shock. Note too that the ongoing price surge extends beyond energy into industrial metals, fertiliser and grains, which have all soared this week. This bodes especially poorly for growth in Europe and much of Asia, while Latin America may be less affected since the region gains most from the global commodity boom.

Hence this could turn out to be one of the most dangerous years for investors. The US S&P 500 has held up remarkably well – better than most countries – but is likely to end the year lower. Investors should favour energy as a hedge against inflation and financials as a hedge against rising interest rates.

It's still too soon to forget about the pandemic. With lockdowns in China spreading from city to city, it's time to get ready for shock to global growth. Much of Shanghai, the world's busiest port, has been in lockdown since late March. Now, officials in Beijing have banned restaurant dining and required proof of a negative test to access public spaces as they scramble to avoid a similar outcome. Many of the city's 22 million residents have already undergone three rounds of mandatory testing.

Fears that the capital could be locked down gave Chinese shares their worst day in more than two years on April 25th. The benchmark CSI 300 index has fallen 18% since the start of the year, while April was the worst month for t he yuan since 1994.

There is a good chance that Beijing will avoid a Shanghai-style lockdown. Shenzhen and Tianjin have done a better job at stamping out virus clusters recently. But that doesn't mean the outlook is bright. China's robust recovery in 2020 was driven by a construction boom and strong global demand for its goods exports. But demand for goods is fading as consumption habits in advanced economies return to pre-pandemic norms. Meanwhile the 25-year property boom has run out of steam as urbanisation has slowed to a crawl.

Investors' spirits were lifted by reports that China's government plans to speed up major construction projects and issue coupons to promote consumer spending. The relief looks premature. While the government may temporarily ease its crackdown on the property sector – a key economic driver – flat buyers are likely to remain skittish.

Beijing still appears reluctant to engage in the large-scale fiscal splurge needed to offset the impact of lockdowns in key cities. In any case, there is a limit to how much you can stimulate an economy that is repeatedly shut down. It is hard to be positive about the economy or the markets in the face of increasing lockdowns of indeterminate length and intensity.

Our strategic partnership with UBS (Union Bank of Switzerland) gives the best of both worlds – personal service and the ability to react in a way that only a small firm can, partnered by one of the world's most prestigious brands.

China's attempt to eradicate Covid will also affect global supply chains. While ports are still open – unlike in previous lockdowns – quarantine measures inland are resulting in some factory closures. As a consequence, goods aren't arriving at export terminals. That has seen export volumes from Shanghai shrink by nearly a third. It takes about five to six weeks for a container ship to travel from Shanghai to Hamburg, and then another fortnight for the goods to reach their final destinations. Thus, knock-on shortages – and another spurt of inflation – will be felt in Europe in around two months.

In this challenging environment, it has never been more important to obtain the best advice based on your unique circumstances. Equity markets are likely to grow from current levels, but active portfolio management has never been so essential, in an environment of high inflation, rising interest rates and elevated volatility.

We look forward to working with you closely throughout 2022.

Why the West must invest in defence

We've got used to a world without war between major powers, but that era is coming to an end as Russia invades Ukraine and China eyes Taiwan.

Britain has been involved in armed conflict somewhere in the world every year since 1914, so the UK's last ten peaceful months since UK (and other forces) were unceremoniously bundled out of Afghanistan are highly unusual. Politicians and military chiefs are keen that this 20-year conflict is forgotten, while muttering that 'lessons must be learnt'. This guarantees that the wrong conclusions will be reached; in practice, it was an old-fashioned, conventional guerrilla war. Modern warfare is about to change radically.

We have not witnessed direct warfare between major powers since 1945. It would be nice to believe this will continue, but unwise. Both China and Russia are on an expansionist march. Since 2008, Russia has annexed parts of Georgia and Ukraine, has made claims over the Arctic and has de facto control of Syria. It will shortly reabsorb Belarus (hard on the EU's border) and has moved peace-keeping forces into Kazakhstan (a country the size of western Europe) from which they are unlikely to leave. Russian president Vladimir Putin has never hidden his desire to re-establish the USSR (which included some current EU nations in the Baltic states) and is doing so opportunistically.

China is also on a roll. Starting quietly in 1974 by taking control of some tiny Vietnamese islands, since 2010 it has ramped up its occupation of numerous atolls and shoals in strategic locations throughout the South China Sea and has even built new heavily fortified islands. Like Putin, China's president Xi Jinping (now ruler for life) has never hidden his desire to control the south and west of the Pacific Ocean, vital to world trade. Both leaders are patiently preparing and probing for their big prizes – Ukraine and Taiwan, respectively – because they now have the edge. Their empire building is undoubtedly a near and present danger.

On paper, Nato and its mostly democratic allies still have an immense superiority in firepower. America's military expenditure was more than twice as much as Russia and China combined last year. Add on its allies such as the UK (which at $59bn is surprisingly just behind Russia's $62bn) and the figure is well over three times greater. This superiority is confirmed in areas such as naval power. The US Navy's battle fleet totals 4.6 million tonnes – more than 50% higher than the two empire builders combined. America's 11 aircraft carriers are nearly as much as the rest of the world put together, and most of the others are owned by allies. The same superiority exists elsewhere, such as in war planes. In nuclear warheads Russia and the US are level, but since the numbers are enough to wipe out the world several times over, such counting seems pointless.

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Yet, for all this superior firepower, it is looking increasingly possible that the likely opposition have developed conventional edges and more importantly, will soon have created a lead in unconventional warfare. On the former, two examples suffice.

In October last year, China launched a low-orbit hypersonic rocket, which flew around the earth at five times the speed of sound and also released a hypersonic glide vehicle that flew back several thousand miles to a test target in China. The US intelligence service was clearly horrified, not only because they knew nothing about its development, but because their vast array of anti-ballistic missiles can only hit regular, slower trajectories. China's rocket can swerve. Satellite pictures show China is building 200 new intercontinental rocket silos and at present, it seems the US has nothing which can shoot these rockets down. The Pentagon is clearly very worried.

As for Russia, she has long enjoyed a 2:1 superiority to America on tanks, but it was rightly assumed that most of these were essentially older models and no match for the well-tried, third-generation Abrams battle tank, the backbone of the US army, or for Germany's Leopard, widely considered the world's best tank. Yet as with China's rockets, in the last five years Western defence ministries have been stunned by Russia's new fourth-generation Armata tank, which appears superior in every aspect. Production has been slower than planned but the build-up continues. The West has nothing to match it.

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The cyberwarfare challenge

Even the least tech-savvy of us has become completely dependent on huge technological developments over the last 30 years, to the extent tech now encompasses our lives entirely. This explosion in electronic capabilities makes much conventional warfare vulnerable.

In 2014, the Ukrainian army assembled an armoured group in a forest area to counterattack into the Russian occupied zone. They were spotted by drones. Russian forces hacked and jammed the communication systems of the Ukrainian command post, then launched rockets. Two battalions of tanks were wiped out miles from the front without firing a shot. More recently in the 2020 Azerbaijan-Armenia war, Russian-backed Armenian forces were obliged to sue for peace after Azerbaijani drones (supplied by Turkey) shredded Armenia's main tanks and artillery. Heavy-hitting and expensive equipment knocked out by the equivalent of a home-made catapult.

Translate this to war at sea and the West's superiority looks more of a liability. Aircraft carriers have always been large sitting ducks, which is why they tend to operate a long way from land. With a top speed of 40 mph, they are hardly racy. Multiple long-distance drone or rocket attacks from the shore, other ships or submarines will certainly get through. It is worth noting that China's submarine-building programme is huge already exceeds America's and in number. Finally, consider an invasion. Ultimately any war requires troops in large quantities to occupy land. D-Day can never happen again or even on a far smaller scale. Why? A single nuclear shell would cripple any such mass attack. Thus, it seems that we are geared up for the most recent set of skirmishes or wars, not the next ones.

While there will always be a need for guns, ships and planes, future wars are likely to be won almost before the first shot is fired because of our dependency on electronics and developments in cyberwarfare. In 1999, two colonels in

China's People's Liberation Army published 'Unrestricted Warfare', a book on strategy that sets out how to avoid democracies' military strengths and undermine them from within, through measures such as eroding the legitimacy of government bodies, encouraging social discord and sewing mistrust between allies – in short, to use technology for propaganda. China's strategy has since ramped up to 'rob, replicate and replace' – steal intellectual property, replicate it and then replace the (usually American) company that had been dominant.

Hence China has steadily been reducing its once-large technology gap while simultaneously undermining its adversaries' economies. But it doesn't end there. The next phase is to be able to disrupt and then close an opponent's entire economy, starting with communications. Here, Russia appears to be in the vanguard. This first became apparent as long ago as 2007 when, following an argument over a war memorial, Estonia's economy was effectively blitzed by Russian cyberattacks which seriously disrupted government internet communications, the media and online banking. This pattern has been repeated many times whenever Russia has had a grievance: Georgia in 2008, Kyrgyzstan in 2009 (to pressure the government to close an American airbase), Ukraine in 2014 (pre-invasion) and successfully hacking German government files in 2015 when it was investigating Russia's role in the WikiLeaks affair.

A larger, more recent example – probably arising from China – is the 2020 hack on SolarWinds, a Texan software business whose systems were widely used by companies and government agencies to manage their IT systems. The hackers inserted codes that allowed them to access information and malware to close down the systems of thousands of companies and government departments. It can rarely be 100% proven that such attacks are government-led, but in the case of SolarWinds, Microsoft estimated it would have required over 1,000 technicians to create, install and operate. Moreover, it has become increasingly clear that China and Russia are more than happy to sub-contract disruption either to other countries such as North Korea and Iran, or to fund and encourage private groups from countries such as Romania – a new hot centre – to America itself.

Thus, preliminary skirmishes in electronics and cyberspace will determine the outcome of future wars. Cut off the ability to communicate, turn off radar and listening devices, and hack the computers to stop ships, planes and tanks from moving or firing, then stroll in.

Budgets are being ramped up in the US, the UK and elsewhere, but it is impossible to know if we are behind or level. Democracies, with their focus on the electoral cycle, free press and human rights, can easily be diverted by well-placed propaganda. There is plenty of evidence that Russian-backed websites were fuelling the conspiracy fires for the QAnon invasion of the White House last year. Dictatorships can play a longer game.

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There is little doubt that Russia intends to try and replicate the old USSR, including the annexation of much of Ukraine. Nor can it be doubted that China wants to take over Taiwan, as it has repeatedly stated for over 50 years.

In the case of Taiwan, China has made gains – flying an armada of warplanes over and around the country, taking warships into Taiwan's waters and expanding its many seized island bases

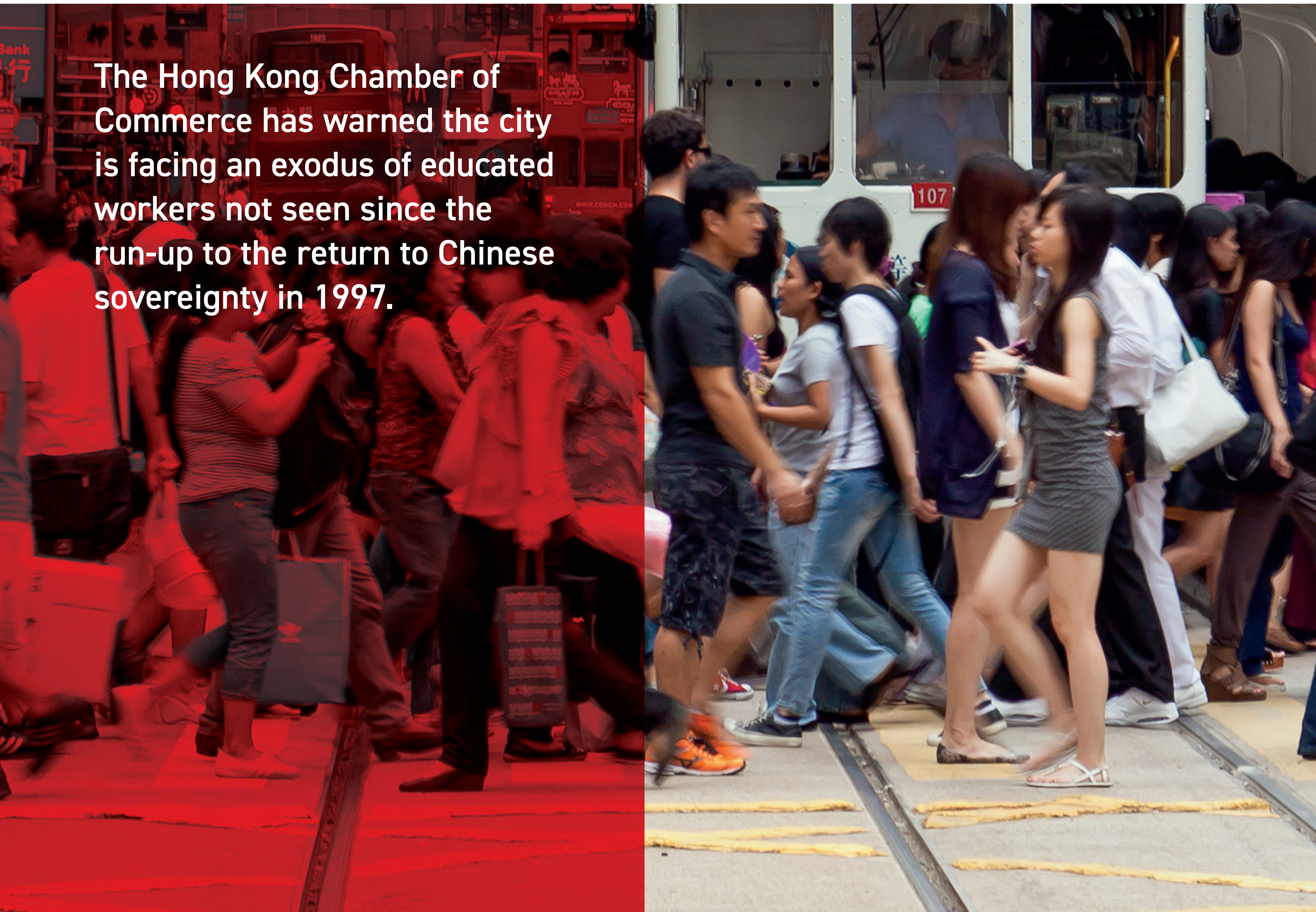
Capital markets are notoriously bad at anticipating major political and military shifts. World War I was wholly unexpected. Stocks were trading along merrily in early July 1914. By the end of that month, the London market (accounting for a third of all global trading) had closed, followed by the rest of the world. London did not reopen until January 1915.

Markets appear to be ignoring the long game being played by Russia and China, and are underestimating, or preferring to ignore, their clear intentions for military conquest. We can at least take some protection by investing in those companies which are in the lead in defence and, especially, in countering cyberthreats.

Hong Kong's precarious future

John Lee, the ultra-hard-line Beijing loyalist who oversaw the introduction of Hong Kong's bitterly controversial anti-sedition law, has been anointed as the territory's next chief executive. The selection, and Lee's appointment, is another step in the steady dismantling of the 'one country, two systems' principle that is supposed to give Hong Kong a special status until 2047. Meanwhile, 800 miles to the north-east, Shanghai – the city that hopes to poach Hong Kong's crown as China's great financial hub – further tightened its already draconian lockdown measures. It came after president Xi Jinping vowed to unswervingly double down on the government's increasingly controversial 'zero-Covid' policy. Millions remain confined to their homes with no end in sight. And in both Hong Kong and Shanghai, question marks are growing over the cities' futures as global financial hubs.

Hong Kong is experiencing a brain draim. The change in the political atmosphere and a harsh zero-Covid regime has seen thousands flee this global financial hub – a true World City. After two years of on-off pandemic restrictions and uncertainty, Hong Kong was battered earlier this year by a far deadlier fifth wave of the virus. For a period in March, it was registering tens of thousands of cases a day and had the world's highest Covid death rate per capita. It meant that just as much of the world was pivoting to living with the virus, Hong Kong – which implemented a 'dynamic zero-Covid' strategy aligned with mainland China – retained some of the strictest restrictions anywhere. That has damaged Hong Kong's lustre as a global hub and sped up an exodus of foreign business and talent. "It's an unarguable fact that we have a brain drain and some senior management of some corporates have left Hong Kong," said chief executive Carrie Lam (who will hand over to Lee on 1 July).



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Hong Kong saw a net outflow of almost 157,000 residents in the first three months of the year. That's a big chunk of people in a city of 7.4 million, with reports of well-heeled residents getting out so fast they are abandoning their expensive cars in car parks. But that might not be the end of it. According to Hong Kong's Public Opinion Research Institute, almost a quarter of the city's residents have plans to leave. Another survey found almost half of European companies with offices in the city were considering leaving. The Hong Kong Chamber of Commerce has warned the city is facing an exodus of educated workers not seen since the run-up to the return to Chinese sovereignty in 1997. Meanwhile, the expected windfall for Hong Kong, as mainland China makes it more difficult for its companies to list in the US, has not materialised.

(continued overleaf)

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Hong Kong can't be written off. The legacy of 200 years as a trading centre will not be lost easily. Hong Kong's most significant ongoing advantage is China's policy of strict capital and currency controls. While they remain in place, Hong Kong – with its separate convertible currency pegged to the US dollar – will remain the key conduit for Chinese investors wanting to diversify into foreign assets, and for foreigners wanting to access China's markets. All that could change fast if China made the renminbi fully convertible and lifted capital controls – but that way is still a long way off.

Lee has pledged to boost the economy and protect its status as a financial hub. And as long as Chinese money flows through the territory, it will remain important, benefiting from low tax and decades of legal expertise. Yet its lustre is diminishing by the day. Without freedom, it is hard to innovate: we can expect the talent drain to continue. Moreover, in any undemocratic jurisdiction, there is the risk of a descent into outright gangsterism, if those in power are corrupt or erode the rule of law. Business depends on certainty of contract and ownership: its loss would be the death knell for any financial centre.

Hong Kong's natural competitor is Shanghai. There, the Covid lockdowns have been even harsher than in Hong Kong. Thousands of foreign bankers, traders and investors have been confined to their homes, with some even struggling to secure food and other essentials.

What happened in Shanghai is shocking to most of the people. Few would have imagined things will get out of hand to such an extent," Melvyn Xu, a Shanghai-based private-equity investor, told Reuters. In the short term, it is estimated that China has lost about 50% of all European expatriates since the pandemic started – and predicts a further exodus this summer when the school year ends. Shanghai as a marketplace has been grossly overplayed, in that it is a state-owned enterprise creation.

Economists are busy downgrading Chinese economic growth forecasts, its stock-markets have fallen sharply in recent months and doubts are growing over the government's ability to turn things round. At this moment, some believe China's economy is in the worst shape in the past 30 years. China has officially set a target date of 2035 for Shanghai to be an international financial centre with 'major global influence'. Right now, as dark clouds hover over the Chinese economy, that looks a long way off.

China consolidates its power over Hong Kong

Hong Kong's former security chief John Lee has been confirmed as the territories next leader by a selection committee mostly comprised of pro-Beijing politicians and business people. Beijing has always enjoyed effective control of the process but, this time, it banned even token opposition. Rival candidates were barred and the composition of the committee changed to all but eliminate any input from directly elected members. As Security Chief, Lee oversaw a crackdown on pro-democracy groups. Critics of Hong Kong's government are right to be concerned about the implications. But there remains a chance that now that, having clamped down on dissent and put a reliable helmsman in charge, China might feel confident enough to ratchet down the repression and return to business as usual.

The fact that loyalty is now the most important quality for leadership doesn't bode well. Hong Kong had suffered firstly from Beijing's National Security law and then the COVID-19 pandemic and is now seeing a brain drain. Lee's tasked with bolstering business. But, rather than luring international companies back, he's taking a different approach by opening the border with the mainland and developing the northern part of the territory, and shoring up connections with the Mainland.

This raises questions about the future of Hong Kong as a global financial hub.

A recovery inRussia?

The sanctions regime against Russia is one of the most aggressive in history, untested on an economy of Russia's size and as entangled in the global financial system. The country is heading for a deep recession, with the finance ministry forecasting an 8.8% fall in GDP this year. Inflation is expected to rise to as high as 23%.

Yet, the economy has so far defied predictions of imminent collapse. Real-time measures of activity, such as electricity consumption, have fallen only slightly. After a lull in March, Russians seem to be spending fairly freely on cafés, bars and restaurants. The Rouble initially collapsed following the invasion of Ukraine, but has since rebounded, making it the second best-performer against the US Dollar this year. The central bank, which raised interest rates to 20% following the invasion, has now slashed them to 11% because the currency had rallied too far.

The Rouble's strength has been driven largely by a soaring trade surplus. High prices for oil and gas are filling the Kremlin's coffers, while sanctions and the withdrawal of hundreds of foreign companies have seen imports plummet. The central bank is confident that the short-term battle for financial stability has been won. Appearances can be deceptive. In the longer term, Russia faces a long, grinding decline in living standards. The country is also haemorrhaging human capital, with about 300,000 Russians – many of them highly educated – thought to have left since February.

The trouble is especially acute in the manufacturing sector. A 2021 report from the Russian Central Bank found that 65% of domestic companies still required imports for manufacturing. Many Russian production lines will grind to a halt once pre-war stocks of parts are exhausted. Efforts to find new suppliers have been complicated by the global supply-chain crisis. Shortages of microchips will hit the production of cars and tanks, while a lack of specialist chemicals will weigh on hygiene products and paper. Civil aviation, cut off from Western aeroplane makers, is in an especially precarious position. Russia looks to be heading back to the consumer wasteland that was the Soviet Union.

Yet, for now, support for the regime within Russia appears to be holding up.

War heads for deadlock

After weeks of negotiations, EU leaders have struck a deal to ban 90% of Russian oil imports by the end of the year. The embargo now contains an exemption for oil delivered by pipeline, which is how landlocked countries such as Hungary get their crude. Hungarian Prime Minister, Viktor Orbán, had said that a total ban would be disastrous for the economy. The sixth package of sanctions also includes the ejection of Russia's Sberbank from the Swift global payments system and restrictions on state broadcasters and individuals.

In addition to soaring energy prices, Western sanctions have led to rocketing food prices and disruption to the supply of fertilisers, stoking fears of a food crisis that will lead to migrations and hit poorer households in Europe. Vladimir Putin reportedly assured France and Germany recently that he would lift a blockade of Ukraine's ports to allow grain and other key foods out. But a Kremlin spokesman subsequently said such a move would "require the lifting of relevant sanctions" in return.

Russian firepower is clearly blocking exports, undermining its propaganda to hungry nations that Western sanctions are to blame. It is also proof that the Kremlin realises that rising food prices, however painful, aren't going to force the West to retreat.

The effects of the war and sanctions will linger in Russia for years. Even if Putin manages to hold the territories he has taken, there will be no money to rebuild shattered cities. With no sign that either side is prepared to make concessions, the war is heading for deadlock.

Britain: 70 years on

The 70 years since Queen Elizabeth II came to the throne have been eventful and, sometimes, difficult. 1952 was the year of the Queen's accession was the year that post-war tea rationing ended, and Britain saw its first van to hunt down those who were not paying their television licences. Few people could afford televisions back then, because they cost around £1,800 in today's money. The price of a refrigerator was around £1,000.

It was the year the first music singles chart was published, and Agatha Christie's new thriller - The Mousetrap - opened in the West End. It is still showing at the St Martins Theatre. Toxic smog killed 4,000 Londoners, while across the country tramways were being demolished, to make urban centres more accessible for motorcars. On average, Britons spent around 30% of their income on food, compared with 10% today.

In 1952, the UK was emerging from post-war austerity as the world's third biggest economy, behind the United States and the Soviet Union. Half the world's trade was conducted in Pounds Sterling, and the government had the benefit of gold reserves from 84 Commonwealth members. National debt was high, but falling from a post-war peak of 250% of GDP as growth helped stabilise the public finances. Interest rates and unemployment were low (though only 35% of women were in paid employment, compared with 72% now). However, much like today, Britons were feeling a cost-of-living squeeze, with inflation leaping from under 2% to more than 10%, in part fuelled by the Korean war and a resulting commodities price spike.

In 1952 it was difficult and expensive for most people to buy stocks, and there were few funds. It is hard to be precise given gaps in data from the 1950s and 1960s, but assuming an average annual return of 2.4% after inflation, £100 invested in equities in 1952 could be worth £536 today (in real terms). Of the1952's top-30 firms, only four still exist: British American Tobacco, Imperial Brands, Tate & Lyle and Rolls-Royce.

Average weekly earnings were about £6.04 in the UK in 1952, compared with £605 in the second quarter of this year. So, earnings have increased about a hundred-fold over the course of the Queen's reign. Prices have increased too – but nowhere near as fast. Inflation averaged a hefty 6.4% between 1952 and 1988, but only 2.5% from 1989 until now. That means that prices have risen by a factor of 20 (on Bank of England figures) – far less than wages.

The main economic feature of the past 70 years has been deindustrialisation and the widening disparities – between and within regions – that have accompanied the shift towards a services economy. On average, though, the UK is much better off. Its economy is more than five times bigger (in real terms) now than in 1952. Factor in a population increase of about a third and that means average incomes are about four times bigger. In today's money, GDP has risen from around £8,500 per person in 1952 to £32,600 now. However, the amount of money spent by the government has barely changed. The state accounted for 41% of GDP in 1952, compared with 43% this year. What that's spent on has changed, though. Defence spending has dropped from 23% to 5%, while health has jumped from 7% to 20%.

Increases in life expectancy have been a triumph of the past 70 years. Of the people born in 1952, 76% of men and 84% of women have made it to age 70. Compare that with those born 70 years earlier in 1882: only 34% of men and 45% of women are estimated to have survived to 1952. Those turning 70 this year can expect to live to 86 for men and 88 for women – an extra six years of life compared with their 1952 equivalents. Moreover, this 'Platinum Jubilee generation' is also the richest in history so far. Expressed in today's prices, this generation's incomes peaked in 2005 (when they were aged 53) at £27,800, a full £5,700 higher than the UK average. But even now, in retirement, they have incomes of £26,400 per year on average. That's 6% (£1,500) more than the population. Much of that is to do with house prices. Some 85% of those born in 1952 are homeowners and 14%, or one-in-seven, own a second home.

Price comparison over 70 years

1952	2022
TV Licence	
£3.00	£159.00
Food expenditure – percentage of income	
30%	10%
Average weekly earnings	
£6.04	£605
Inflation	
6.4%	2.5%
GDP	
£8,500	£32,600
Defence spending	
23%	5%,
Health spending	
7%	20%.
Average house prices	
£1,891	£260,771

Elizabeth's reign kicked off with a house-building bonanza. Between 1952 and 1958 some 2.15 million homes were built, 1.4 million by local authorities. Yet, in the long run, houses have been a glaring exception to the rule that pay has kept up with – and beaten – price increases.

In 1952, the average house price was £1,891, according to the Nationwide Building Society's house-price index. That's equivalent to £39,065 (using the Bank of England's calculator for 2021). The latest average for the Nationwide index is £260,771 – meaning that house prices have vastly exceeded both general inflation and average earnings. Broadly, houses cost about four times the average (male) earnings then, compared with eight times now.

This implies a huge strain on the economy, government finances and social solidarity in the coming decades, as the anger of younger generations over housing inequalities crashes into unfavourable demography. In 1952, there were 5.5 people of working age for each person aged 65 and over. Longer life expectancy and falling birth rates mean this ratio is now just 3.3. Projections suggest that it could fall to 2.3 by 2040 – around the time we might expect, barring a republican revolution, the accession of King William V.

House prices falling

As recently reported in MoneyWeek, the World's hottest housing markets are faltering. Is the UK next?"

As interest rates rise, house prices in the world's most overpriced markets are starting to fall. The UK's turn will come. But will it be a slowdown, or a full-blown crash?

One of the most important factors driving house prices higher has been low and falling interest rates. When interest rates fall, you can borrow more to buy a house; most homebuyers borrow to their limit to get the best house they can afford. In practice, they're not worrying about the overall price, they're worrying about the monthly payment.

A drop in the price of money means a given monthly payment will buy a bigger home loan, and so more money goes into the housing market, and house prices go up. It's practically a mechanical relationship.

Interest rates are now going up. So, the obvious question is: when do house prices start to crater?

Britain ranks 13th of 20 countries in its house-price risk table. Sweden, the Netherlands and New Zealand comprise the top three, with famously-overpriced Australia coming in at five, similarly expensive Canada in at seven, and the US joint eighth place (with Denmark).

In the two pandemic years (taking average prices from the end of 2019 to the end of 2021), British house prices have 'only' risen by around 18%; prices in New Zealand by contrast, are up by 46%.

In Britain, the share of homeowners who own homes with mortgages outstanding is about one in three. Again, New Zealand stands out as being double that.

Britain has a very low proportion of mortgage-holders on variable-rate loans. In Norway (fourth on the vulnerability list), 94% of loans are variable rate. In the UK, it's below 10%. That said, apparently about half of those who have fixed mortgages are on two-year loans – so that's not as reassuring as it may sound at first.

Finally, in terms of overall indebtedness, the UK is again mid-table. Borrowers in the most vulnerable countries are far more over-extended than in the UK. Given that the cost of necessities has been rising and continues to do so, that bodes ill for people struggling to keep up with their payments.

In short, high property prices are a global problem. Some countries and areas are worse than others but, overall, the global drift lower in interest rates in the last 40-odd years has helped to inflate prices in the majority of economies.

This implies a couple of things. One, if we have a house-price crash in the UK, we'll have plenty of company. Two, if you want to get an idea of just how vulnerable housing markets are to interest rates, we probably just need to look at how our riskier cousins are doing.

On that score, the answer the answer is pretty clear. The Bank of Canada started raising interest rates from 0.25% in March this year. They're now up to 1%.

Last month, house prices in Canada fell for the first time since April 2020 according to one popular measure, while sales volumes are down by more than 25% on the year. Sales have fallen across 80% of local markets.

That's a significant movement, and it's clear what is causing it – concerns about rising interest rates. There are plenty of other economic concerns, including the rising cost of living. But it's a fear of rising mortgage rates that are are really rattling the market. Analysts are starting to roll out their predictions of 10-20% corrections.

It's a very similar story in New Zealand. The central bank there has been raising interest rates for a bit longer than elsewhere because New Zealand managed to avoid most of the Covid pain. It first started hiking rates in October, raising from 0.25% to 0.5%. Now rates are at 1.5%.

Britain ranks 13th of 20 countries in its house-price risk table.

As for house prices? They showed an almost immediate reaction. Prices peaked in November and have been edging lower since, and are down by 5% since then. Transactions fell by 30% in a single month in April.

Again, economists are starting to talk about 20% falls. That's a crash – but at the same time, it would only return prices to early 2021 levels, which implies that perhaps prices have further to fall.

Returning to the UK, it's not obvious from the latest Rightmove data that there are any jitters. This month, asking prices hit another fresh record high, and are up 10.2% on last year. However, while our market is probably slightly less sensitive to rate changes than the above two, it's only a matter of time.

That doesn't necessarily spell a crash: rising rates are one side of the equation – they affect demand for houses (in terms of the potential price paid). But for crashes to happen, there need to be forced sellers, otherwise what happens is that sales volumes crash (which happens quite quickly), but prices go into a form of stasis. No one wants to sell their home at a loss, so they just don't move.

Forced sellers are mostly a recession phenomenon. A recession is very possible. it's also not set in stone. The jury is out on whether it'll be a slowdown, or a crash.

What could stop a slowdown? The main thing that could spark a rally now would be the same thing as we saw in 2005. Central banks panic because they think that inflationary pressure is going to give way to recession. As a result, they start to relax monetary policy again. Homeowners and vendors breathe a sigh of relief, while frustrated first-time buyers give up holding out for a crash and decide to leverage up as much as they can, and buy.

If you're buying a home to live in, then you shouldn't try to time the market. The important thing to focus on is your personal circumstances: is this the right home for you? Does it work with your commute? What are the schools like? And all the rest of it. But just be cautious when thinking about your immediate circumstances for the future, and don't overstretch yourself. You might be able to fix your mortgage, but your living costs aren't likely to stop rising for a while yet.

India's bull run ends

The bears are here for India's stock markets, The Wall Street Journal reported recently. While a full-scale massacre isn't necessarily imminent, investors should brace for a nasty mauling.

India's BSE Sensex index has been a top pandemic performer, gaining 77% over the past two years, despite a severe wave of Covid-19 in early 2021. Investors have been optimistic about the country – a thriving technology sector and major economic reforms are among the confluence of forces standing to transform its economy over the next decade. But, the bullish mood may now be under threat for now. The Sensex has slid almost 8% so far this year.

The end of the party is partly due to the Reserve Bank of India (RBI). It recently raised rates for the first time in more than three years, by 0.4 percentage points to 4.4%, and is set to go much higher. Investment bank Goldman Sachs is forecasting a further 1.25 percentage point increase in rates this year.

As in many countries, higher interest rates are being driven by soaring prices: domestic inflation hit a 17-month high of 6.95% this March, well above its target range of 2%- 6%. However, the RBI has a distinctly tricky task ahead of it. Its challenges also include supporting the rupee, which faces multiple severe headwinds such as soaring crude oil prices, the US Federal Reserve raising its interest rates, and an exodus of foreign money. For example, the country imports 80% of its oil, so as oil prices soar, the current account deficit is set to increase. These factors help explain why the rupee has recently fallen against the US dollar, recording a new low of Rs77.73 a dollar.

These factors help to explain notably weaker demand for Indian stocks. Foreign investors have been selling stocks in India since September, taking out nearly $24bn. Now there are signs that domestic retail investors are starting to sell. High-flying tech stocks have been particularly hard-hit, with the sector falling by nearly 21% this year.

The performance of the country's largest initial public offering (IPO) is another disappointing sign. Last month, the government sold a 3.5% stake in state-run Life Insurance Corporation (LIC). While the IPO had been scaled back in size, it was still three times oversubscribed and priced at the top of its range. There were expectations that it would yield windfalls for millions of investors. Yet the shares fell 9% in their first day of trading this week. The drop demonstrates that the country's equity market is losing its appeal.

Market report

Bonds
Better Prospects Ahead

Global bond markets have sold off heavily since the start of the year. A combination of post-pandemic economic reopening, with intense price pressures, have led major central banks to ramp up their hawkish rhetoric and accelerate the speed at which they raise official policy rates and withdraw liquidity support. This is translated into higher credit rates across the yield curve, reflecting significant expectations of a meaningful and front-loaded interest rate hike.

Following lacklustre returns across most fixed income segments, and based on current valuations, there are better prospects ahead.

Gold
Sound insurance asset

Gold has again proved its worth as an insurance asset, rising in price by around 7% this year. This rise has been underpinned by multiple risks such as the war in Ukraine and the sharp rise in inflation globally (the highest since 1981 in the US).

Gold prices remain well supported around the current level at least until US inflation declines or geopolitical risks ease. However, unless the risk of a US recession rises further, there is little romm for more price growth.

Foreign Exchange
Sterling's stong run to slow

Among G10 currencies, the US Dollar is favoured against European currencies, with the Euro and Swiss Franc looking particularly vulnerable. The Federal Reserve's fast tightening, high commodity prices, and slowing global growth should support the Dollar in coming months. Commodity currencies like the Australian Dollar should also remain on the front foot while commodity-importing, export-orientated and low yielding currencies, like the Euro and Swiss Franc will suffer.

Sterling is unlikely to continue its recent strong run as the size of interest rate increases from the Bank of England looks uncertain.

Commodities
Strong upside potential

There is room for another 10% move up in total return indexes over the next six months. Hence, investors with the appropriate risk appetite should retain strong exposure to commodity markets.

Industrial metal supply is struggling. While Russian exports of industrial metals can be easily redirected, markets were already tight at the turn of the year. Higher energy costs are exasperating material production problems in Europe - mainly in aluminium and zinc. The result is a further tightening in supply. Almost all base metal markets are set to be under supplied this year.

In agriculture, grain supplies continue to be disrupted. Russia accounts for around 19% of global wheat and barley exports, while Ukraine makes up about 8% of global wheat exports, 13% of global corn exports and 46% of global sunflower oil exports. The war's impact on Ukraine's production exports is severe.

Whilst there are no official sanctions on Russian grain, self-sanctions have been imposed by some commodity traders. Prices are likely to rise sharply.

Oil
Forecasts rising

With the US releasing 180 million barrels (mb) and other OECD countries releasing 60mb over next six months, some of the market tightness caused by the self-sanctioning of Russian crude buyers (either in fear of future sanctions or for reputational reasons) should stop. Meanwhile, oil demand in China and Russia (the 2nd and 5th largest oil consumers) will be affected by pandemic-driven mobility restrictions and international sanctions respectively.

UBS has raised its forecast on oil prices for early 2023 by almost 10%. The oil reserve releases will not fix the structural imbalance resulting from years of under investment at a time of recovering global demand for oil.

Investors with a high risk tolerance should add long-term positions to their portfolios.

Equities
Focus on Energy and Healthcare

UK and Australian equities look attractive at current values.

Globally, energy and health stare healthcare stocks looking particularly good value. Energy is one of the biggest beneficiaries of the economic reopening and the sectors performance has lagged the increase in the oil price. The sector is likely to use its increased profits to extend share buybacks and dividends. The healthcare sector offers attractive long-term growth, appealing shareholder returns and a defensive quality profile

Consumer staples and industrials remain least preferred, as the economic slowdown bites.

The MSCI All-country World index got off to a rough start this year driven by higher-than-expected inflation readings, a more hawkish Federal Reserve, increasing COVID-19 cases in China and geopolitical tensions. Despite all these risks, the global economy is unlikely to enter a recession. However, earnings are likely to fall requiring careful attention.

We've over 200 years experience in the world's largest Banks

Alexander Wade

Alexander is one of the most experienced London advisers in the international market, specialising in this field over the last 20 years at HSBC, consistently recognised as one of its most accomplished advisers. He has over 24 years' experience in financial services. He is particularly interested in the Middle East market and understands the specific issues which are relevant there.

Stuart Poonawala

Stuart has worked in financial services since 1998. In 2003, he helped to found HSBC's specialist London arm advising international clients which quickly became one of the bank's most successful UK divisions. In 2009, he launched Kubera Wealth, our sister company, focussing on providing quality advice to the UK market.

Graeme Cowie

Graeme is responsible for building our professional connections with international lawyers and accountants, as well as co-ordinating our relationship with key fund managers at a number of international Private Banks and Discretionary Fund Managers. He has spent over 20 years in financial services and investment management, most recently spending more than six years at UBS where he led the Strategic Partnership team.

New Additions to the Team

Joanna Bailey joins the team as Associate Planner. She started her career as a Molecular Biologist, having gained a degree in Genetics from the University of Liverpool. She became an Account Manager in a Laboratory Supply company, gaining a wealth of knowledge in a number of roles.

Having always had an interest in personal finance, Michelle finally took the plunge to start a career in personal finance, attaining the Level 4 Diploma in Investment Advice in 2021. She is now working towards becoming a Chartered Financial Planner with the Chartered Insurance Institute and looks forward to meeting Knightsbridge Wealth's clients in the coming years.

Michelle Bye
Business Manager

Claire Hobbs
Senior Client Services Assistant

Michelle Hoskin
Head of Operations and Business Development

Kellie Lewis
Client Relationship Manager

Caroline Lvy
Client Relationship Manager

Kelly Kular
Personal Assistant to the Partners

Daniel Hawes
Relationship Officer

Heidi Witham
Paraplanner