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WEALTH PLANNING

Portfolio and Market Review

3rd Quarter 2022

Update

Against a backdrop of leadership changes in the UK, market turmoil, rising living costs and the sad passing of our longest reigning monarch, we have remained focused on continually reviewing our processes and services to ensure we deliver for our clients. We would like to express our sincerest thanks to our clients and are very grateful for your unwavering support and loyalty during this time.

We appreciate the difficulty to stay calm and trust the investment process, but you are all doing a great job. If we all hold our nerve and I am confident there will be better times ahead. Remember our financial press mainly focusses on the doom and gloom of the UK only. Your investment strategy is globally diversified, so try to keep that in mind when reading the headlines!

On a more positive note, there have been developments in the following areas of our services, aimed at improving outcomes for our clients, and many more behind the scenes improvements we are working on to ensure we are at the cutting edge of Financial Planning in the UK.

- Our Investment Partner, Betafolio, has now safely unified under the Timeline brand, and our partnership with them has the potential to add even greater value to our clients and us. Currently after much lobbying, Timeline has been able to secure institutional shares classes with Vanguard and L&G. This means typically costs of around 0.06% to 0.08% pa will be taken out of the investment portfolios for our clients. Immediately adding £££s to our clients' bottom line.
- With Ethical, Social & Governance (ESG) Investing continuing to gather interest, we have expanded our ESG offering to better suit our client needs.
- There has been improvement to your MyThanks App including a refreshed display of valuation history charts, introduction of performance reporting, the ability to scan documents from your phone, biometric login, and the addition of MyThanks video box sets offering you simple to understand financial education videos. Behind the scenes, improvements to how we communicate with you should be more streamlined in the future too.
- Finally, we are pleased to announce that we have reached an agreement to partner with KryptoKloud, an independent cyber operations and intelligence company to provide improved 365/24/7 "eyes on" cyber security intelligence and monitoring services inc. GDPR compliance monitoring to improve the security of all Thanks Wealth Planning client data. KryptoKloud are endorsed by Optimum Speciality Risks (OSR), our insurers, and come highly recommended.

To reflect the improvements to our investment strategy you may notice some small changes to your portfolios in the coming weeks but don't worry these only reflect the changes highlighted above. Everything will be done for you.

These continual developments further justify our decision to partner with firms that are aligned to our values and vision. We hope they further justify our clients' decision to partner with us.

As you know, the focus of our entire business is to empower our clients. We're confident with your feedback, and our vision, this will lead to greater streamlining and services, and a wider proposition that will unquestionably benefit our clients. If you are interested to hear more about any of these developments or what else, we are up to please get in touch. Likewise, please let us know about anything you like or dislike as we are always looking to improve. Your feedback is vital for us to keep improving.

Market Commentary

By Laurentius van den Worm

A Sailing Ship, Staying Afloat

It was in the summer of 2013 that I teamed up with three college friends to redefine the meaning of "adventure". We booked a one-way flight to Kigali, Rwanda and hitch-hiked all the way back to South Africa with a budget of only £300 to get us home. I never thought that market events in the United Kingdom would give me flashbacks of this irresponsible yet adventurous journey we went on. But, alas, the back-and-forth political and economic events of the past quarter sure gave me a déjà vu moment worth sharing.

About two weeks into our journey, we decided to take a detour to the tropical island of Zanzibar to spend Christmas Eve. This all sounded idyllic until we were struck with the reality that we only had about £200 left in our budget, and a return ferry would cost roughly half that amount. But, as with any know-it-all, hard-headed student, we refused to engage in logical reasoning and went to a small fishing village north of Dar-es-Salam to negotiate with the local traders to take us to Zanzibar on their traditional sailing vessel, called a dhow, which is basically a handmade wooden sailing boat about 60 feet in length that would never pass any standard buoyancy test. This 30-mile journey, with its eight-man-strong crew, is the flashback I get when I reflect on the recent economic and political events in the UK.

Economic Outlook

Inflation

Similar to the start of this quarter in the UK, we were hopeful that our journey to Zanzibar would be smooth sailing, unlike the previous weeks. We started the third quarter of 2022 with an inflation rate of 9.1% in the UK,[1] with high hopes of a turning point on the horizon. Unfortunately, that was not the case. Inflation reached a high of 9.9% at the end of quarter three. However, it does seem like there is light at the end of the tunnel, with rates expected to peak at around 11% in the final quarter of 2022 according to the Bank of England[2] before it will slowly come down and normalise at an elevated level of approximately 3.3% towards the end of 2023, that is, if you believe the experts at both Vanguard[3] and Northern Trust[4].

The peak and subsequent decline in inflation will primarily be driven by two factors. First, we are entering a timeframe where the inflation fears started more than 12 months ago when the CPI index reached a high of 115 in November 2021[5]. Due to this high base rate, we should expect a flattening of the inflation curve. The second factor that will contribute to declining inflation numbers can be attributed to some relief in energy prices. As an example, the price of Brent crude oil came down to $88[6] a barrel from a high of $127 in the first quarter of the year.[7]

[1] Office for National Statistics (2022).
[2] Bank of England (2022).
[3] Vanguard (2022).
[4] Northern Trust Asset Management (2022).
[5] Office for National Statistics (2022).
[6] As of 03/10/2022.
[7] Market Watch (2022).

Fiscal vs. Monetary

Just like the people in charge of the UK economy, we were also left to the mercy of our 8-man-strong crew to get us safely across the ocean. There is so much symbolism between these eight men and the people currently in charge of the UK economy. Six men, three on either side of the vessel, were working against each other, trying to rig the sails as we steered through the waters. This symbolises how the fiscal and monetary policy played out during the quarter. On the right-hand side, we had three prominent figures (Liz, Kwasi and the rest of the cabinet) trying to steer us through a cost-of-living crisis with some unexpected financial support and tax reform.

Key takeaways from Kwasi Kwarteng's mini-budget speech:

- *Cutting the basic Income tax rate from 20% to 19%*
- *Increasing the tax-free threshold of the Stamp Duty Land Tax (SDLT) from £125,000 to £250,000*
- *Increasing the tax-free threshold of SDLT for first-time home buyers from £325,000 to £425,000*
- *Capping household energy bills on an average of £2,500 per year*
- *Abandoning the planned increase in corporate tax rates from 19% to 25%*
- *A reversal of the National Insurance tax rate increase*
- *A digital VAT-free shopping scheme to be introduced for international visitors*
- *Creating Local Investment Zones where there will be significant tax reliefs to "unleash the power of the private sector."*
- *A decision was made to scrap the 45% Income tax rate with a single higher rate of 40%, however, this decision was recalled a few days later.*

** Pressure is mounting to backtrack on more of the announcements above. However, at the date of writing this report, nothing has been announced.*

In general, it seemed as if the budget reform primarily focused on preventing a stagnating economy and less on getting control of the current inflation levels. I think it is fair to say, politics aside, that the mini budget was not in favour of the markets in general, which triggered a significant sell off across all British assets; in both the UK equity, and especially in the UK bond markets.

Moving towards the left side of our vessel, we had another three highly skilled sailors working against their counterparts on the right side of the ship, trying to steer us forward without tipping the boat. You can probably guess the symbolism of these three sailors. They are reminiscent of the ones in charge of our monetary policy; The Bank of England (BoE), its governor and the rest of the Monetary Policy Committee (MPC).

The latest budget reform spooked the markets to such an extent that the general public expected the BoE to call an emergency meeting to raise interest rates to save a tumbling British pound. Instead, a different scenario played out in the market, which forced the BoE to take emergency action by announcing that they would engage in a temporary shopping spree of long-dated UK government bonds. The BoE stated that the purpose of these purchases is "to prevent an unwarranted tightening of financing conditions and a reduction of the flow of credit to the real economy."[8] This basically meant that the BoE was forced to restore financial stability in the markets by gaining control over falling bond prices, which are explained in more detail in this document's asset class returns section.

[8] Bank of England (2022).

Aside from engaging as an active player in the UK bond market, the BoE also made it clear in its Governor's statement on 26th September that "the MPC will not hesitate to change interest rates by as much as needed to return inflation to the 2% target sustainably in the medium term."

These actions mentioned above indicate that we have an expansionary fiscal government, trying to do the right thing at the wrong time by stimulating economic growth during an inflationary period. While the people in charge of monetary policy are more contractionary, trying to get inflation under control with a short-term goal of ensuring financial stability in the markets. The effect of these two contradictory policies, on top of an already struggling economy with a negative balance of payments, was visible in the asset class returns of the third quarter.

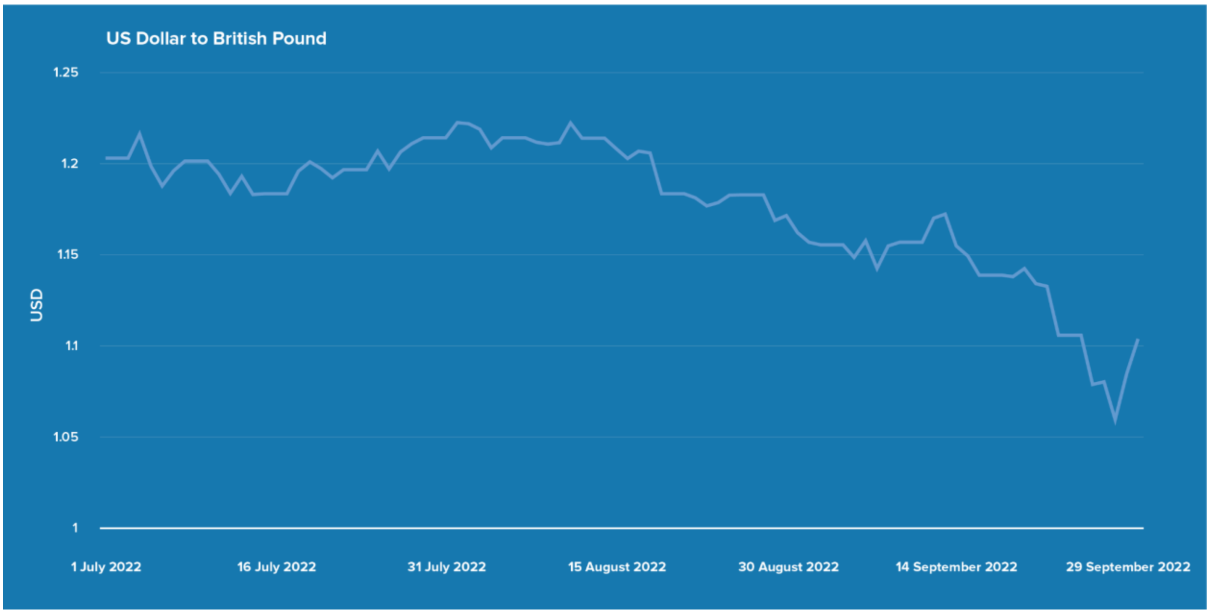
Asset Class Returns

Over the third quarter, not only were investors faced with continued economic headwinds like the previous quarter, but for some, it might feel like the wind has completely disappeared. This is precisely how we felt on our adventure to Zanzibar. Not only were we faced with almost no wind, but the light breeze that did come up now and then was blowing in the most undesirable direction for sailing, which resulted in us having to sail in a zig-zag pattern across the Atlantic Ocean. For a moment, I also thought that we would never reach our destination until the 7th member of our crew, the captain of the ship, fired up a small petrol engine and steered us towards our destination. Most asset class returns behaved in a similar zigzag fashion at the start of the third quarter. However, without any driving force to steer us in a positive direction, we ended the quarter in negative territory across all major asset classes.

[9] Developed Equities: iShares Developed World Index; Emerging Markets: Vanguard Emerging Markets Stock Index; European (ex-UK) Equities: Fidelity Index Europe ex UK; Global Bonds (hedged to £): Vanguard Global Bond Index Hedged; Global Equites: iShares MSCI ACWI UCITS ETF; Global Property: iShares Global Property Securities Equity Index; Global Value Equities: Dimensional Global Core Equity; Japanese Equities: Fidelity Index Japan; UK Equities: Vanguard FTSE U.K. All Share Index Unit Trust; UK Government Bonds: Vanguard UK Government Bond Index; UK Inflation (RPI): Index: UK Retail Price Index; US Equities: Fidelity Index US. Performance periods: 1 Year: 30/09/2021 - 30/09/2022; 3 Year: 30/09/2019 - 30/09/2022, 5 Year: 30/09/2017 - 30/09/2022; 7 Year: 30/09/2015 - 30/09/2022.

Foreign Exchange

Surging commodity prices (which are primarily traded in US dollars) have, without a doubt, supported the dollar's valuation over the past year. However, the overwhelming reason for a strong dollar in the last two quarters should be attributed to the Federal Reserve's willingness to get its feet dirty in the fight against inflation. The below chart visually illustrates how Sterling has depreciated by 8.2% against the US Dollar over the last quarter.[10]



Source: Fxtop (2022)[11]

[10] Fxtop (2022).
[11] Performance period: 01/07/2022 - 30/09/2022.

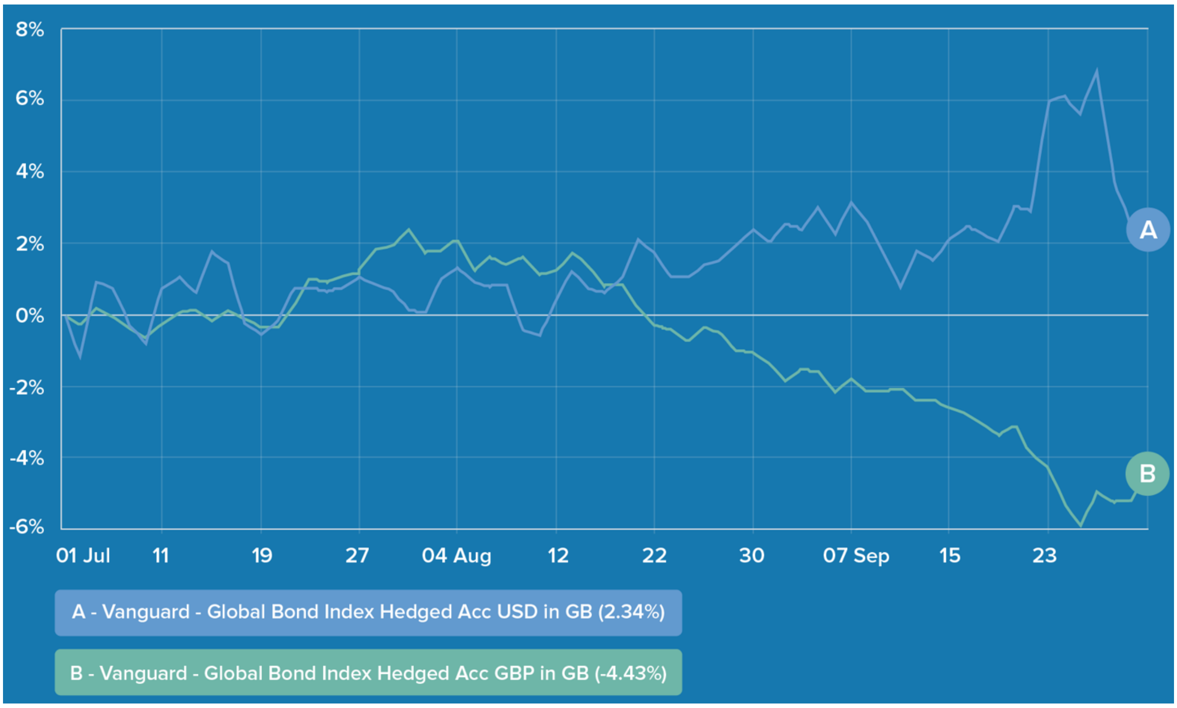
Fixed Income

Fixed income markets continued their struggle throughout the third quarter. The severity by which any particular group of bonds have declined over the last quarter was driven mainly by its underlying duration. And just to be clear about what duration means in this context - it measures the expected change in a bond's price for an expected 1% change in rates. It is essentially measuring a bond's sensitivity to (expected) interest rate changes. Currency exposure also had a secondary, albeit significant, impact on bond performance. That said, let's look at what transpired in different bond markets.

Global Bonds: GBP hedged vs. Global Bonds-unhedged

According to the Morningstar Global bond index, the global bonds market managed to keep its head above water with a positive quarterly performance of 0.7%[12]. However, the negative effect of a stumbling sterling completely overshadowed the fixed income performance for UK investors, who avoid currency risk in fixed income by hedging all foreign currency exposure back to GBP. Global bonds, hedged back to GBP, had a negative performance of -4.4%[13] for the third quarter of 2022.

The effects of Sterling depreciating against the US dollar can be seen in the chart below. The two lines are both representing a version of the Vanguard Global bond fund, which is tracking the performance of the Bloomberg Global Aggregate index, with the only difference being that the upper line is hedged back to US dollar, and the bottom line is hedged back to Sterling. This performance discrepancy of 6.8% is in line with the sterling depreciation shown above.



Source: Timeline (2022)

The above might raise the question of why we hedge out currency risk. The impact of currency hedging in a portfolio is driven by the volatility level of the hedged asset relative to the volatility level of currencies. Currencies are generally more volatile than bonds. Therefore, currency hedging in fixed income portfolios remains an effective tool to drive down portfolio volatility.

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12 Morningstar (2022).

13 Measured by the performance of the Vanguard Global Bond GBP hedged index, which is closely tracking the performance of the Bloomberg Global Aggregate Float-adjusted and scaled GBP Hedged index. Performance period: 01/07/2021 - 03/10/2022.

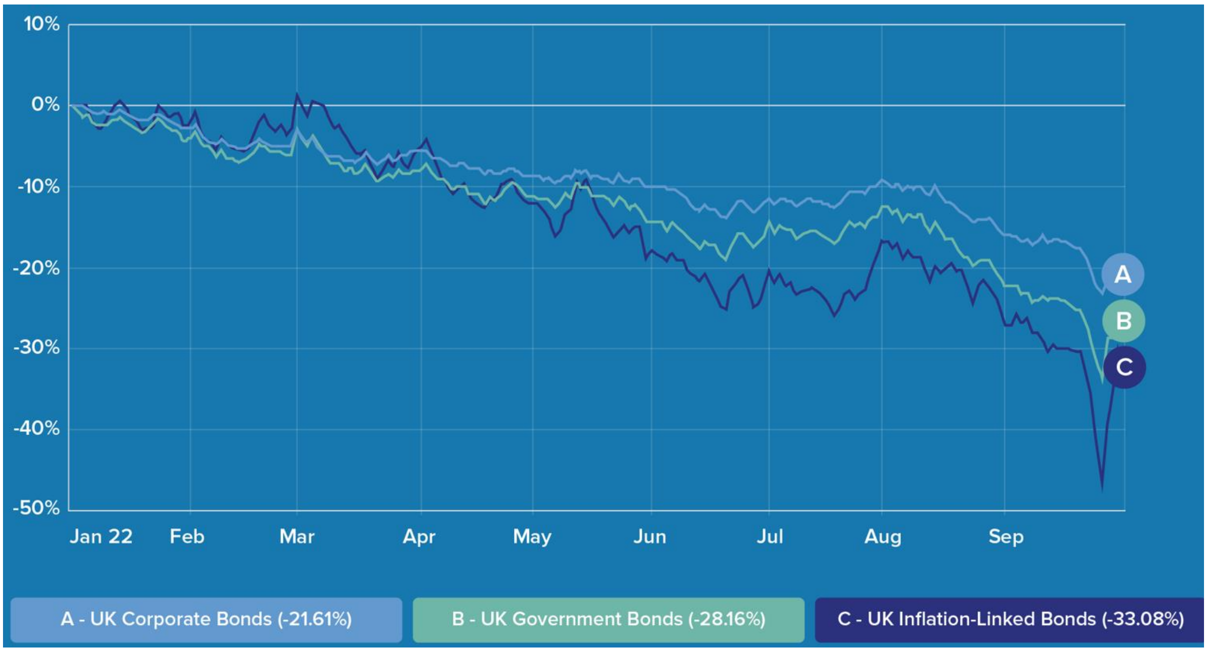
UK Government vs. UK Corporate vs. UK Inflation-linked

Unfortunately, adverse currency movements were not the main contractor of fixed income performance over the quarter. Long-duration UK gilts have seen one of the worst drawdowns in history following the mini-budget speech in the final days of the quarter.

There were three main reasons for the significant sell-off in the UK bond market:

- First of all, investors anticipated that the BoE would engage in an emergency monetary tightening to counter the loose fiscal policy to fight inflation, which means higher rates, and declining bond prices.
- Secondly, the market expects more debt to be issued following the announcement of the unfunded tax cuts and further economic relief, putting even more downward pressure on bond prices.
- And finally, declining asset prices gave rise to most defined benefit pension funds being faced with the threat of significant margin calls due to a modern “hedging” strategy called Liability-Driven Investing (LDI). LDI is basically an investment strategy that involves a lot of leverage to circumvent the stress on funding ratios that resulted from artificially low interest rates. To raise money for these margin calls, pension funds were forced to sell gilts (amongst other assets), further decreasing their value, leading to devaluing their posted collateral even more and almost creating a spiral where they had to sell more and more assets to cover further margin calls. This is where the BoE had to step in to “prevent an unwarranted tightening of financing conditions.”

UK corporate bonds have, on average, a much lower duration than UK government bonds (6.3 vs 11.5). Therefore, UK credit has been more resilient than its government counterpart. UK inflation-linked bonds have, on average, a very long duration of 17.9. The difference in price sensitivity can be seen in the chart below.



Source: Timeline (2022)[14]

[14] UK Corporate Bonds measured by the Vanguard U.K. Investment Grade Bond Index Fund, UK Government Bonds measured by the Vanguard U.K. Government Bond Index Fund and UK Inflation-Linked measured by the Vanguard U.K. Inflation-Linked Gilt Index Fund. All funds are closely tracking the performance of their underlying Bloomberg index. Performance period: 31/12/2021 - 03/10/2022.

To further illustrate that duration was the main driver of underperformance for most of the last year, we can compare the Vanguard UK Inflation Linked Gilt Index Fund with a duration of 17.9 to the Dimensional Sterling Inflation Linked Intermediate Duration Fixed Income Fund, with a much shorter duration of 8.92. The Dimensional fund has seen a less significant decline than its Vanguard counterpart, as illustrated below.

Source: Timeline (2022)[15]

Why do we have exposure to longer-duration bonds in our portfolios if they are so much more volatile? This is a fully justified question that we often receive. Our internal research[16], supported by external research from Dimensional[17] and Vanguard[18], found that there is no significant conclusion to be made as to whether shorter-duration bonds outperformed longer duration bonds over historical interest rate hiking periods. We, therefore, maintain a laddered duration exposure covering all parts of the yield curve with an average duration of just below the global market average.

We also diversify our fixed income assets across quality and issuer. Our portfolios are only exposed to investment-grade fixed income. We do not invest in high-yield debt, as the defensive properties of high-yield fixed income are much more equity-like than investment-grade bonds. High-quality fixed-income securities provide a solid foundation for a portfolio. Although losses can occur over the short term, these assets should offer stability over time. With interest rates expected to normalise at a higher level, we should expect a stronger income yield going forward, making fixed income an attractive asset again in any multi-asset portfolio.

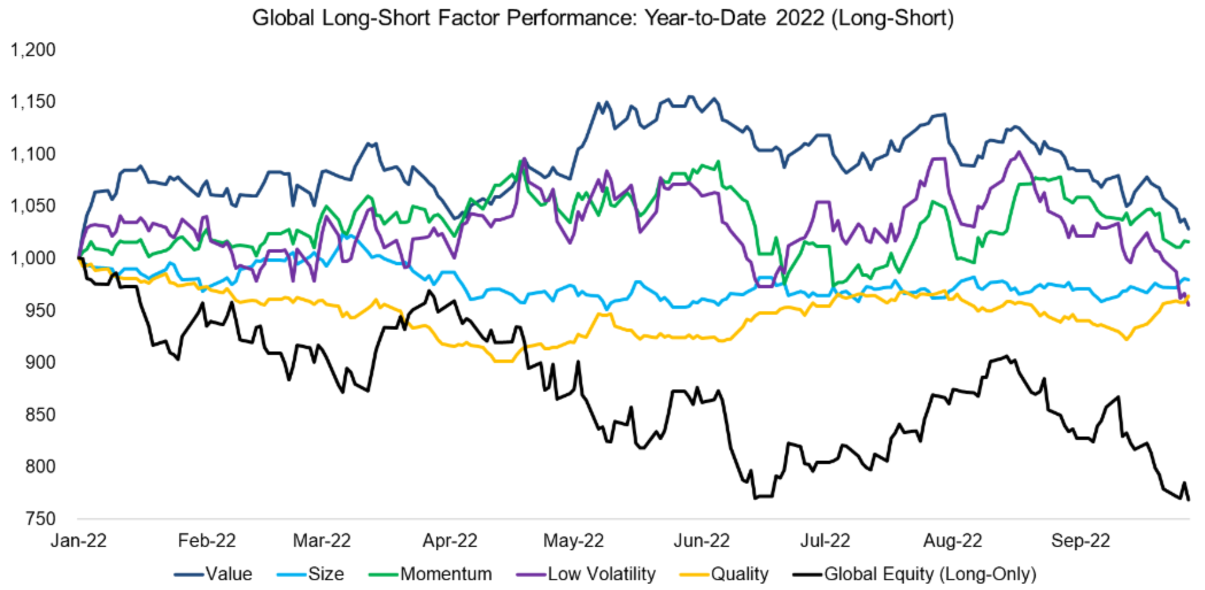
[15] Performance period: 31/12/2021 - 03/10/2022.
[16] Timeline (2021).
[17] Dimensional (2022).
[18] Vanguard (2022).

Equities

As with most asset classes, equity markets experienced a major repricing towards the end of quarter three as leading indicators of a global recession became more prominent. Developed markets were more resilient over the quarter, falling 4.6%, compared to emerging markets, which fell by 9.1%, according to the Morningstar Developed and Emerging market indexes.[19] The Russell 3000, a broad US index, returned -5.9%, the European Stoxx 600 returned -4.7%, and the FTSE UK All Share, -4.5% over this quarter.

Even value stocks, which were able to maintain their resilience for the first half of the year, were faced with some turmoil in the third quarter. However, global value stocks are still leading the performance charts with a negative return of 1.8% for the year, whereas global growth stocks have seen a decline of 17.7% for the year to date.[20]

Large-cap growth stocks were particularly hard hit in the first half of this year as global investors turned their backs on overpriced big tech companies and turned towards companies with better valuations. The size and profitability (quality) risk factors, which are prominent alongside the value premium in our evidence-based investment philosophy, were not able to keep up with the performance of value stocks over the past year, however, they did manage to maintain a low level of volatility and outperformed the global equity markets in general, as can be seen in the chart below from Finominal.



Source: Finominal (2022)

[19] Morningstar (2022).
[20] Morningstar (2022).

Property

With interest rates rising at their fastest pace in 30 years, trying to gain control of soaring inflation and an economic recession looming, many investors are trying to make sense of what is happening in the property market and its effect on a multi-asset portfolio.

When assessing the performance of property as an asset class, we have to consider the structure in which these assets are being owned.

Physical property funds are funds that invest in physical properties themselves, meaning the fund as an entity owns the buildings. We saw an aggressive sell-off in these physical property funds towards the end of quarter three, which seemed very similar to what was happening in the fixed-income market. As pension funds were selling fixed-income securities to meet collateral demands, many of them also had to convert some of their physical property holdings to cash. However, unlike fixed income, the assets within these physical property funds are much less liquid, giving rise to a liquidity mismatch between the units of the property fund and the underlying assets. The sudden increase in exit requests from these funds sparked a liquidity crisis, forcing some of these property funds to introduce withdrawal suspensions. These withdrawal suspensions are not a new phenomenon in physical property funds. Therefore, we maintain our view that these funds are not suitable investments in a multi-asset portfolio.

We prefer to capture property exposure in our portfolios by investing in global equity index funds, which provide exposure to listed property companies according to their share of the global equity market capitalisation. That said, where an investor wants to see property as an isolated asset class in their portfolio, we recommend Real Estate Investment Trusts (REITs) as a suitable investment structure rather than physical property funds.

When considering the performance of REITS over the last quarter, it seems like they have tried their best to redefine the meaning of a “roller-coaster performance.” The following chart shows how global property securities started the year with a drawback of about 10% in the first two months, followed by a 10% rally, then a 14% drawback, followed by another 10% rally and ended the third quarter with one more drawback, scoring a negative return of 15.2% for the year to date.[21]

[21] Measured by the performance of the iShares Global Property Securities Equity Index Fund, which is closely tracking the performance of the FTSE EPRA/NAREIT Developed Index.

Source: Timeline (2022)[22]

Many REITs are now trading on significant discounts to net asset value (NAV). These low valuations were mainly influenced towards the end of quarter three by expectations of a higher and faster rise in interest rates which would ultimately deepen the impact of a global recession. However, not all are doomed. Like fixed income, a significant component of property return comes from an income yield. With declining vacancy rates in the property market, [23] supply is expected to remain under pressure, ensuring strong support for growth from an income perspective, at least until rates are normalising again to support future price returns.

[22] Global Property measured by the iShares Global Property Securities Equity Index. Performance period: 31/12/2021 - 03/10/2022.

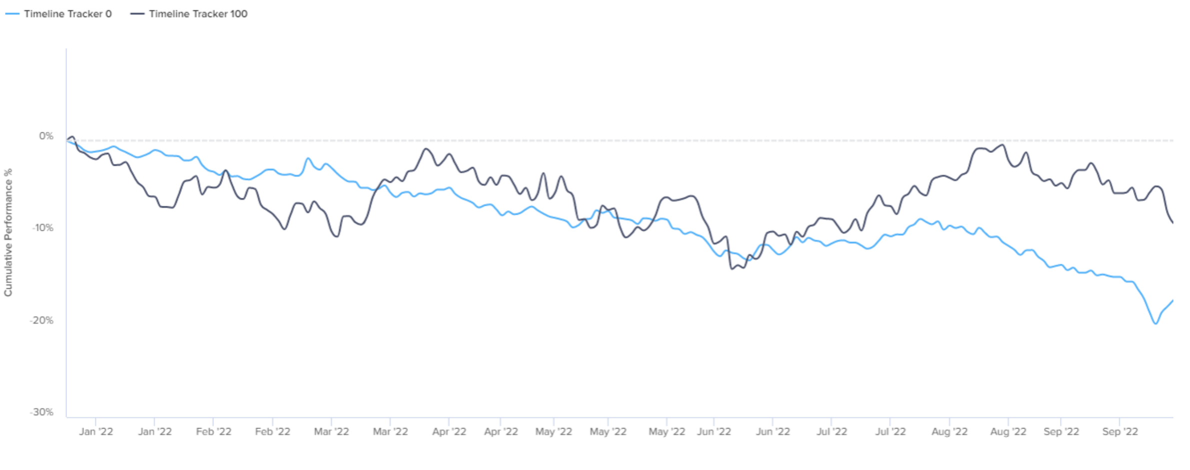
[23] British Retail Consortium (2022).

Portfolio Performance

After reading the economic outlook and asset class returns, you probably don't have any high hopes for the portfolio performance section of this document. And, unfortunately, I must admit that I won't be able to surprise you with any mysterious results in our performance. However, the great thing about following a globally diversified market-cap approach to investing is that you always have relative predictability of what will happen in your portfolio relative to the general market. This is not the case for concentrated, actively managed portfolios, which historically have underperformed the general market most of the time, especially during times of heightened volatility.

Timeline Tracker

As seen in the chart below, both the equity and fixed income portion of the Timeline Tracker portfolio are treading along in negative territory for the year to date. Timeline 100, our equity position in the Tracker model, has returned -8.9% over the first three quarters of 2022, whereas Tracker 0, our fixed income position in the Tracker model, has returned a negative performance of 17.3% over the same period.



Source: Timeline (2022)

Timeline Classic

The performance of our Classic model may look identical to the Tracker model above at first glance. Our Classic 100, the equity portion of our Classic model, has returned -8.5% for the year, coming in line with the performance of Tracker 100 after a sharp drawdown in value stocks at the end of quarter three. The Timeline Classic 0, the fixed income portion of our Classic model, has performed somewhat better than its Tracker counterpart, with a performance of -13.1% for the year to date. The outperformance of Classic 0 compared to Tracker 0 can be attributed to a shorter average duration in the Classic model, as explained in the fixed income performance section above.

Source: Timeline (2022)

Timeline ESG

The chart below illustrates how both the equity and fixed income portion of the Timeline ESG model have produced roughly the same results for the first three quarters of 2022. Timeline ESG 100 returned -12.0% for the year to date. Compared to our Tracker and Classic portfolio, this underperformance in equity was primarily driven by active ESG risks. The Timeline ESG 0 portfolio, the fixed income portion of our ESG model, had a negative return of 12.6% for the year to date. This fixed income performance was in line with Timeline Classic, which has a similar average duration.

Source: Timeline (2022)

For individual performance charts and data of each portfolio, please get in touch. We can compare our portfolios' efficient frontier against the "masters of the universe" at the touch of a button. As a starter for ten, when doing so, you will note that all Timeline portfolios are performing highly efficiently against their peers and prove that a disciplined long-term investment strategy will always deliver rewards at the end of the day.

Closing Comments

By now, you are probably feeling hopeless after reading all the negative information from what can be described as a quarterly commentary without a single silver lining. And on top of that, you have an author that bores you with a story of a not-so-wonderful random sailing experience. However, I must conclude by sharing with you the job description of our eighth crew member while sailing toward Zanzibar. It was about halfway towards Zanzibar, with no land in sight on either end of the horizon, when the eighth crew member reached into the vessel's hull and pulled out an empty bucket. And that is when we were struck by reality. The final member of the crew had by far the most important job of them all. He was responsible for draining a leaking hull to keep the ship afloat.

And like a leaking hull, the past quarter felt like we were being dragged down by more of the same threats of the previous quarter. Inflation is soaring, and rates are increasing. Average citizens are worried about whether they will be able to afford their mortgage payments in the future or whether they will be able to keep warm during the winter. We have a fiscal government trying to patch the holes of a leaking hull by providing much-needed relief to the energy crisis whilst trying to blow wind into our sails with economic stimulus. We have a Monetary Policy Committee that is finding itself between the devil and the deep blue sea. Do they increase rates to fight against inflation at the expense of economic and asset growth? Or do they engage in even more quantitative easing to establish financial stability in the markets at the expense of even more soaring inflation?

I don't know the exact answer to what is needed to solve our current economic dilemma. But I do know that at the end of the day, we also have an eighth member in our crew to keep us afloat. That member is Thanks Wealth Planning, Timeline Portfolios, you, and the force of the market, which is investing in real, profit-making companies. And this market force has proven time and time again that we will advance at the most unexpected time. At the end of the day, we will all be sitting on an idyllic island, reaping the rewards of maintaining a disciplined long-term investment approach.

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Important Regulatory Information

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