IMPACT LENS

2022 in Review

An Update from John Ditchfield

Firstly, I'd like to take this opportunity to wish all of our clients a happy and peaceful Christmas holiday and a fulfilling 2023!

The life of a financial planning business is full of events: births and marriages, people retiring or setting up businesses or moving to new organisations. Sadly, we've also said goodbye to one or two clients due to age or illness. My two children both entered their teenage years, and my long-suffering business partner Matt has some big news coming next year.

I hope we've been able to assist people through troubling or difficult times as well helping our clients with their long-term planning.

Looking back at 2022

2022 has, for the most part, been a tough year for investors. Of the **34 ABI Investment Sectors,** only four remain in positive territory to the end of 2023.

The Commodity and Energy Sector delivered a return of 8.5%, and several cash-based funds were in positive territory. For Gilts (UK Government Bonds), it was a truly awful year with very sharp falls as investors took a negative view of UK Government Debt and the ability of the Government to manage the economy successfully.

When we factor in the impact of inflation, all asset classes lost money over the past twelve months.

In his excellent **Annual Letter for Investors,** the owner of Montanaro asset management Charles Montanaro considers the history of bear markets and how an awareness of human behaviour might assist us as we plan. Charles trained as an anthropologist, so tends to emphasise how human behaviour impacts markets.

In brief:

- The past ten bear market periods have lasted for an average of 18 months and the present bear market period is twelve months old.
- Bear markets come to an end when asset owners will no longer sell, this is when all of the bad news is already in the price. We can analyse this by looking at the historic price of shares (Shiller PE or PE are the most commonly used measures).
- Bloomberg's data on retail private investors suggests that sentiment is currently at an all-time low.
- Institutional investors are also in the doldrums and have a broadly negative view of markets.
- **Cash levels in the US have soared**: According to the Fed's quarterly Flow of Funds, checkable deposits for households and nonprofit organizations rose to a record of USD 5.12 trillion at the end of the third quarter, from USD 4.28 trillion at the end of 2021.
- Insider buying has dramatically increased: Insider buying is when company directors make purchases has also been increasing, so "insiders" are buying the shares of companies that they are closely connected to. This indiciates a good level of confidence from business owners prepared to put more of their own money into companies they know well.
- Very speculative assets have come unstuck, or as Warren Buffett once famously said, "It's only when the tide goes out that we see who has been swimming without their trunks". The case study for this is Cathie Wood's ARK funds over in the US, losing $50bn in assets from their peak in 2021 due to a focus on "disruptive innovation" (Tesla, Bitcoin, robotics, AI).

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Rampant Inflation in 2022

'A time of War (Russia and Ukraine), Famine (soaring food prices) and Pestilence (Covid-19).'

This was how a leading fund manager chose to open his annual shareholder meeting recently as he tried to describe the torrid past few years investors suffered. In particular, 2022 proved one of the most challenging years in decades as inflation took hold and central bankers moved quickly to raise rates. The excellent macro-economic expert Russ Mould is fond of quoting Adam Smith in The Wealth of Nations on this point:

"History shows that once an enormous debt has been incurred by a nation, there are only two ways to solve it: one is to simply declare bankruptcy and repudiate the debt. The other is to inflate the currency and thus to destroy the wealth of the ordinary citizen."

According to the **Institute of International Finance (IIF)**, following four quarters of consecutive decline, the global debt-to-GDP ratio is edging back up, approaching 350% of GDP in Q2 2022. As a result, IIF expects the global debt ratio to reach 352% of GDP by end-2022.

Mould argues that higher, persistent inflation is a 'natural' consequence of this excess money in the financial system chasing assets to buy.

The expansion of the money supply has led to a boom in highly speculative asset classes such as NFTs, cryptocurrency exchanges and platforms. Much of this is now starting to unwind.

"Not a single bee has ever sent you an invoice. And that is part of the problem – because most of what comes to us from nature is free, because it is not invoiced, because it is not priced, because it is not traded in markets, we tend to ignore it."

Key themes for 2023: Biodiversity

As **Pavan Sukhdev** from The Economics of Ecosystems and Biodiversity puts it *"Not a single bee has ever sent you an invoice. And that is part of the problem – because most of what comes to us from nature is free, because it is not invoiced, because it is not priced, because it is not traded in markets, we tend to ignore it."*

Most of us know bees are critical for our environment. But perhaps less of us know they also directly contribute to agricultural outputs via their pollination efforts. Bees contribute over £400 million a year to the agricultural industry, all the while producing honey and beeswax. The European Union values insect pollination at £134 billion (€153bn), but bees' significance to our environment is arguably priceless. To say that every person, family, company and city is 100% dependent on nature and the biosphere is both indisputable and staggeringly obvious.

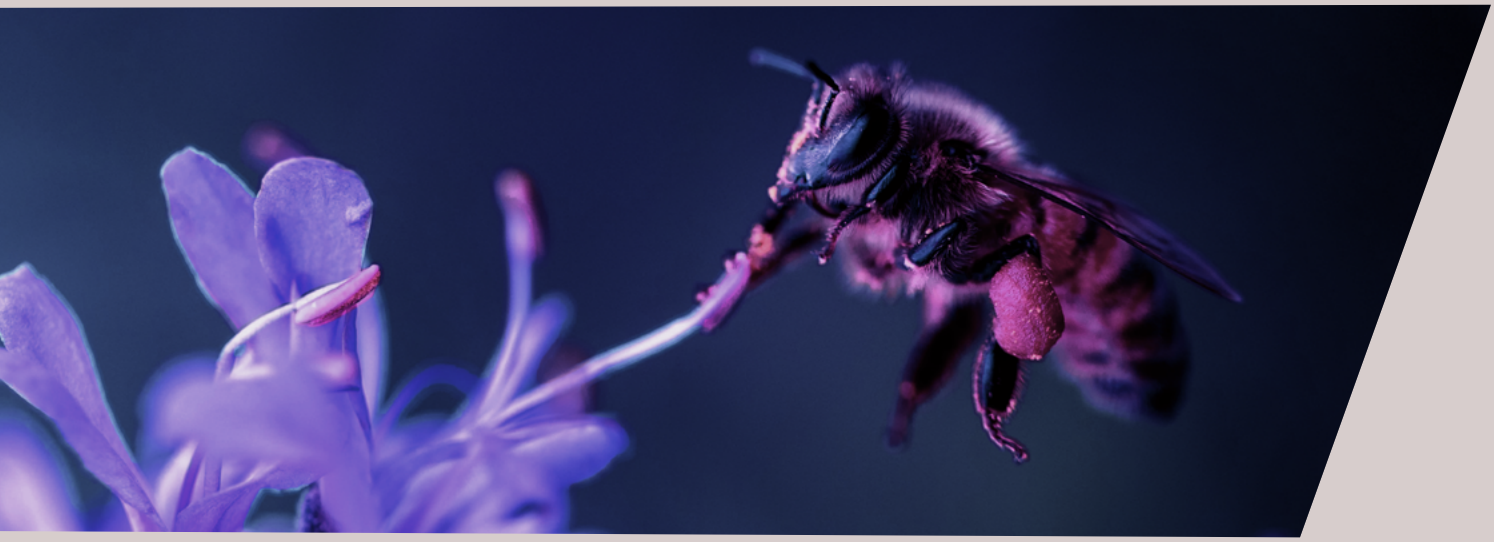
How does one put a price on or value the loss of ecosystems, species and natural resources? Recent **research into biodiversity** has reinforced the interconnected nature between our economy and global ecosystems. The United Nations Environment Programme (UNEP) Finance Initiative found that the production processes in 13 of the 18 sectors that comprise the FTSE 100 are either highly or very highly dependent on nature. Biodiversity loss will impact all industries to varying degrees.

In an analysis published by the PNAS (Proceedings of the National Academy of Sciences) scientists found 515 of the 29,000 land vertebrate species have populations below 1000, and half these species only had 250 individuals remaining.

Rightly so, biodiversity is considered the next key area of investment focus after climate change. Among the nearly 17,000 participants attending the UN Convention on Biological Diversity conference (COP15) in Montreal between December 7th to 19th, there are at least several hundred representatives from financial institutions and private sector companies, from Bank of America and Citi to Unilever and L'occitane.

Similar to the UN Climate Change Conference (COP27) in Sharm El-Sheikh this October, COP15 also comes with high stakes. Negotiators are seeking to agree on a landmark deal that will ensure protection of 30% of the Earth's land and ocean by 2030 — an achievement that could hold **analogous significance** to the 2015 Paris Agreement. This year's talks come as the global population hit 8 billion, more than doubling since 1970, while animal populations have declined by **nearly 70%**. This appalling decline in biodiversity is often referred to as a **mass extinction event**, a period comparable to the era when the dinosaurs became extinct.

Kate Hewitt (a former Impact Lens Researcher) produced this **excellent report** on biodiversity as part of her new role at Montanaro Investment Management.



Impact Lens Update

As we move into 2023, Matt and I are focusing on questions about more efficient and effective working to improve the service we offer. This year, we've been looking at the fast-moving adviser technology industry, working to identify the best systems for data security and providing services to existing clients. Crime involving personal data theft is a huge problem in the UK, so we want to develop better systems in this regard.

In practice, this will mean:

- Data is held more securely, and when we send or receive data from clients, this is done safely.
- Collecting data and updating information will be much easier.
- Client reporting will improve dramatically.

With your assistance, all of these changes will come in during the first half of 2023.

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We are currently working through our programme of annual reviews with clients and also booking in calls and meetings to discuss portfolios and performance. Please do get in touch if you would like to book a call.

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