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EUROPE EX-UK?
THE REAL EUROPEAN CHAMPIONS REVEALED

DB DILEMMA
IS MORE PROTECTION THE ANSWER?

WARNING SIGNS
AVOID THE BUY-TO-LET BUBBLE

NATHAN PRIOR OF PARTNERS WEALTH MANAGEMENT HELPS CLIENTS PRESERVE THEIR PENSIONS FOR FUTURE GENERATIONS

SMART SOLUTIONS

Is buy-to-let about to hit the rocks?

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What is the most popular investment we have seen in the last few years? UK Equity Income? In terms of funds, yes, but it's not the right answer. Gold? With the 'gold bugs' but not the masses. The correct answer is buy-to-let (BTL).

'You can't lose with property,' scream the adverts, estate agents, newspapers, TV shows, mortgage brokers, your mum, and your mum's neighbour. And, more or less – primarily in the South East – they have been right for many years.

Investing is the only industry where, when prices are high and soaring, everyone rushes into the store. When prices are low and falling everyone rushes out of the store. Hence why BTL has been a phenomenon in terms of investment numbers in recent years.

The problem is, to quote Wall Street Journal legend Herb Stein: 'If something cannot go on forever, it will stop.'

WHEN THE INEVITABLE?

In my view this bull market will not continue.

Residential property prices have been in a bubble for at least 10 years. The bubble was caused, primarily, by easier and easier lending.

Asset prices have gone up because of liquidity and very little else.

Then, when liquidity dried up after the banking collapse, the chancellor introduced the 'cruel and heartless' policy of 'help to buy.'

Thus, liquidity resumed and another collapse was postponed. The last 25% crash was in 2008, which was reversed by bailing out the banks and slashing the base rate to 0.5%. The problem is that in the next recession they cannot slash interest rates.

So, it seems we are at the beginning of the end of the 40+ year bull market.

With deflation looming and low growth expected, long term, we look increasingly as if we are 'turning Japanese'. From 1990 to 2012, Japanese house prices fell 60% on average. Ours could too.

Here is a quote from legendary trader Rick Ackerman: 'Deflation is best understood not in relation to money supply, but by its chief symptom: an increase in the real burden of debt.'

So, that BTL mortgage you set up, on an interest only basis, five years ago is still about the same debt – nominally and real – as it was in 2011. If zero inflation continues or even becomes deflation the debt will rise in real terms.

A big change is the new BTL taxation that, materially, detrimentally affects cashflows. By 2020/21 a current BTL just washes its face – requiring capital growth to make it work, which many do – will be a net annual cash loss maker.

> Denial, anger and acceptance. When it comes to BTL, I believe the first has been prevalent in the market and society for many years

Also, the next recession and stock market crash will likely crash house prices, which will then see lower rents and further exacerbate cashflow losses.

WHAT GOES UP...

Denial, anger and acceptance. When it comes to BTL, I believe the first has been prevalent in the market and society for many years. We will also go through the other two in turn.

It surprises me that, in a zero inflation and interest rate world, financial planners always still assume property rates of growth of 4% *per annum* or more.

Just because that is what has happened does not at all mean it will do so in the next 40 years, or whatever your planning horizon is.

If your client has BTLs and you are assuming a) positive cashflows and b) huge above-inflation capital rises, your planning is potentially inadequate.

Remember what the great Star Trek engineer and sometime economist 'Scotty' used to say: 'Cap'n, ye cannae change the laws of economics!'

That is why I steer my clients away from BTL.