ALBERT E SHARP

INVESTMENT MANAGEMENT & STOCKBROKING

Market Commentary

December 2023

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MONTHLY COMMENTARY

DECEMBER 2023

Monthly returns and summary

Index	Portfolio Benchmark Risk Level	31/12/2023	1 Month	3 Months	1 Year	3 Years	5 Years
ARC Cautious	Low Risk	199.76	+3.0%	+4.2%	+4.6%	+0.8%	+13.4%
ARC Balanced	Medium Risk	247.05	+3.9%	+5.2%	+6.3%	+4.0%	+21.2%
ARC Steady Growth	Medium High Risk	296.74	+4.5%	+5.7%	+7.7%	+6.6%	+28.2%
ARC Equity Risk	High Risk	348.12	+5.1%	+6.2%	+8.8%	+8.2%	+35.2%

Source: Figures based on ARC estimates.

Index	Region / Asset Class	31/12/2023	1 Month	3 Months	1 Year	3 Years	5 Years
UK 100	UK	7733.24	3.7%	1.6%	3.8%	19.7%	14.9%
UK All Share	UK	4232.01	4.4%	2.5%	3.8%	15.2%	15.2%
Dow Jones Ind Avg	US	37689.54	4.8%	12.5%	13.7%	23.1%	61.6%
S&P 500 Index	US	4769.83	4.4%	11.2%	24.2%	27.0%	90.3%
Nikkei 225	Japan	33464.17	-0.1%	5.0%	28.2%	21.9%	67.2%
MSCI Europe Ex UK	Europe	191.88	3.8%	7.5%	14.9%	20.1%	49.0%
MSCI Asia Ex Japan	Asia	641.54	3.3%	6.1%	3.6%	-23.9%	7.5%
MSCI Emg Mkts (£)	Emg Mkts	625.53	3.2%	3.3%	3.6%	-8.3%	19.7%
MSCI World Index (£)	Global	3169.18	4.8%	11.1%	21.8%	17.8%	68.2%
UK Conventional	Gilts	3129.34	5.4%	8.1%	3.7%	-25.1%	-13.3%
UK Index-linked	Gilts	4037.49	6.4%	8.7%	0.9%	-30.2%	-17.5%
UK Real Estate Investment Trusts	Property	2162.05	9.7%	17.9%	6.3%	-12.0%	-10.1%
WTI Crude ($/Barrel)	Oil	71.65	-5.7%	-21.1%	-10.7%	47.7%	57.8%
Gold Spot $/Oz	Commodities	2062.98	1.3%	11.6%	13.1%	8.7%	60.9%
£1 = US$	Currencies	1.2731	0.8%	4.4%	5.4%	-6.9%	-0.2%
£1 = €	Currencies	1.1535	-0.5%	0.0%	2.1%	3.1%	3.7%
£1 = Yen	Currencies	179.56	-4.0%	-1.5%	13.3%	27.2%	28.4%

Source: Bloomberg. NB: Price returns only, excluding dividends

Index	Region / Asset Class	31/12/2023	1 Month	3 Months	1 Year	3 Years	5 Years
UK Investment Companies	Diversified	11,812.84	6.2%	7.5%	1.9%	-8.5%	24.2%
Latest Weighted Average Discount	-8.4%						
12 Month Weighted Average Discount	-12.4%						

Source: Bloomberg, Morningstar. NB: Price returns only, excluding dividends

General Comments

A strong December for most assets rounded off what ended up being a reasonably positive year. Most equities, bonds and property assets were up over the month, while the oil price continued to fall, even dipping below $70 per barrel at one point.

Japanese equities lagged most peers with the yen strengthening significantly over the month. They did, however, lead the way over 2023 posting strong returns over the year despite a weak finish.

Multi-asset portfolios, as shown by the ARC Private Client Indices, benefitted from these returns. The above numbers show positive returns over all periods and reasonable long-term numbers too. Meanwhile, investment companies had a tough year, but a rally in the last few months took the index to a modest positive return for the year, with discounts finally narrowing slightly in December.

UK Commentary

UK inflation (CPI) came down significantly with a fall to 3.9%, which was much better than the 4.4% expected by economists. This is the lowest headline inflation number since September 2021 and offers encouraging signs that prices may finally be stabilising and inflation returning to more normal and manageable levels.

The UK economy contracted unexpectedly in October, official GDP figures showed. The reported numbers showed a 0.3% contraction over the month. We would caution that single month GDP numbers are often unreliable, frequently revised, and are not reported by many countries partly for these reasons. That said, this was a surprise so the next few months' readings should be watched closely, especially to see if the UK manages to avoid a technical recession.

UK stocks continued to be the target of takeovers, proving many believe them to be undervalued. Examples this month (with the respective premiums to prior closing price shown in brackets) include ten-pin bowling venues Ten Entertainment Group (33%), energy metering infrastructure group Smart Metering Systems (40%), and workspace software specialist Smartspace (145%).

North America Commentary

The US jobs market remains strong with 199,000 jobs reportedly added in October, significantly stronger than economists' expectations. The official unemployment rate also fell to 3.7% from 3.9%. Furthermore, US headline inflation fell to 3.1% as expected. The 0.1% monthly inflation figure was marginally above expectations of no rise in prices, but is still consistent with a below target (2.0%) annualised number.

The Nasdaq 100 (the 100 largest non-financial companies listed on the Nasdaq stock exchange, based in New York) hit a record high. Once again, this was driven by the largest companies in the world such as Amazon and Meta (Facebook). In fact, the Nasdaq 100 outperformed the Nasdaq composite by over 10% this year, and this broader Nasdaq index did not hit a record level in 2023, highlighting just how large the largest companies have become and how dependent on them index returns have become. Please see more comments related to this below.

In corporate news, Adobe's acquisition of Figma was abandoned as the company saw no way to achieve regulatory approval for the deal in Europe or the UK. The UK's CMA (Competition and Markets Authority) would have required significant divestments to approve the deal, which Adobe viewed as "wholly disproportionate". As a result of this termination Adobe must now pay Figma a $1bn termination fee.

In other tech news, Apple have been forced to stop selling two models of their smartwatch after losing a patent infringement case to medical device maker Masimo. The issue relates to the blood oxygen sensor included in the recent versions of the watch.

Europe Commentary

Producer Price Inflation in the Eurozone came in at a remarkable -9.4% year-on-year, having seemingly now troughed at -12.4% in September. With producer prices being so significantly negative and consumer prices now seemingly under control it is no wonder many expect quite a few interest rate cuts from the ECB next year.

This positive news on the inflation front led the ECB to announce no change to their base interest rates and a tapering down of reinvestments under their PEPP program, all the way to zero by the end of 2024, which effectively means quantitative tightening in the coming year.

Asia Pacific Commentary

Toshiba, one of Japan's most recognisable brands, was de-listed from the Tokyo stock exchange after 74 years. The conglomerate manufactures electronics from nuclear power stations to keyboards. Scandals have been frequent in recent years, and a syndicate of investors took the decision/opportunity to take the company private and out of the spotlight.

There were significant reforms in China with the central bank losing some of its power. In effect, the CCP (Chinese Communist Party) government now have far more control thanks to enacting laws which give more power to their regulator. This is yet another centralisation of power in China, as the CCP looks to tighten their grip even further. This came as many of the state-run banks that the government use to control matters cut deposit rates further in a bid to stimulate growth.

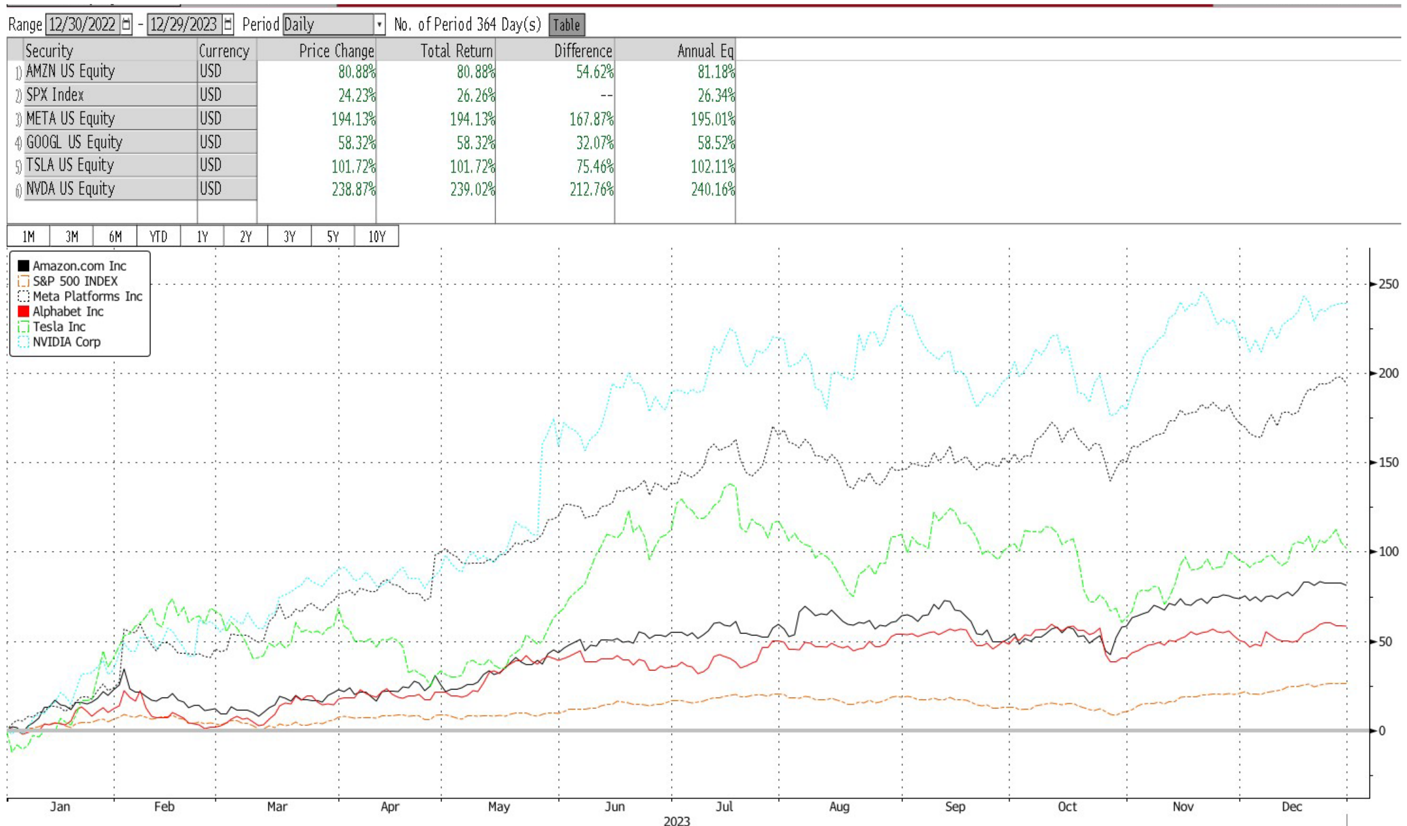
Emerging Market Commentary

Argentina's new president Javier Milei wasted no time in his new role, enacting several policies swiftly. Notably, he opted to devalue the peso by 54% against the US dollar and introduced a "crawling peg" which means the currency will weaken a further 2% each month against this peer. The new policies were praised by the International Monetary Fund, to whom Argentina is heavily indebted.

Reportedly tens of billions of dollars' worth of cargo has been redirected from routes via the Red Sea thanks to Houthi rebels in Yemen targeting civilian vessels. Attacks have apparently stepped up significantly since the escalation of the Israel-Hamas war in October. This led to US navy increasing their presence in the region in order to protect this vital shipping route which passes through the Suez Canal.

Chart of the month – "Magnificent 7" performance 2023

The below Bloomberg chart shows the 5 best performing stocks from the so-called "Magnificent 7" in 2023, and the S&P 500 index (orange). The other two members of this group, Apple and Microsoft, returned 49% and 58% respectively (including dividends), which is still impressive.



Range 12/30/2022 - 12/29/2023 Period Daily No. of Period 364 Day(s) Table

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	AMZN US Equity	USD	80.88%	80.88%	54.62%	81.18%
2)	SPX Index	USD	24.23%	26.26%	--	26.34%
3)	META US Equity	USD	194.13%	194.13%	167.87%	195.01%
4)	GOOGL US Equity	USD	58.32%	58.32%	32.07%	58.52%
5)	TSLA US Equity	USD	101.72%	101.72%	75.46%	102.11%
6)	NVDA US Equity	USD	238.87%	239.02%	212.76%	240.16%

Given the S&P 500 was up around 26%, the returns of these seven largest companies are astounding. The old stock market maxim that “elephants don’t gallop” was utterly wrong in 2023, as the largest companies in the world delivered remarkable returns to investors. These companies now make up a little over 28% of the S&P 500 index. Given these weights, the top 7 companies were responsible for approximately 2/3rds of the index’s return in 2023. As US equities represent over 70% of the MSCI World index, these companies now also represent around 19% of world equities. Goldman Sachs recently highlighted that the S&P 500 is more concentrated than it has ever been. By extension, returns of global equities have rarely been as reliant on such a few companies as they are now. We are truly in unprecedented times.

The oldest of these companies is Microsoft, which was founded in 1975. Some of these businesses were founded in the 2000’s. They are still relatively young enterprises in the grand scheme of things. Some (or all) of them may be remarkable businesses, but it would be irresponsible for investment managers not to recognise that there are risks with relying so heavily on these businesses to drive returns, especially given the valuations which they have reached in recent times. Passive investors in these indices may not be as diversified as they believe, and we would argue there are benefits to strategies that don’t rely on these few companies as much. Admittedly, this would have been the wrong call in 2023, and in recent years, thanks to the phenomenal returns generated by these stocks.

However, never in history have the largest companies in the world stayed in that position over the long term, as demonstrated by the relative youth of these seven. Change has always come, even for exceptional businesses. There are risks (namely concentration risk) of becoming overly reliant on a small group of companies if investors are not careful, especially for those who rely on a few passive strategies.

Investment Profile – Pershing Square Holdings

Readers who are active on Twitter (now known as X) may be familiar with Bill Ackman, the Billionaire manager of this London-listed investment company, who is frequently on the platform. People may also be aware of the movie "Betting on Zero" which features one of Pershing Square's historic short bets focussed on the company Herbalife, which they believed to be akin to a pyramid scheme.

However, what most people don't realise is that Pershing Square follows a simple investment strategy looking for high quality companies. Bill Ackman often airs his views, and sometimes uses the holding company to bet on macroeconomic outcomes, or to short company stocks. However, this is rare and a small proportion of what they do. Ultimately, the vast majority of the portfolio is invested in a concentrated manner into what they deem to be some of the best companies in the world, but particularly in the US. Such investments include Hilton Hotels, Alphabet (Google) and the largest owner of music rights in the world in Universal Music Group.

Returns from this company have been extraordinary, compounding at over 30% per annum for the last 5 years, giving a total return approaching 290%. Despite this, shares are still trading at over a 30% discount to assets (at time of writing). Bill Ackman owns over a fifth of shares and the company are active in buying back their own shares, reducing the free float by around 40% since the 2014 IPO. From the start of 2023 to mid-August this year buybacks have added 0.5% to the value of the company.

However, while buybacks, short bets and derivatives contribute to performance, what we like is very much the high-quality collection of companies in the portfolio. The management obviously agree, as this is where they spend the vast majority of their time and where the largest proportion of assets are invested.

Investment Team's thoughts

2023 was a good year for most asset classes. It may not feel that way as the general sentiment among many market participants seems to be one of melancholy, and many of our investment team would be hesitant to call it a good year. However, the above numbers do not lie. Markets were up and down, which was likely the reason for a general feeling of negativity. Significant central bank action, and market participants attempting to predict this, played a large role in adding to this volatility.

UK GDP outperformed many major European neighbours (such as Germany, the Eurozone's largest economy) and pound sterling strengthened against most major global peers (such as the US dollar, the euro, the Chinese renminbi, and the Japanese yen). Meanwhile, inflation has come down more than expected while UK unemployment remains well below long-term historic averages, so restrictive measures taken by the central bank have not been overly detrimental to growth or employment. Despite all of this, many are also seemingly down-beat on the UK, the UK economy and particularly UK stocks, which are trading near decade-low valuations and not far off all-time low ratings. It is hard to argue that there is not value in the UK market, and we believe that the recent spate of takeovers of listed UK companies (some of which have been highlighted in recent commentaries) speaks to this.

As the FT recently pointed out, about half of the adult population of the globe are heading to the polls in 2024, and there are many rumours of the UK joining them rather than waiting for the January 2025 deadline. Given this fact, there is also call for optimism based upon historic precedents of economic stimulus prior to

elections. There are many examples of governments and central banks embarking on expansionary policies in the run up to elections, often in an attempt to "bribe" voters. Stock markets often respond to this, and such measures are typically bullish for most asset classes.

That said, we do not invest for (and cannot predict) single year periods; we invest for much longer time horizons. However, we do believe there are reasons to be optimistic for 2024 and hope that optimists prosper in the coming year, as they ultimately did in the past year.

However, what really drives our optimism are the above long-term return numbers. The 5-year returns shown above are reasonably positive in most cases, despite all the ups and downs we have had in between. Among other issues, over this period we saw the end of unprecedented monetary policy experiment in terms of zero/negative interest rate policies, a global pandemic that temporarily shut down capitalism as we knew it, inflationary shocks not seen for decades, war in Europe, and energy price spikes that required government intervention around the world.

Despite all of this, multi-asset portfolios have made decent progress, as highlighted by the ARC Private Client benchmarks. Long-term optimists have prospered once again, as has been the case throughout history. We believe this will continue to be the case into the future, hence why we work in the industry we work in. This is why previous commentaries, even when performance numbers may not have looked good, have always attempted to strike a positive tone and find reasons to see the upside.

We remain of the view that there are areas of good value in the stock market and that there are now reasonable yields/returns on offer from other asset classes as well. We firmly believe that well-diversified portfolios can continue to deliver for our clients, so we remain resolutely optimistic for 2024 and beyond.

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