ALBERT E SHARP

INVESTMENT MANAGEMENT & STOCKBROKING

Market Commentary

July 2023

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MONTHLY COMMENTARY

JULY 2023

Monthly returns and summary

Index	Portfolio Benchmark Risk Level	31/07/2023	1 Month	3 Months	1 Year	3 Years	5 Years
ARC Cautious	Low Risk	193.23	+1.1%	+0.1%	-1.5%	+1.6%	+5.7%
ARC Balanced	Medium Risk	238.31	+1.5%	+0.7%	-0.5%	+7.2%	+9.8%
ARC Steady Growth	Medium High Risk	286.14	+1.7%	+1.4%	+0.5%	+12.6%	+14.2%
ARC Equity Risk	High Risk	336.15	+2.0%	+2.1%	+1.5%	+17.7%	+18.5%

Source: Figures based on ARC estimates.

Index	Region / Asset Class	31/07/2023	1 Month	3 Months	1 Year	3 Years	5 Years
UK 100	UK	7699.41	2.2%	-2.2%	3.7%	30.5%	-0.6%
UK All Share	UK	4198.02	2.5%	-2.0%	2.2%	27.9%	-1.3%
Dow Jones Ind Avg	US	35559.53	3.3%	4.3%	8.3%	34.6%	39.9%
S&P 500 Index	US	4588.96	3.1%	10.1%	11.1%	40.3%	62.9%
Nikkei 225	Japan	33172.22	-0.1%	15.0%	19.3%	52.8%	47.1%
MSCI Europe Ex UK	Europe	187.92	1.8%	1.2%	10.0%	32.3%	26.3%
MSCI Asia Ex Japan	Asia	666.41	5.7%	5.7%	3.8%	-4.9%	-1.2%
MSCI Emg Mkts (£)	Emg Mkts	628.74	5.0%	5.9%	2.5%	6.6%	11.0%
MSCI World Index (£)	Global	3064.30	3.3%	8.1%	11.6%	32.9%	42.3%
UK Conventional	Gilts	2935.11	0.8%	-3.1%	-16.0%	-30.5%	-18.3%
UK Index-linked	Gilts	3878.03	-0.5%	-3.3%	-21.6%	-34.1%	-20.7%
UK Real Estate Investment Trusts	Property	1956.28	6.8%	-7.2%	-26.9%	-14.6%	-30.5%
WTI Crude ($/Barrel)	Oil	81.80	15.8%	6.5%	-17.1%	103.1%	19.0%
Gold Spot $/Oz	Commodities	1965.09	2.4%	-1.3%	11.3%	-0.5%	60.5%
£1 = US$	Currencies	1.2835	1.0%	2.1%	5.5%	-1.9%	-2.2%
£1 = €	Currencies	1.1671	0.3%	2.3%	-2.0%	5.1%	4.0%
£1 = Yen	Currencies	182.62	-0.3%	6.7%	12.6%	31.9%	24.4%

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

Index	Region / Asset Class	31/07/2023	1 Month	3 Months	1 Year	3 Years	5 Years
UK Investment Companies	Diversified	11,442.42	2.9%	0.5%	-6.1%	6.8%	9.3%
Latest Weighted Average Discount	-13.7%						
12 Month Weighted Average Discount	-12.3%						

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

General Comments

July was an upbeat month for markets as there was plenty of good news on the inflation front and interest rate expectations subsequently moved lower.

Most major equity indices were modestly higher on the month, with the rally being felt in almost all geographies. This helped the ARC private client indices to also record positive returns across the board.

Listed property assets finally had a good month, posting a near 7% positive return on average, much of which came in a single day in many cases thanks to the strong economic data released in the US (highlighted below). Meanwhile, oil prices increased significantly as constrained supply and greater demand created perfect conditions for such.

UK Commentary

UK inflation came in BELOW expectations. Yes, you read that right. It has been a rare event in recent times as inflation has often been higher than economists have predicted, but July's reading surprised at 7.9% (versus 8.2% expected). This is still obviously well above the 2% target, however, it is a significant move in the right direction given the previous reading was 8.7%. Furthermore, Producer Price Inflation (PPI) was noticeably negative with input costs to producers' production processes recording a 2.7% fall (versus a 1.6% fall expected, and a 0.4% increase in the previous reading). We have mentioned PPI and CPI's relationship in previous commentaries, but once again, this is a good sign for future inflation levels as PPI usually indicates a trend of what is to come from CPI. We imagine it will be almost impossible for CPI to turn negative anytime soon, but falling producer prices do mean there is less pressure on them to raise prices and thus CPI can hopefully move lower.

There was plenty of political news in the UK this month as there were mixed by-election results and the head of NatWest, a bank whose largest shareholder is the UK government, was forced to step down following controversy surrounding the closing of former MEP Nigel Farage's account. While the NatWest/Coutts debacle made plenty of headlines and shines a light on an important issue for the financial services industry, perhaps the by-election results were the larger story. The Conservatives did not do well, but they did hang on to former PM Boris Johnson's old seat, so were able to claim some form of victory on what could have otherwise been a bleak day for them. While the Conservatives were handed a kicking elsewhere, perhaps this is somewhat of a sign that the next general election will not be a complete landslide victory for Labour, as some are presently expecting.

North America Commentary

Economic growth in the US was significantly stronger than expected in the second quarter as the world's largest economy expanded 2.4%, far exceeding the 1.8% expected by economists. This likely contributed to the Federal Reserve's decision to go for an eleventh interest rate increase since March 2022, as they lifted rates by another 0.25% to a range of 5.25% to 5.50%.

However, earlier in the month there was an exceptionally positive inflation release in the US, with CPI coming in below expectations in terms of month-on-month data, year-on-year data and even core inflation. In fact, this was the 12th consecutive month of CPI falls. Headline inflation fell a whole percentage point to 3.0% while core inflation managed half that fall to 4.8%. While still above target, things are clearly going in the right direction and are doing so at a faster pace than previously anticipated. This data caused a significant upwards move in markets, felt by almost every asset class, as expectations of future interest rates came down significantly.

There was more drama in the Twitter/X world, as the company rebranded to new owner Elon Musk's favourite letter to become aligned with other projects of his (such as SpaceX). Meanwhile, Meta's attempt at stealing some of this market initially made some headway but did somewhat taper out as there were reports of a degree of lack of functionality on new app Threads.

Elsewhere, plans are in motion to build the world's largest nuclear plant in Canada, as an existing plant in Ontario will likely be expanded. Uranium is seen as a solution to the energy transition to many, but advances have been slow in many developed countries, so it is interesting to see Canada making progress on this front.

Europe Commentary

The ECB raised interest rates back to the record high of 3.75%, last seen in 2001 when it was attempting to promote the newly launched euro. Eurozone PPI also moved negative and did so to a greater degree than expected, so there are signs that rates may not need to go much further. However, there are still inflationary pressures (for consumer prices, at least) in pockets of the EU so the ECB is trying to remain vigilant on inflation.

In Switzerland, headline inflation (CPI) did fall back below the 2% mark. The franc remains strong and the Swiss National Bank may indeed be finished with their interest rate rises. The market had previously expected one more raise to 2% in September but now expects this not to go ahead, and predictions are mixed for any changes further into the future.

The Netherlands' Prime Minister Mark Rutte's coalition fell apart over a disagreement on immigration, prompting the PM to announce he would not run for re-election. Rutte was the EU's second longest-serving leader after Hungary's Orban (who has faced allegations of election-rigging). Rutte was seeking to reduce immigration numbers given pressures on their asylum system and constrained housing market, however, their more liberal coalition partners vetoed the plan causing a split which has proved unsolvable.

Asia Pacific Commentary

The world welcomed a new mega bank with HDFC Bank and mortgage lender HDFC undergoing what was reportedly India's largest ever corporate merger. This has apparently created the world's 7th largest bank, overtaking the likes of HSBC and Citigroup.

In terms of central banks, the Bank of Japan finally tweaked their monetary policy with a relaxation of their yield curve control. Essentially, this means they will allow the yields on ten-year government bonds to reach up to 1%, rather than the prior 0.5% cap. This had the effect of sending yields to nine-year highs.

Meanwhile, the Reserve Bank of Australia held their base interest rate flat at 4.1% and named their first female governor. This came as unemployment fell for a third consecutive month to 3.5%. With inflation still above target, the bank is still minded to not hit the economy too hard and want to see the full effect of the recent rate rises before moving rates further.

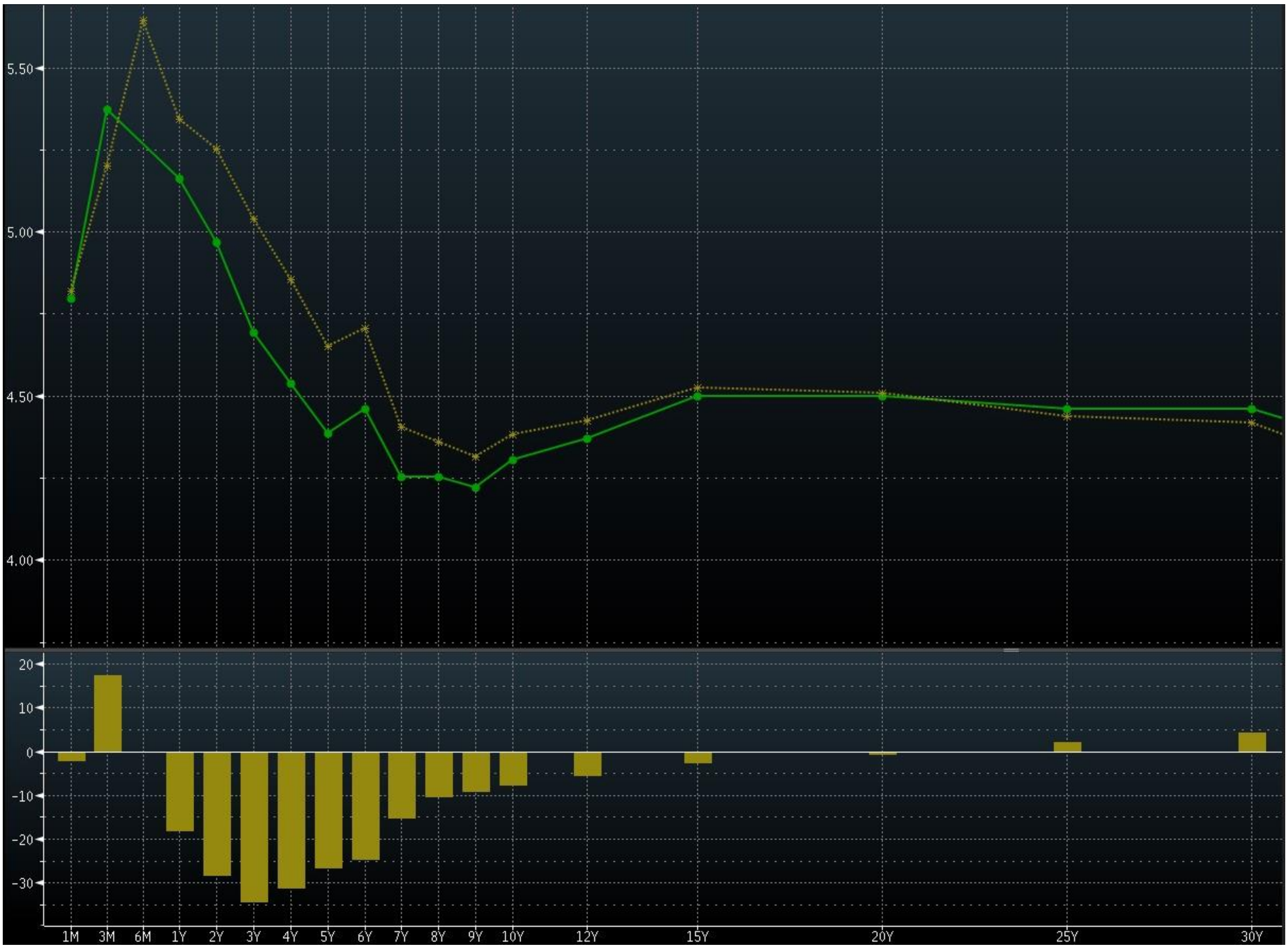
Emerging Market Commentary

China continues to struggle with youth unemployment as 20.8% of 16 to 24-year-olds are unable to find work. Or, perhaps more accurately, jobs they want. The ever more educated youth appear to not be attracted to the low skilled, low paid jobs that are available. Overall unemployment is just 5.2%, so it is clearly an issue of finding the right types of jobs for this demographic.

Turkish inflation continues to run rampant and the central bank fell short of expectations by only increasing rates by 2.5% to 17.5%, rather than to the expected 20% level. In contrast, Chile actually cut rates by a full percentage point to 10.25%.

Argentina agreed a last-minute deal with the IMF to prevent default. The financially troubled nation continues to struggle with repayments to the IMF and negotiated further funds from the IMF in order to be able to repay monies owed to the IMF themselves. It is indeed quite a messy situation.

Chart of the month – UK Yield Curve



The above chart from Bloomberg shows in solid bright green the UK's yield curve at the end of July, and the more yellow-coloured dashed line represents the curve at the start of the month.

We believe this month's move in the UK's yield curve highlights the signficance of the various pieces of positive economic data mentioned above. At the short end, yields available on UK government debt contracted by up to 35 basis points (0.35%) in July. This is a large move and reflects the degree to which interest rate expectations have come down.

Also of importance is the shape of the curve. Yields at the long end (10+ year bonds) were virtually unchanged. While the yield curve is still inverted (short term yields higher than long term yields), it is a far flatter shape. To those that believe that an inverted yield curve is a sign of an impeding recession (a somewhat contentious topic), this effectively shows that the market believes there is now a far smaller chance of a recession in the UK than there was a month prior.

Investment Profile – Foresight Global Real Infrastructure Fund

A recent addition to our Model Portfolio Service portfolios, this fund offers diversified exposure to global infrastructure companies. More specifically, their focus is the underlying infrastructure projects. This means that rather than investing in large conglomerates which own various pieces of infrastructure, the managers consider the merits of various projects from renewable energy generation to transportation assets such as railways tracks and bridges.

The fund invests in a few of the investment companies which our Bespoke Portfolio team also invest in directly, so there are nice synergies here and we have had a few interesting conversations with the fund's managers. Crucially, while this is an open-ended fund, they invest in large and liquid closed-ended structures, so there is no issue with liquidity mismatching.

Infrastructure as an asset class offers attractive characteristics at present thanks to the high degree of contractual inflation linkage that many projects benefit from. Foresight are also infrastructure and real asset specialists, so are well positioned to manage such a strategy and believe they have the resources to properly assess asset quality.

Investment Team's thoughts

As expected, and mentioned in previous commentaries, the overly pessimistic IMF predictions have been revised upwards. They now expect 3% global growth this year and the UK to avoid recession. Given their appalling record, we do not give much (if any) weight to their forecasts. It is, however, important to mention as the negative predictions inevitably make for sensationalist headlines.

We do agree though that things now look more positive than they did previously. July saw various pieces of very positive inflation and economic growth data, some mentioned in this commentary. Macroeconomic conditions, at least on a backward-looking view based on these recent data, have improved.

While some countries have paused or cut interest rates, most are far from out of the inflation woods yet. However, we have seen negative PPI in many cases, which is a very positive sign for the future direction of headline inflation numbers. The war is not won, but July certainly saw positive outcomes from a few battles. This optimism was very much reflected broadly across markets through strong asset price returns, as shown at the top of this note.