ALBERT E SHARP

INVESTMENT MANAGEMENT & STOCKBROKING

Market Commentary

June 2023

Published: 07/07/2023

Monthly returns and summary

Index	Portfolio Benchmark Risk Level	30/06/2023	1 Month	3 Months	1 Year	3 Years	5 Years
ARC Cautious	Low Risk	191.20	-0.5%	-0.5%	-0.6%	+0.8%	+4.8%
ARC Balanced	Medium Risk	232.33	-0.1%	-0.7%	+1.2%	+5.8%	+9.2%
ARC Steady Growth	Medium High Risk	281.09	+0.2%	-0.9%	+2.7%	+10.0%	+13.4%
ARC Equity Risk	High Risk	328.51	+0.5%	-1.3%	+4.1%	+14.1%	+17.3%

Source: Figures based on ARC estimates.

Index	Region / Asset Class	30/06/2023	1 Month	3 Months	1 Year	3 Years	5 Years
UK 100	UK	7531.53	1.1%	-1.3%	5.1%	22.1%	-1.4%
UK All Share	UK	4096.26	0.7%	-1.5%	3.9%	20.1%	-2.5%
Dow Jones Ind Avg	US	34407.60	4.6%	3.4%	11.8%	33.3%	41.8%
S&P 500 Index	US	4450.38	6.5%	8.3%	17.6%	43.5%	63.7%
Nikkei 225	Japan	33189.04	7.5%	18.4%	25.7%	48.9%	48.8%
MSCI Europe Ex UK	Europe	184.60	2.5%	1.0%	16.7%	28.9%	29.1%
MSCI Asia Ex Japan	Asia	630.60	2.2%	-2.2%	-3.4%	-2.8%	-6.2%
MSCI Emg Mkts (£)	Emg Mkts	599.02	1.2%	-1.9%	-2.8%	4.1%	8.8%
MSCI World Index (£)	Global	2966.72	5.9%	6.3%	16.5%	34.7%	42.0%
UK Conventional	Gilts	2912.89	-0.4%	-5.4%	-14.5%	-30.7%	-19.2%
UK Index-linked	Gilts	3896.63	3.1%	-6.6%	-17.0%	-33.3%	-19.9%
FTSE All-Share Real Estate Investment Trust Index	Property	1832.52	-7.6%	-7.8%	-25.6%	-18.2%	-35.3%
WTI Crude ($/Barrel)	Oil	70.64	3.7%	-6.6%	-33.2%	79.9%	-4.7%
Gold Spot $/Oz	Commodities	1919.35	-2.2%	-2.5%	6.2%	7.8%	53.2%
£1 = US$	Currencies	1.2703	2.1%	3.0%	4.3%	2.4%	-3.8%
£1 = €	Currencies	1.1637	0.0%	2.3%	0.2%	5.4%	3.0%
£1 = Yen	Currencies	183.19	5.7%	11.8%	10.8%	36.9%	25.3%

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

Index	Region / Asset Class	30/06/2023	1 Month	3 Months	1 Year	3 Years	5 Years
FTSE All-Share Investment Companies Index	Diversified	11,115.28	-1.2%	-2.1%	-2.6%	3.9%	8.4%
Latest Weighted Average Discount	-14.0%						
12 Month Weighted Average Discount	-11.9%						

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

General Comments

June saw some strong returns from global equities, with the MSCI World index up nearly 6% thanks to some good performance in the US and Japan. The UK and emerging markets offered more muted positive returns, while European stocks did slightly better.

Sterling continued to trade stronger against major global peers such as the US dollar and the Japanese yen. Meanwhile, oil (priced in US dollars) moved up. Although, the oil price increase for a UK buyer will obviously not be as pronounced thanks to those currency moves.

The ARC private client indices performance highlight that June was yet another month where bonds performed worse than equities as interest rate expectations rose once more following further upside surprises in inflation, particularly in the UK.

UK Commentary

UK inflation was a key talking point once more this month, with CPI coming in flat at 8.7%, rather than falling to 8.4% as expected. Meanwhile, core CPI rose to a multi-decade high of 7.1%, which was also above expectations (6.8%). The good news on the monetary front is that UK producer price inflation (PPI) fell more than expected to -0.5% for output prices and -1.5% for input prices. Producer prices tend to be more of a leading indicator, so hopefully this will feed through into consumer prices in due course.

Overall though, this was a pretty disappointing data release, which likely had a fair bit to do with why the Bank of England opted for a larger than previous increase in base rates of 0.5%. Interest rates now stand at 5% in the UK, the highest they have been since 2008.

As has been the case for a while now with inflation and interest rates making headlines, there has been plenty of doom mongering about the impact increased mortgage payments will have on households, and the implications for the economy as a whole. It is worth pointing out though that ONS data showed that in 2020 only around 28% of homes were owner-occupied with a mortgage, while 36% were owner-occupied mortgage-free, so many more people own their home outright than do so with the help of debt. It is also worth remembering that of those homes with a mortgage, the periods when they need to refinance are staggered and it will take years more for all currently fixed deals to feel the effect of higher rates.

Additionally, there were plenty of political shenanigans for the UK to deal with in June, as former Scottish First Minister Nicola Sturgeon was arrested by police and former PM Boris Johnson was forced to step down as an MP following an investigation finding him in contempt of parliament. A few Johnson allies followed him out of the door, leaving some upcoming by-elections which will be a test for the Conservative Party.

North America Commentary

Anyone who was worried about the US deciding to default on their debts had their mind firmly put to rest at the start of the month as US lawmakers voted through a deal to approve the raising of the debt ceiling.

Meanwhile, US inflation dropped to its lowest level in over two years, with the annual CPI reading coming in at 4.0%, which is welcome news. As the disappointing UK reading prompted action from the central bank, this positive reading encouraged inaction from the Federal Reserve, who decided to leave their base interest rate unchanged at 5 to 5.25%. In contrast, the Bank of Canada opted to raise rates with a 0.25% hike to 4.75%.

At the end of the month, Apple became the first company in the history of the world to surpass a $3 trillion valuation. While reviews of the newly announced “mixed reality” headset have been somewhat mixed, Apple continues to produce exceptional returns for shareholders and led the technology-heavy Nasdaq Composite index to its best start to a year since 1983, as the first half of 2023 ended in high spirits.

Europe Commentary

There were plenty of interest rate rises to talk about in Europe this month, with the likes of Norway hiking 0.5% to 3.75%, Switzerland adding 0.25% to 1.75% and the European Central Bank (ECB) increasing rates with a 0.25% move to 3.5%, the highest level in 22 years. Please see the below 'Chart of the month' section for some comments on why this may have been the case, given the inflation numbers shown there.

This comes as the Eurozone is also now officially in recession, as downward revisions showed that in both of the previous two quarters (fourth quarter 2022 and first quarter 2023) that GDP fell -0.1%. This is of course the mildest possible recession and only just meets the technical definition, but it is a recession nonetheless.

In company news, Volkswagen announced it would cut electric car production, citing 'strong consumer reluctance' as a key reason. Interestingly, electric vehicle demand is around 30% lower than the company's projections. It is worth noting though that US peer Tesla's recent price cut was successful in generating record demand for their vehicles, so this market will be an interesting one to watch.

Asia Pacific Commentary

Profits at China's industrial firms shrank nearly 19% in the first five months of 2023, compared to the same period last year. While we have seen earnings contractions around the world, it is significant to see such a decline in a nation that is so important for global industrial production.

This pessimism was echoed in currency markets, as the Renminbi dropped to levels not seen since last November against the US dollar.

Meanwhile, Amazon and Alphabet (Google) committed to increase investments in India after Joe Biden met with Indian Prime Minister Narendra Modi in the White House. Amazon committed to invest $15bn by 2030 while Alphabet will open a global fintech centre in Gujarat (Modi's home state).

The optimism in India was once again reflected in the stock market, as the Nifty 50 index added another 3.8% in June, despite being one of the more expensive indices around the world already.

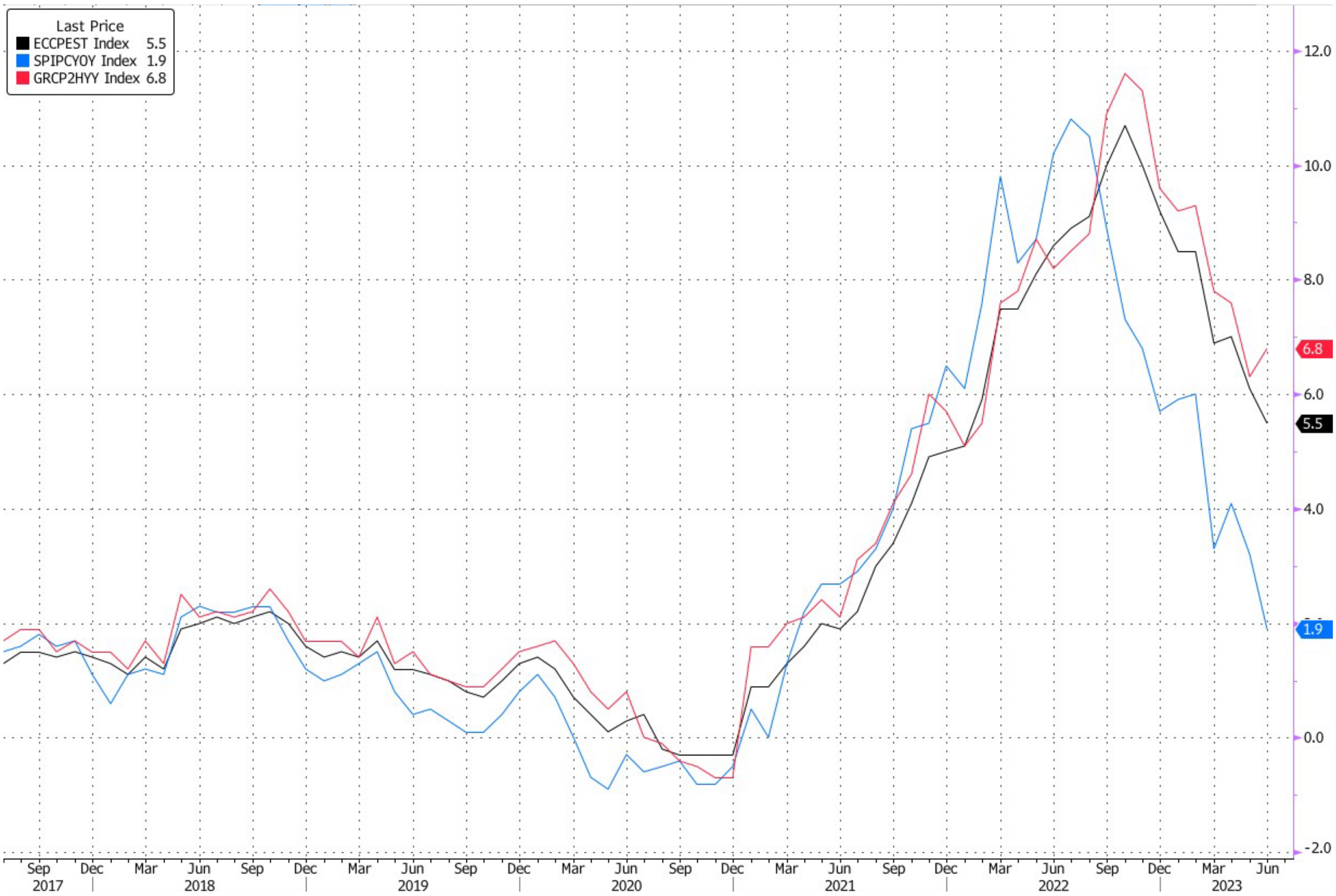
Emerging Market Commentary

There was a very brief coup, or civil war (or something..?) in Russia, as the Wagner Group left the front lines in Ukraine to march towards Moscow. In a rather bizarre series of events however, they turned around after a matter of hours. Highly educated commentators on this matter struggled to explain these events, so we have little hope of being able to do so ourselves. It is however a good reminder of the fragility of Putin's reign and of the state of Russian morale.

As above, June did see a stabilisation of oil prices, so perhaps the Saudi oil production cut did have some effect. They announced a cut of one million barrels per day, which is not insignificant by any means.

Elsewhere, Nigeria ended their currency peg against the US dollar, which resulted in the biggest fall in value in its history. The Naira devalued from around 470 per dollar to nearly 800 per dollar in a few days, before stabilising around the 750 level. While there are negatives in terms of purchasing power, the idea is that it will make foreign investment more attractive and Nigeria's exports more competitive.

Chart of the month – European Inflation



This chart from Bloomberg shows Eurozone consumer price inflation as a whole (black), Spanish inflation (blue) and German inflation (red). The European Central Bank (ECB) has a dilemma to deal with here, as Spain is now officially below their 2.0% inflation target, and with ECB base rates at 3.5%, Spanish savers can make positive real returns on risk-free securities.

Meanwhile, German inflation is still running hot at 6.8% and the ECB is minded to put the breaks on it's largest economy in order to reduce Eurozone inflation as a whole.

The market currently expects another 2 hikes from the ECB this year, to a peak base rate of 4.0%. However, the Spanish people and their economy may not thank them if they do go ahead and do this. They do not need restrictive monetary policy as their inflation is under control.

There are many nuances to this, such as the nature of countries' energy production and exposure to exogenous shocks, as well as how government subsidies/tax breaks affect inflation. However, ultimately the ECB will have some incredibly tough decisions to make in the coming months, and there will be some unhappy member countries forced to compromise.

Investment Profile – TR Property

TR Property is an investment company which invests primarily in listed real estate companies across the UK and Europe, while also having a small exposure to some direct commercial property investments in the UK.

The company has been managed by the fascinating Marcus Phayre-Mudge since 2011 (although he has worked on the strategy for far longer). The highly quotable manager had some more pearls of wisdom in their recent report when referring to the state of listed real estate prices over the past year or so; "Everyone became central bank-focused whilst real estate fundamentals were ignored." He believes that fundamentals in the real estate market remain attractive and that much of the pain for the sector has been driven by investors' overreactions to exogenous, macroeconomic factors.

At time of writing, shares in TR Property currently offer a near 6% yield and are trading at a near 9% discount to assets. There is also a "double discount" opportunity here as many of the underlying investments are trading well below their own asset values.

June was yet another poor month for commercial property returns, as highlighted in the numbers at the top of this document. Whether one agrees with Marcus' assessment or not, one would have to admit many shares are trading at extraordinarily depressed levels. Institutional buyers also agree, as we have seen a few London-listed companies being purchased at significant premiums to their prevailing share prices in recent weeks, which TR Property have themselves benefitted from.

Investment Team's thoughts

June saw investment company discounts widen once again. Some sources such as Refinitiv calculate average discount to be around 17%, while our calculations based on Morningstar data confers with those who see the average as around 14%. However one looks at it, this is historically unusual and is potentially a remarkable opportunity for those willing and able to exploit it. We are very excited about long term returns for investment companies from here.

With gilt yields rising further, savers are also now able to get a decent return on their money, well north of 5% at the short end of the yield curve. We see this as an attractive offering, especially given the tax advantages of buying low coupon gilts (a tax-free capital gain!).

It is a truism to say that there will be many more macroeconomic and political gyrations to come (there always has been!). While there are plenty of potential headwinds to markets, we see ample reasons to be positive today about long term returns from current levels. With base rates now offering attractive rates to savers, and equities and bonds now restored to what used to be the status quo with them having negative correlations (moving in opposite directions) to each other, we believe the investment environment to be in a decent position.

There are many reasons to be positive. The encouraging returns in June, and indeed in the year-to-date for many indices, offer support for this view.