ALBERT E SHARP

INVESTMENT MANAGEMENT & STOCKBROKING

Market Commentary

May 2023

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Monthly returns and summary

Index	Portfolio Benchmark Risk Level	31/05/2023	1 Month	3 Months	1 Year	3 Years	5 Years
ARC Cautious	Low Risk	191.59	-0.9%	-0.5%	-2.9%	+2.3%	+5.3%
ARC Balanced	Medium Risk	243.86	-0.9%	-0.7%	-2.4%	+7.4%	+9.2%
ARC Steady Growth	Medium High Risk	279.69	-1.0%	-0.9%	-1.8%	+11.9%	+13.1%
ARC Equity Risk	High Risk	325.91	-1.1%	-1.3%	-1.4%	+16.1%	+17.0%

Source: ARC. NB: Price returns only, excluding dividends. Figures based on ARC estimates.

Index	Region / Asset Class	31/05/2023	1 Month	3 Months	1 Year	3 Years	5 Years
UK 100	UK	7446.14	-5.4%	-5.5%	-2.1%	22.5%	-3.0%
UK All Share	UK	4066.80	-5.1%	-5.5%	-3.2%	20.9%	-3.7%
Dow Jones Ind Avg	US	32908.27	-3.5%	0.8%	-0.2%	29.6%	34.8%
S&P 500 Index	US	4179.83	0.2%	5.3%	1.2%	37.3%	54.5%
Nikkei 225	Japan	30887.88	7.0%	12.5%	13.2%	41.2%	39.1%
MSCI Europe Ex UK	Europe	180.02	-3.0%	-1.1%	4.4%	30.3%	25.0%
MSCI Asia Ex Japan	Asia	617.23	-2.1%	-1.1%	-10.3%	2.6%	-13.0%
MSCI Emg Mkts (£)	Emg Mkts	591.99	-0.3%	-2.2%	-6.9%	10.5%	3.8%
MSCI World Index (£)	Global	2800.56	-1.2%	3.2%	0.3%	30.4%	33.8%
UK Conventional	Gilts	2924.88	-3.4%	-2.3%	-15.7%	-30.8%	-19.3%
UK Index-linked	Gilts	3778.26	-5.8%	-3.8%	-23.2%	-35.0%	-22.9%
FTSE All-Share Real Estate Investment Trust Index	Property	1982.26	-6.0%	-8.8%	-28.2%	-12.1%	-29.8%
WTI Crude ($/Barrel)	Oil	68.09	-11.3%	-11.6%	-40.6%	91.9%	1.6%
Gold Spot $/Oz	Commodities	1962.73	-1.4%	7.4%	6.8%	13.4%	51.2%
£1 = US$	Currencies	1.2441	-1.0%	3.5%	-1.3%	0.8%	-6.4%
£1 = €	Currencies	1.1639	2.1%	2.4%	-0.9%	4.7%	2.3%
£1 = Yen	Currencies	173.36	1.3%	5.9%	6.9%	30.3%	19.8%

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

Index	Region / Asset Class	31/05/2023	1 Month	3 Months	1 Year	3 Years	5 Years
FTSE All-Share Investment Companies Index	Diversified	11,251.10	-1.2%	-4.3%	-7.0%	9.3%	10.5%
Latest Weighted Average Discount	-12.3%						
12 Month Weighted Average Discount	-11.6%						

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

General Comments

May was a somewhat weak month for markets, with most assets trading modestly lower. The notable exception to this was the Japanese stock market, which continued the strong run it has been on in the past year. In fact, despite strong performance in 2023, the technology-heavy US NASDAQ index is still behind the Nikkei over the last 12 months.

Another significant move shown above was the continued fall in the price of Oil, now below $70 per barrel. This will have significant impacts on inflation numbers, as energy prices feed into just about everything else.

We also saw rate rises from the Federal Reserve, European Central bank and Bank of England in May, all opting for a 0.25% increase to base interest rates. The ECB also announced they would stop reinvesting proceeds from their Asset Purchase Programme, meaning they will be buying less bonds in the future, which may have a similar effect to an (additional) interest rate rise on the cost of borrowing.

UK Commentary

Inflation continued to dominate news in the UK this month, with CPI falling significantly to 8.7% & finally dropping back below double-digits. However, this fall was smaller than expected, leaving inflation once again above expectations from the Bank of England and economists elsewhere.

The good news on the inflation front is related to the aforementioned oil price in that the energy price cap will fall to £2,074 in July, from the current £3,280. While the government-backed £2,500 cap means the average household will pay £426 less, rather than the whole £1,206 fall, it does mean the headline inflation number is likely to fall noticeably in the coming months when this feeds through.

UK GDP rose 0.1% in the first quarter of the year, as both the Bank of England and the IMF upgraded their predictions for the UK Economy. Neither now predict the UK to fall into recession this year, despite earlier doom mongering. We also saw the coronation of a new monarch in King Charles III, on another bank holiday which is predicted to have had a further positive impact in terms of boosting the economy.

North America Commentary

US banking sector profits reached an all-time high in the first quarter. While some reputable sources (such as the FT) have reported overall banking profits to be around 1/3rd higher than they were over the same period last year, just looking at those in the S&P 500 shows an increase of 23% year over year. Of course, this is despite worries of bank runs and various cries of financial collapse. As we have said previously, it is often the case that in times such as these that the strong, in fact, get stronger. Darwinism has often proved as applicable to financial markets as to nature.

In an arguably more exciting sector, semiconductor designer Nvidia reached the significant milestone of a trillion-dollar market capitalisation, joining Apple, Alphabet (Google), Microsoft and Amazon in the most elite of clubs. This came on the back of bumper results and a wave of optimism around AI and the potential applications of it, with the belief that Nvidia's chips will be crucial in enabling the technology.

Meanwhile, there were continued political issues surrounding the US debt ceiling. Politicians on the far right and far left of their parties once again attempted to prove horseshoe theory correct and whip up a storm around this very serious issue. However, in the end President Biden and speaker of the house McCarthy came to an agreement on the issue without too much fuss. Previous episodes of this drama have proved to be far more drawn out and have seen greater displays of brinkmanship. Ultimately, this one seems to have been solved calmly by the adults in the room coming to an agreeable bipartisan arrangement, which is good to see.

Europe Commentary

Revised figures contradicted previous commentaries on the matter (including ours) of the German economy. First quarter GDP was adjusted down from flat to -0.3%. Given the contraction in the fourth quarter of 2022, Germany is now officially in recession.

However, despite this, Germany's premier stock market, the DAX, hit an all time high in May. This is an excellent reminder that the stock market is not the economy and that companies with pricing power can in fact do well in inflationary periods.

In corporate news, Adidas finally decided what to do with their €1 billion or more inventory of Yeezy shoes. Chief Executive Björn Gulden announced they would sell the shoes & donate profit to charities representing those who were hurt by rapper & Yeezy designer Kanye West, who they have terminated their partnership with following various antisemitic comments. In other news, luxury stocks such as Richemont continued to perform exceptionally well. The Cartier owner announced sales had risen 14% to an all-time high in yet another positive update.

Asia Pacific Commentary

As mentioned above, Japan's stock market has been an exceptional performer in recent times, with May continuing this trend. Major index the TOPIX has returned to levels not seen since 1990. It is not all one way thinking regarding Japan though, as there are still concerns around their unusual monetary policy and the (albeit very modest in international comparison terms) levels of inflation and wage growth, as well as worries over the value of the yen, particularly against the dollar.

Elsewhere, Amazon announced their largest ever investment in India, with a $13 billion commitment to build cloud infrastructure in the country. The Indian stock market remains one of the few in the world still commanding a premium rating for its stocks, with strong demographic drivers and attractive levels of GDP growth attracting investment from all corners.

Finally, it was interesting to see JPMorgan chair Jamie Dimon comment on youth unemployment (comfortably in double digits, with some measures reading north of 20%) and economic uncertainty in China, partially blaming the Chinese Communist Party for this. With so many consumer facing companies reporting exceptional sales data in China, it is interesting to hear a different perspective.

Emerging Market Commentary

The Turkish Lira hit a new record low against the US dollar following Recep Tayyip Erdogan's victory in the Turkish presidential election. The vote was forced to a second round, but Erdogan ultimately prevailed, despite the obvious economic issues in the nation with rampant inflation. Images of him handing out cash outside of a polling station may be too on the nose for opponents.

Argentina has faced similar inflation worries, and rose interest rates to an astounding 97%, up from 75% just a few months ago. Inflation in the country recently hit 109%, so amazingly these are still negative real interest rates.

There were also stories of a diplomatic row between the US and South Africa, with the latter allegedly selling arms to Russia. US intelligence reportedly discovered ship in a secure military base which was bound for Russia which was loaded with armaments.

Chart of the month – UK Capital Markets EY Report

Figure 1: The UK capital markets remain one of the strongest in the world
2021

Source:
Ecosystem – UK Parliament and Zippia (for financial services); ONS, US Bureau of Labor Statistics, Eurostat (for Workforce jobs); Worldbank (for Political stability index)
Companies – Stock Exchanges, WFE, Refinitiv
Investor base – Investment Association, BCG

Note:
i. Talent pool by number of jobs in the financial and insurance sectors.
ii. BCG; Global Assets Management 2021; Estimated value by applying 90% to North America total AuM.
iii. Percentile Rank (0-100) indicates the rank of the country among all countries in the world.
iv. Stock exchange market capitalisation: Calculated as the aggregated value of market capitalisation of all listed companies from the issuer list of the given exchange (includes companies who are not exclusively listed on the given exchange).

The above comes from an EY report released this month concerning the strength of UK capital markets. The report is based on quantitative research & involved over one hundred interviews with key participants from company founders to investment managers. It identified 4 key challenges facing the UK market, but ultimately highlighted an incredible number of strengths. As shown above, many of these strengths contribute to the UK coming out very well in the global rankings.

To cherry-pick some of the more impressive findings:

- The UK is only just behind the US in terms of the number of businesses per capita, and ahead of European peers.
- The UK is ahead of any & all European peers by some margin in terms of the number of Unicorns and Soonicorns (private startup companies with $1bn+ valuations, or expected to get there soon).
- The UK has a well-capitalised start-up environment thanks to schemes such as VCTs (which we invest in at Albert E Sharp).
- The UK has an incredibly deep pool of invested capital, with up to £15tn (trillion!) of investing power.
- The UK is actually an attractive place for technology companies, despite perceptions.

Many people in this country are very good at talking the UK down, but this report highlights many of the things we have been saying for a while & shows that there are plenty of reasons to be upbeat about the prospects for the UK and for its capital markets.

Investment Profile – Polen Focus US Growth

As the name suggests, this is a strategy which focusses on growth in the US market. As a result, they invest in some of the most successful companies in the world from recent years, such as Amazon, Alphabet (Google) and Microsoft.

Manager Dan Davidowitz is happy to run a concentrated portfolio with approximately 25 names. He firmly believes that it is worth paying a higher multiple to own companies with superior growth prospects and operating metrics.

After a tough 2022, this year has been more encouraging for the fund so far and the long-term performance numbers remain impressive. This is a good example of a strategy that is willing to accept short-term volatility in exchange for long-term returns. If investors are willing to look past short-term price movements, they can benefit greatly.

Investment Team's thoughts

Our thoughts mirror those given in previous months. May saw yet further negative headlines and arguably undue pessimism. Meanwhile, companies are getting on with things and performing reasonably well. Elevated levels of inflation and rising interest rates do not make for an easy environment, but overall companies are taking things in their stride and continuing to do good business.

The recent fall in energy prices offers hope of easing inflation, although with core inflation proving sticky we are far from out of the woods yet. Central banks continue to consider rate rises, though we may finally be at or near the end of this hiking cycle, with noises in the US seeming to indicate there may be no further increase at the next meeting. We continue to see many assets trading at attractive valuations and believe that while we must be mindful of these factors, that ultimately asset fundamentals drive long-term returns more than politics or macroeconomics do.