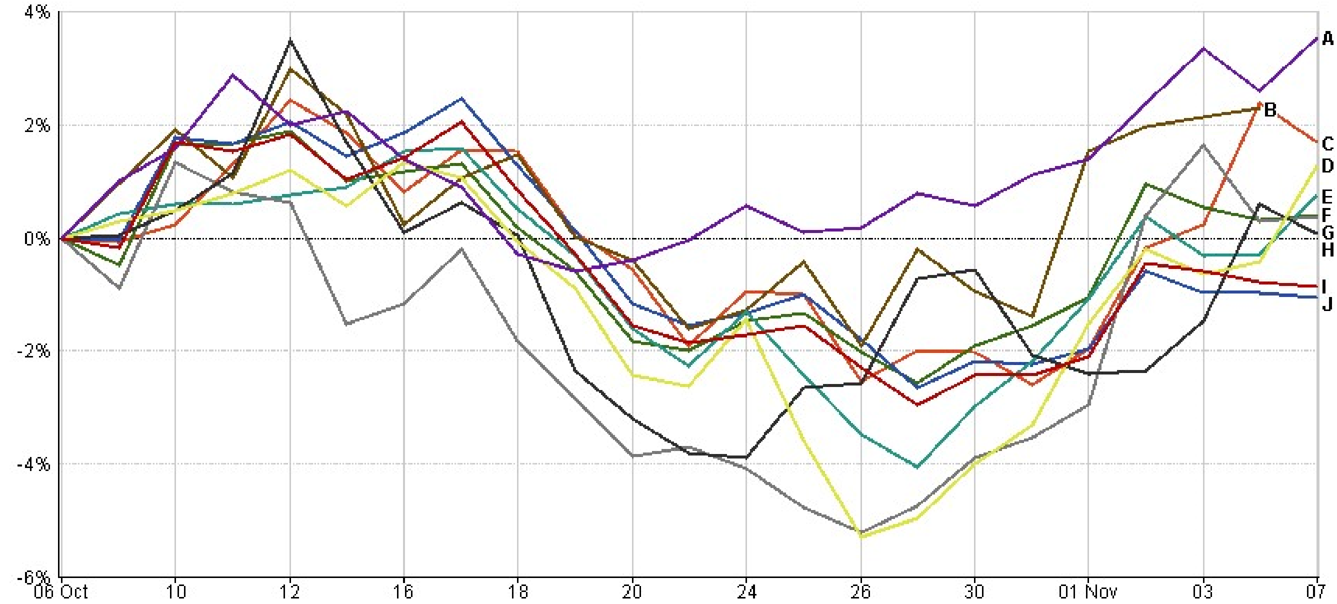
INVESTMENT COMMENTARY

7 NOVEMBER 2023

OVERVIEW

Whilst the major equity markets are still registering negative returns in sterling terms over the past six months, more recent performance has turned positive following the latest round of central bank meetings at the end of October/early November. After nearly two years of rising interest rates, as central banks sought to combat above target inflation levels, it now appears that this monetary tightening is having an impact. Inflation levels are falling whilst somewhat counterintuitively, poor economic news has been supportive of investment markets with indicators such as slowing growth, rising unemployment and a shrinking money supply pointing to decreasing demand and hence fewer inflationary pressures in the global economy. Investment markets have reflected increasing optimism surrounding inflation and the possibility that interest rates have peaked in recent days. However, any escalation in the conflict in the Middle East could lead to oil prices rising and so stoking inflation once again.

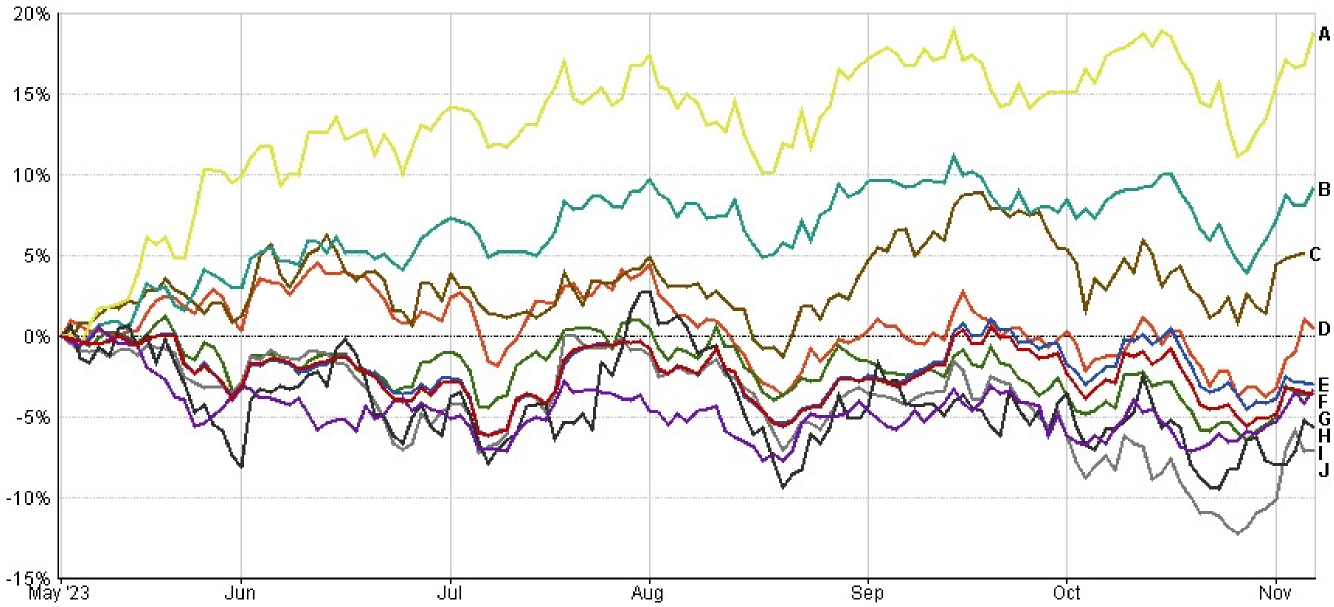
ONE MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



A - FTSE Actuaries UK Conventional Gilts 10-15 Years TR in GB [3.52%]
B - TSE TOPIX TR in GB [2.31%]
C - FTSE World Asia Pacific ex Japan GTR in GB [1.71%]
D - Nasdaq 100 GTR in GB [1.27%]
E - S&P 500 TR in GB [0.76%]
F - FTSE World Europe ex UK GTR in GB [0.39%]
G - FTSE 250 TR in GB [0.37%]
H - MSCI China TR in GB [0.07%]
I - FTSE All Share TR in GB [-0.85%]
J - FTSE 100 TR in GB [-1.06%]

06/10/2023 - 07/11/2023 Data from FE fundinfo2023

SIX MONTH INVESTMENT MARKETS STERLING TOTAL RETURNS



A - Nasdaq 100 GTR in GB [18.83%]
B - S&P 500 TR in GB [9.19%]
C - TSE TOPIX TR in GB [5.21%]
D - FTSE World Asia Pacific ex Japan GTR in GB [0.45%]
E - FTSE 100 TR in GB [-2.96%]
F - FTSE Actuaries UK Conventional Gilts 10-15 Years TR in GB [-3.31%]
G - FTSE All Share TR in GB [-3.54%]
H - FTSE World Europe ex UK GTR in GB [-3.62%]
I - MSCI China TR in GB [-5.70%]
J - FTSE 250 TR in GB [-7.05%]

05/05/2023 - 07/11/2023 Data from FE fundinfo2023

The US Federal Reserve (Fed) maintained the federal funds rate at a range of 5.25% to 5.50% for the second meeting in a row. Jay Powell, Chair of the Fed, commented that economic conditions would dictate future strategy with all options still available and that the Fed would continue to act "carefully" when making interest rate decisions. Inflation has fallen to 3.7% pa whilst the US economy is still growing strongly at a rate of 4.9% pa in the third quarter of 2023. The US consumer continues to spend helped by increased wage levels and the remains of pandemic-related savings, as well as fixed rate mortgages providing insulation from higher interest rates. The use of Artificial Intelligence (AI) has also seen productivity gains in the US supporting growth. The recent US jobs report showed that although unemployment is still under 4.0%, the number of new jobs being created has started to contract indicating that tighter monetary policy is having an impact. There are also signs that consumer confidence has dropped as petrol prices have increased, credit card defaults are rising and student loan payments have been reinstated. It would now appear that this interest rate cycle is at or is almost at its peak but the question for markets now is how long the Fed will keep interest rates at current levels to bring inflation back to target without causing a recession.

Similarly, the Monetary Policy Committee (MPC) of the Bank of England (BoE) kept Bank Rate at 5.25% again. The BoE has warned that the UK economy is facing stagnation in the short term whilst inflation is likely to remain more persistent than previously expected. Consumer price inflation is at 6.7% currently and third quarter economic growth remains flat with a marginal increase predicted for the final quarter of 2023. Over the last two years, interest rates have risen from 0.25% to 5.25% with the aim of slowing demand and therefore inflation. The impact of such moves takes around a year to eighteen months to have an impact, so there is likely to be further economic weakness in the coming year. It is expected that the inflation rate will fall back to its 2% target by the end of 2025.

The European Central Bank (ECB) also kept its deposit interest rate on hold - at 4.0%. Its tight monetary policy has also reined back demand and economic growth. Eurozone Gross Domestic Product (GDP) contracted by 0.1% in the third quarter of 2023. Unemployment has risen in the region to 6.5% with expectation of it rising in the coming months as the economy contracts.

Even the Bank of Japan (BoJ) seems to be tightening its relatively loose monetary policy, although its interest rate remains at -0.1% - the only negative interest rate globally. Its control of the yield curve is gradually being changed. The strict 1% yield cap on 10 year government bonds is being loosened to a more flexible “reference” rate. The Bank of Japan has been expected to scrap its yield curve control completely as the yen is so weak and inflation is above target. The yen has remained weak indicating that it is more likely that the BoJ takes further steps to control inflation and move away from its loose monetary policy stance.

Yields on US, UK and European government bonds have all fallen in the wake of the last raft of central bank meetings (i.e. bond prices have risen) as investors expect inflation to continue to fall and central banks not to raise interest rates much further, if at all. The prices of bonds have increased so mitigating some of the losses that investors have experienced in the last few years, over which inflation and interest rates moved upwards. As bond yields fall, other long duration assets such as those related to infrastructure are likely to see greater demand as they offer relatively attractive yields coupled with the potential for greater capital growth in the longer term.

With interest rates stabilising and the next moves around the world perhaps cuts as economic growth slows, share prices of companies which are particularly impacted by rising interest rates have recovered to some extent. Medium sized and smaller companies have seen their share prices increase very recently. Their cost of capital is likely to decrease so improving their profitability. Growth companies, the future earnings of which are based on current interest rates, are likely to see their share prices increase as these future earnings are given a greater value.

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge Morland's Investment Services team.

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

We have been steadily increasing exposure to fixed interest funds in portfolios as the underlying bonds were offering attractive yields. As inflation falls, interest rates stabilise and eventually are cut, demand for bonds will increase and some capital gain is possible over time. In the interim, the yields on offer comprise important components of total returns for portfolios and/or provide a healthy income stream for investors requiring income. We prefer higher quality debt currently, as weaker economies in the shorter term could see riskier higher yielding bonds come under pressure as defaults increase.

We have maintained exposure to equity income and infrastructure funds again for their attractive yields and their potential for longer term capital growth. Financially strong, dividend producing companies will always form the bedrock of our portfolios. The inflationary and interest rate pressures facing medium and smaller companies have perhaps reached their zenith in this economic cycle. From here, we would expect sentiment to improve and attractive capital returns in the longer term. We continue to allocate to cash funds whilst interest rates remain high. They provide liquidity for the portfolios to be used as attractive investment opportunities arise always bearing in mind risk constraints.

Positive returns for Sterling investors over the past six months have been dominated firstly by the continued rise in the share prices of the 'Magnificent 7' mega-tech stocks, which have been driving the S&P 500 Index and secondly by Japanese equities, despite the precipitous fall in the value of the Yen against Sterling. We remain optimistic concerning Japanese equities and despite high valuations, will have to take a larger position in the mega-techs owing to their accounting for 10% x global equity market capitalisation – as we alluded to in our last Investment Commentary.

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OUR VIEW .... Continued

European and UK equities – and indeed non mega-tech US stocks, stand on firmer ground now that the escalating inflation/interest rate cycle appears to be over. Although slower growth – and potentially even mild recession over-hang national economies and affect sentiment towards companies, markets will soon be considering the need for the central banks to stimulate growth through reductions in interest rates. A return in confidence combined with lower cash/bond yields will support equities.

The UK market – both the FTSE 100 and the FTSE 250 parts of the market - are significantly under-valued according to comparable global market measures and smaller companies are too. This factor, high dividend yields and the prospect of re-pricing all conspire to support our overweight position in UK equities which proved defensive in 2022, so far as the FTSE 100 is concerned. Those spending in Sterling also require significant Sterling exposures to avoid undue currency risks.

Both major political parties accept that more needs to be done to re-develop a natural domestic constituency for UK shares. According to the Pensions and Lifetime Savings Association around 32% of all pension assets in the UK are held in UK assets (bonds and equities) of which 11% are held in UK equities. This globalisation of institutional investment policy is deeply unhelpful to the domestic equity market and Labour is supportive of the present government's efforts at reform. Announcements are expected in the Chancellor's Autumn Statement – although any change is going to be long-term. At the very least, domestic institutions' holdings of UK equities broadly reflect their weighting in global markets – so are likely only to increase from current levels.

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If you have any queries please do not hesitate to contact your Cartlidge Morland consultant.

OUR VIEW .... Continued

Investors have experienced a prolonged period of stop/start disappointments, as the various factors we have reported over recent years have frustrated sustained, stable returns. Barring conflagration in the Middle East or other exceptional geo-political events, we believe the 'normalisation' of interest rates and global bond markets provide an essential stable foundation – as a 're-set' from the long-term aftermath of the global financial crisis more than a decade ago. Robust US economic performance will drag the rest of the developed World in its wake too. China's current economic difficulties are unhelpful to the 'global recovery' theme and it may be that the next phase of growth will be supported to a lesser degree by the Chinese economy. China still has to make the very difficult transition from a 'middle income' economy fuelled by manufacturing exports, to a 'high income' one driven by domestic consumption and exports. To date, domestic consumption has relied too heavily on property/construction (around 25% x GDP) – but encouragingly, the authorities have set out to expand consumer consumption – and the rest of the world is likely to benefit from that over time.

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