GIBBS DENLEY
INVESTMENT MANAGEMENT

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INVESTMENT MARKET REVIEW & OUTLOOK

financial@gibbsdenley.co.uk

www.gibbsdenley.co.uk

Over the previous quarter stock markets have been very volatile, with sharp rises and falls that have been characteristic of 2022 so far. Rises have followed periods of optimism for better economic times; however, inflation and interest rate data frequently triggered falls. Central banks continued in their efforts to dampen the path of inflation and warned that this could come at the price of causing recession. Towards the end of September, the UK government's emergency 'Mini-Budget' caused further disruption in markets.

UK ECONOMIC DATA

2022	RPI (%)	CPI (%)	Unemployment (%)	GDP Growth* (%)
April	9	7	3.7	
May	11.1	9	3.8	Q2= -0.2%
June	11.7	9.1	3.8	
July	12.3	10.1	3.6	
August	12.3	9.9		Q3= -0.1%†
September				

**Based on percentage change on previous quarter (ONS)*   *†TradingEconomics Estimate, 2022*

ECONOMY

In the UK, Chancellor Kwasi Kwarteng's 'Mini-Budget' included cuts to personal and corporation tax rates and removed the caps on bankers' bonuses. This £45bn unfunded fiscal giveaway was the catalyst for a plunge in the value of the pound, as global investors baulked at the prospect of much higher UK borrowing and the risk that these measures may add to inflation. The new UK Prime Minister, Liz Truss, had already announced a cap on household energy bills and a similar cap for businesses. These measures are aimed at protecting individuals and businesses from the soaring costs of energy, but they come at a substantial cost. The Bank of England resisted undertaking an emergency rate increase to protect the value of the currency, but indications are that the next interest rate hike may be larger as a result. The Bank of England did intervene in bond markets by buying long-dated gilts to provide some stability. The passing of Her Majesty Queen Elizabeth II marked the end of an era, as Charles III became King.

The US Federal Reserve continued to raise interest rates as inflation showed insufficient signs of abating. The 0.75% increase was the third of this size in a row and took rates beyond 3%. The risk of recession in the US was increased as a more difficult economic backdrop could hold back growth. This was deemed an acceptable loss in order to halt rising prices which could cause much worse damage further down the line.

Ukraine reclaimed around 10% of the territory taken by Russia, and President Putin retaliated in a statement which announced a 'partial mobilisation' of troops and alluded to his country's significant arms potential. Russia's referendums were declared a 'sham' by global observers and Ukraine applied to NATO for expedited membership. The European Union convened to make plans to cap the revenue flowing to Russia from oil sales.

In Asia, China continued to stimulate its economy with lower interest rates and capital requirements ahead of the upcoming Congress of the Chinese Communist Party. This could have significant impact on a wide variety of policies, which may in turn affect fund values. Japan also intervened to hold up the value of the Yen, to try and halt its decline versus a relentlessly strong US Dollar.

FIXED INTEREST

The prices of UK government bonds (gilts) fell heavily over the previous three months, pushed down by substantial increases to interest rates and exacerbated by the promises to cut taxes that would be funded by a significant increase in bonds issued. The yields on these bonds (which move inversely to the prices) pushed much higher, to over 4% on the ten-year bond, its highest in more than a decade. This was only tempered by the Bank of England carrying out an impromptu buying of government bonds in late September in an attempt to maintain trading conditions and protect pensions.

Corporate bonds, which are broadly priced in relation to government bonds, also fell, pushing their yields up to even higher levels. The market is pricing a much higher default rate (the rate at which the issuer is expected to fail to pay its coupons). We believe that this rate is unrealistically high, particularly on high-quality bonds, and there is therefore an opportunity for us. There will be more downside to come as rates continue to rise, but the longer-term capital gain, the yield, and the protection that these assets can provide make them useful despite the volatility.

We expect a further 1.25% in increases to interest rates in the US before the end of this year and current projections are for a more moderate rate of increases next year, moving to reductions toward the end of 2023. The Bank of England will likely enact a significant hike in its November meeting, and potentially again in December. Rates in the UK look likely to peak toward the end of the first quarter of 2023, and could be as high as 5%.

Some of the funds that we use in the fixed income space can use short-term hedging strategies to mitigate against large or sudden moves in prices. These have helped to protect value in our portfolios to a larger extent than would have been possible without them.

EQUITIES

Despite so many heavily negative headlines, most of the equity funds we hold delivered positive returns over the quarter. The best returns were from the US and Asia, with UK and European assets struggling to retain value.

Recession is considered inevitable for the UK and Europe at the moment, but this disguises the nuances below the data. The UK may experience a shallow recession, but its equity market has many opportunities and attractively valued companies that are providing essential goods and/or services. The FTSE 100 as a whole has more than three quarters of its sales from outside of the UK. The fall in the value of sterling boosted our overseas holdings (which are denominated in other currencies) but also buoyed many of the top FTSE 100 stocks as their international revenues will be worth more when converted back to GBP. We are moderately underweight in UK equities, which aided performance during this period. We hold very little in the more domestically-focused UK stocks, which have suffered considerably more recently.

The US looks to be the least troubled region in a tough market environment and the US Dollar reflects this. The dominance of the US currency is likely to continue as rates increase and its counterparts struggle much more against energy uncertainty, consumer weakness, higher prices and uncertain trade. The US also benefits from being home to some of the largest and most exceptional companies in the world. Stocks such as Microsoft, Alphabet, Apple and Amazon have the size and strength to protect against most economic shocks and are at the top of most portfolios' holding lists.

We are maintaining our defensive equity asset base which holds a high degree of robust, less market-sensitive stocks in sectors such as consumer staples, healthcare and infrastructure. We hold a bias toward large companies and those that have excellent financial strength, many of which are returning cash to shareholders via dividends. This should help us to ride out excess volatility in stock markets and to have a stable base from which to grow once the environment is appropriate for this.

COMMODITIES

Oil continued to be volatile over the quarter, sustaining falls of more than 15% in July. The demand environment for oil is in question as consumers are weakening in many areas and supply levels are uncertain as many of the usual sources are in question. A very strong dollar was another headwind for oil, but the lack of investment in fossil fuel procurement, and low and receding inventories should support the price in the near-to medium-term.

With Germany likely to stop importing gas from Russia, the price of natural gas spiked in September after significant damage was discovered to the Nord Stream pipeline.

CONCLUSION & OUTLOOK

In the UK, the government's plans to help with energy bills and reduce taxes will not prevent real incomes from falling across the board, as inflation has been much higher than income increases. This fall in real incomes is significantly higher than the fall that occurred during the financial crisis in 2008/9.

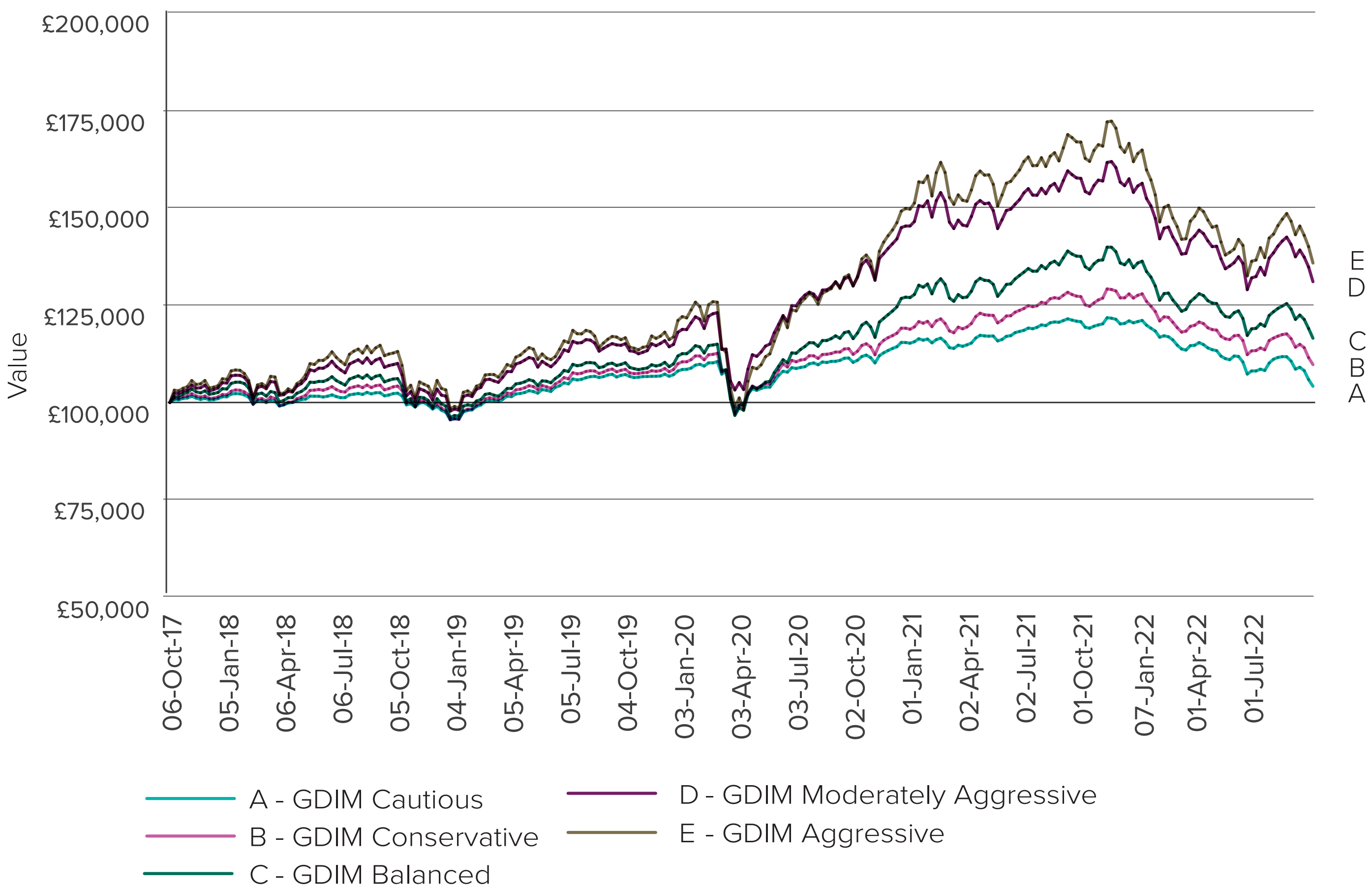
The remainder of this year contains many potential catalysts for markets. We are looking toward the imminent Congress of the Chinese Communist Party, which could trigger changes to their 'zero-COVID' policy, and to the US mid-term elections in November, which look to be very close and could dictate near-term policy for the country. The outcomes of these events could have significant influence over the path for global economic growth over the next 12 months and beyond.

Overall, we anticipate low levels of global economic growth over the next year, held back by Russia's invasion of Ukraine, higher interest rates and inflation, a slowdown in housing activity and a reticent consumer. Inflation should peak before the year is out as demand falls further, supply chains are eased, and stronger monetary policy takes its toll. We are wary of the unanticipated effects of the sharp move from very low to very high (in relative terms) rates (on financial conditions) and expect that there will be casualties of this that are not currently expected.

The defensive stance we hold in our Balanced, Conservative and Cautious portfolios position us well to ride out the volatility that will be evident in the near-term. Our Aggressive and Moderately Aggressive portfolios continue to take a higher degree of risk in the short term and target long-term growth.

Gibbs Denley Investment Committee
October 2022

FIVE-YEAR PERFORMANCE OF GDIM INVESTMENT MODEL PORTFOLIOS



These figures are representative of the performance of Gibbs Denley Investment Management (GDIM)'s 5 Whole of Market Investment Model Portfolios, initiated on the 17th April 2009 and re-balanced in-line with the latest portfolios whenever changes were recommended. Graph shows representative returns on an initial investment of £100,000 over 5 years to the 30th September 2022.

Performance does not reflect trading in actual accounts (and is therefore gross of all management fees, except fund charges). Data provided by Financial Express 2022. Past performance is not representative of future returns. Capital may fall as well as rise and you may not get back the full amount invested.

Gibbs Denley Investment Management (GDIM)
Crystal House, Buckingway Business Park, Swavesey, Cambridge, CB24 4UL

01954 234 383 financial@gibbsdenley.co.uk www.gibbsdenley.co.uk