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GIBBS DENLEY

INVESTMENT MANAGEMENT

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INVESTMENT MARKET REVIEW & OUTLOOK

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Positive market movements in January were a welcome beginning to 2023 after an 'annus horribilis' in 2022. This was to ultimately be short-lived as the quarter progressed and the collapse of Silicon Valley Bank in the US sparked fears that a 2008-style financial crisis may be upon us. Swiss bank Credit Suisse was one of the next high-profile casualties but swift, co-ordinated action from central banks and governments ensured the damage was contained.

UK ECONOMIC DATA

2022/2023	RPI (%)	CPI (%)	Unemployment (%)	GDP Growth* (%)
October	14.2	11.1	3.7	
November	14	10.7	3.7	Q4= 0%
December	13.4	10.5	3.7	
January	13.4	10.1	3.7	
February	13.8	10.4		Q1= 0.2%†
March				

**Based on percentage change on previous quarter (ONS) †Trading Economics Estimate, 2023*

ECONOMY

Central bank policy and the fight against stubbornly high inflation have been the over-riding themes of the last two years now and investors may have had a long-awaited glimpse of the end of interest rate increases following the banks' most recent meetings. The effects of a more fretful banking system (resulting in tighter lending standards) should slow economic activity and with it, inflation too.

Many regions, the US in particular, are seeing a significant deceleration in the rate of price increases and so the expectation for the ultimate peak in rates has come down. This is encouraging for companies that are heavily indebted or to whom interest rates are key to success. We have seen some more signs of positivity in the beleaguered technology stocks that have sold off aggressively during the period in which interest rates were rising.

Of course, if we see it, less loans issued by banks may lead to lower levels of economic growth, and while we may avoid descending into full-blown recession in many regions, there will be more sluggish expansion in the majority of sectors.

UK house prices continued to be under pressure, falling 3.1% year-on-year, as the effect of the damaging 'mini-budget' in September of last year continues to be felt. This is the seventh consecutive monthly fall in prices and the largest since 2009, as high mortgage rates continue to put off buyers.

The looming prospect of the US debt limit ceiling (the total amount the country can borrow) is a concern once again this year, as neither the Democrat or the Republican parties look close to compromising in order to get approval passed through Congress. In 2011 this was very damaging and resulted in the US losing its optimal AAA-rating for Treasuries (government bonds). We expect more to come on this as we approach the summer when the current limit is likely to be reached.

China's resurgence after emerging from COVID lockdown controls is continuing apace with the republic likely to achieve 6% GDP growth this year. A huge increase in consumption has been the main driver of the increase to activity and the People's Bank of China (PBoC) has maintained policy that is in-keeping with their growth objectives.

FIXED INTEREST

Western government bonds continued their rally from last year, with the averages adding over 4% in January. Corporate bonds, those issued by companies, rewarded investors with even more growth as they continued their recovery from last year's lows.

Our faith in the bond market has produced good returns so far this year, and with limited further interest rate increases to come, the outlook for the asset class remains positive from our point of view. We have maintained a high-quality bias in these assets for two main reasons – the impending slowdown in bank lending and economic growth may lead to higher levels of default (bond issuers failing to pay their bond-holders) in lower quality lenders, and with bond yields at their current levels there is no need to take on more risk to achieve our goals for returns.

As bond prices are inversely linked to the level of interest rates (as the yield on cash increases meaning that bond yields look less attractive in comparison), we see the potential end to rate increases as a positive sign for fixed income. There are currently attractive yields to be had across the bond universe, and at these levels

bonds hold a lower degree of risk than they have in some time.

As ever, we hold a diverse mix of fixed income assets, spread across numerous regions, sectors and timeframes to maturity. This reduces the risk of weakness in one particular area from affecting the whole portfolio.

EQUITIES

Most equity markets are close to, or above the levels at which they entered the year, having enjoyed a fruitful January and February and less favourable March. Developed markets have experienced better returns than their emerging market counterparts so far, a trend we do not expect will continue throughout this year.

European stocks have performed very well this year, rebounding from an especially poor year in 2022. The greatest performance has generally been in secular growth sectors, such as technology companies, but there has been good support for consumer-sensitive stocks too, in stark contrast to last year. The UK's FTSE 100 has also been an area of strength as investors looked to the safety of larger and more profitable companies in times of stress. We have held a bias toward the larger end of the capitalisation scale due to our concerns over the numerous headwinds that mid and small-scale businesses face. Far from the least of these is the expiration of the energy price cap which has limited the amount businesses have to spend on essential power requirements. Many smaller firms may find that their costs have escalated significantly.

The 'contagion risk' (the chance that a loss of faith in one financial institution spreads to others) from the collapse of Silicon Valley Bank, has been evident in the financial sector, hindering the progress of banks and insurers who may normally benefit from a higher interest rate environment. The strength in technology and semiconductors has originated from a rebound from last year, an improved outlook for economies, and the prospective end of interest rate increases this summer.

We are maintaining our defensive equity stance in the Balanced, Conservative and Cautious portfolios as we do not believe the recent period of heightened volatility is over yet. We did not foresee weakness in the banking sector, but as we have discussed in prior communications, we did foresee unintended consequences from significantly higher interest rates.

COMMODITIES

Oil prices remained volatile, but a strong end to the quarter meant prices recovered to around $80 per barrel, more or less the same level as three months ago, led by continued signs of recovering demand in China. Earlier in March, prices had fallen to as low as $66 per barrel as fears of recession and a potential banking crisis weighed on traders. Those same fears caused a rally in gold as investors flocked to the safe haven asset, and prices reached their highest level since this time last year.

European gas storage facilities ended the winter at a record high level of 55% of capacity on average. As a result, gas prices have come down even further as future demand for gas also fell.

CONCLUSION & OUTLOOK

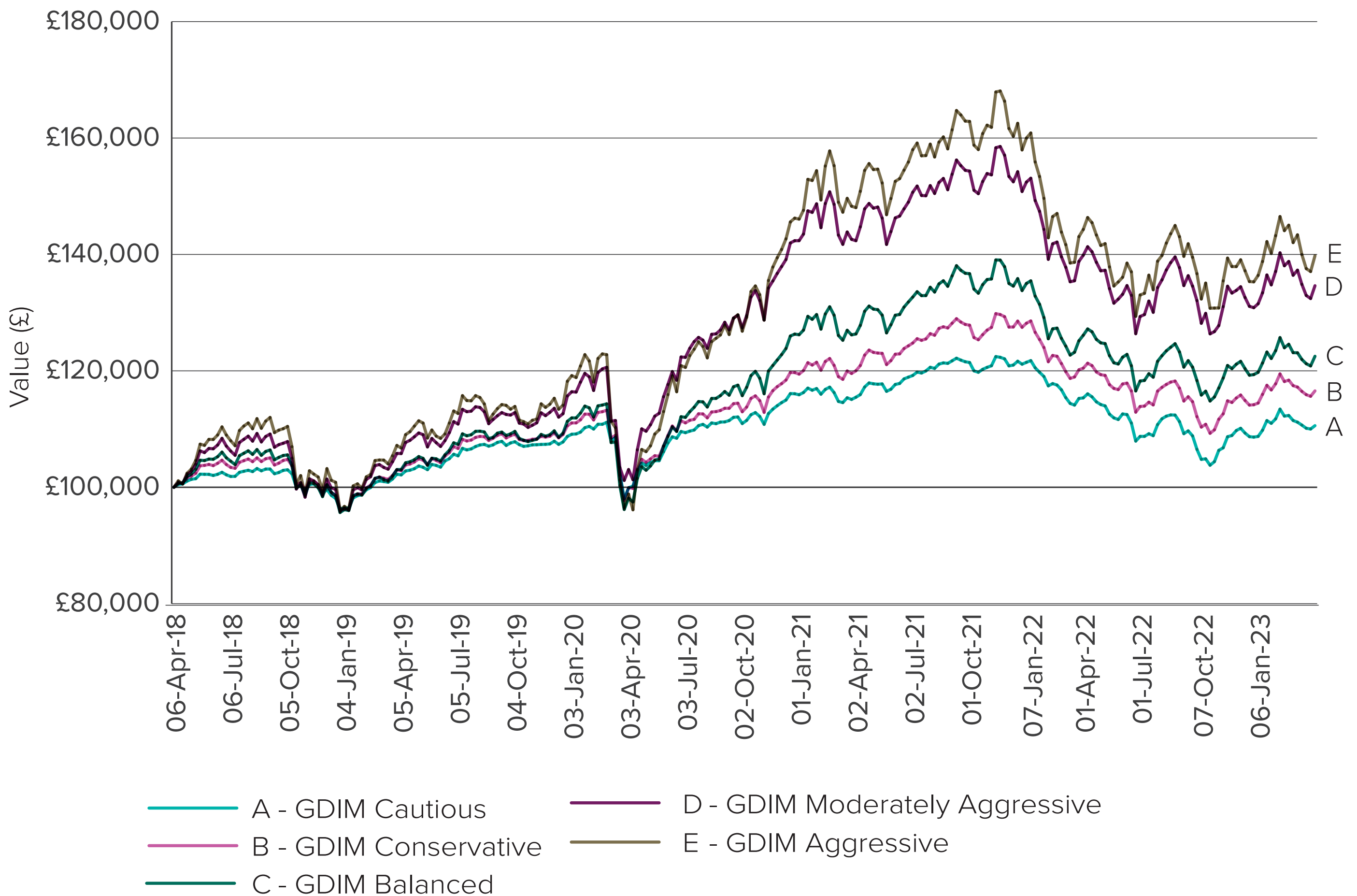
The long period in which the world enjoyed low interest rates is over, but the effect of this was that a lot of money was borrowed at very low interest rates. As rates are now significantly higher, servicing this debt has become more problematic and cracks are beginning to show. Historically, this has always been the effect of strong increases in interest rates, so it was somewhat inevitable, but the question remains how much more is there to come and for how long?

We can see that banks are in much better shape than prior to the Great Financial Crisis of 2008, thanks to the much more stringent regulations that were brought in as a result of it – on average banks are currently holding around half the debt they held (as a percentage of GDP) heading into that crisis. The risks that were apparent in the recent bank failures were localised to those entities and in the case of Silicon Valley Bank, a very specific asset base of customers, namely technology-based start-ups. There is some question over whether commercial real estate may be the most vulnerable this time round as reduced lending, higher rates and a trend toward flexible working are all negatives for this sector.

We remain happy that the more defensive areas of our portfolios have navigated the start of the year well and our solid base of fixed income (bonds) has been a valuable buffer in the more difficult times. If we see the end of rate increases in the near term, there should be better times ahead this year, bringing a renewed optimism and increased confidence in the corporate world.

Gibbs Denley Investment Committee
April 2023

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 31st March 2023.

Performance does not reflect trading in actual accounts (and is therefore gross of all management fees, except fund charges). Data provided by Financial Express 2023. 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.

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