GD
GIBBS DENLEY
INVESTMENT MANAGEMENT

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INVESTMENT MARKET REVIEW & OUTLOOK

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2022 was one of the worst years in history for equity markets, which saw record falls in the first few months. Bond markets followed suit at the prospect of an aggressive programme of raising interest rates in both the UK and the US, designed to tackle inflation that reached the highest levels seen in a generation. All of this was set against a backdrop of unpredictable commodity prices as a result of Russia's invasion of Ukraine. For 2023, we find ourselves looking ahead at a year that will include recession, but we also know that markets have already anticipated some of the negative news.

UK ECONOMIC DATA

2022	RPI (%)	CPI (%)	Unemployment (%)	GDP Growth* (%)
July	12.3	10.1	3.6	
August	12.3	9.9	3.5	Q3= -0.2%
September	12.6	10.1	3.6	
October	14.2	11.1	3.7	
November	14.0	10.7		Q4= 0.1%†
December				

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

ECONOMY

With US interest rates still at the forefront of investors' minds, economic data has started to provide evidence of deteriorating financial conditions, which central banks (particularly in the US) have been waiting for and which affect the path of future interest rate changes. We would expect smaller increments in interest rate increases after the central bank February and March meetings, heading to a probable peak near the middle of this year. Clearly this is not set in stone, and much will depend on the economic data.

UK and US inflation has been abating and, while the jury is still out on whether this will re-emerge as a threat in the near future, it is clear that prices at home will persistently be higher than we have been used to in recent years. There have been lay-offs from many of the world's biggest employers, which may help to curb wage inflation, one of the toughest elements to overcome. The US is leading the way in battling inflationary forces currently, with Europe lagging behind.

Taking into account higher interest rates, it is not surprising to see that global growth is slowing. While this will help to reduce inflation, it is likely that some economies will fall into recession in the near term. Europe is the closest to this, but the severity of the slowdown should be cushioned by fiscal policy and the deployment of the sizeable gas reserves that have been accumulated, which can help to avert an energy crisis.

House prices in the UK fell 2.3% between October and November of last year, the fastest fall since the financial crisis in 2008, according to Halifax. This is largely on the back of much higher mortgage rates following the disastrous mini-budget in September.

The ongoing, tragic war in Ukraine has continued, with further offensives launched and many more lives lost. Toward the very end of the year forces were active on both sides. Further sanctions were enacted by the UK, the USA is providing more advanced weapons and the EU pledged another €18bn in support to Ukraine.

China has initiated an easing of COVID restrictions in a move away from their 'Zero COVID' approach that led to so much disruption globally. The Chinese government is now allowing home quarantine for those with mild or no symptoms. This has resulted in significant market uplifts and further easing is expected in the coming weeks and months. Resumption of business, travel and services should boost China's economy and as usually follows, the rest of the world's too.

FIXED INTEREST

Government bonds increased from their October lows and rallied into the year's end as interest rate expectations moderated and poorer economic data showed that higher interest rates were having their desired effect. These rallies were not enough to make up for the poor performance of fixed interest instruments earlier in the year though, as the major sovereign indices all ended 2022 down significantly.

A more encouraging year was had by many in the corporate bond space (debt from high quality companies, rather than governments) and we believe there is still very good scope for further price appreciation from these assets, which currently can have attractive yields of between 4% and 7%, over the course of 2023.

Our funds are generally positioned at the highest quality end of the bond market spectrum. We see no need to reach for higher yields in an environment that is supplying mid to high single digit income while taking very little credit risk (the risk that the company fails to pay its liability). This may also mean that we get a lower return in 2023 from the funds that performed best in 2022 – namely Chinese bonds and inflation-linked securities – but they provide excellent diversification.

EQUITIES

The last three months of the year were positive for equities, which was at odds with the rest of 2022. European equities rallied and were among the best performers at the end of the year and lower-risk infrastructure stocks gave up some of their gain as investors preferred riskier holdings. We still appreciate the predictable, reliable earnings and income that infrastructure investments bring, so will be holding on to these for now.

European assets have been hit hard this year due to the effects of the conflict in Ukraine, high inflation and the European Central Bank raising rates. Stocks look inexpensively valued throughout the region but we are not yet convinced that the valuations are low enough to warrant a larger position in portfolios.

Our portfolios hold a significant weight of UK equities which is moderately higher than the global average. This is not because we are particularly positive on the domestic front but it is a reflection of two main factors: 1) that London is home to many large, international companies; and 2) that UK stocks are currently undervalued in relation to their global peers. The lower volatility sustained by companies such as Unilever, Reckitt Benckiser and Intertek (which is a multinational assurance, inspection, product testing and certification company) provides an increased certainty of returns. Conversely, some major UK-based entities have been sold down disproportionately and are now trading at valuations that make them appear very attractive – amongst these are Natwest, BP and 3i (private equity and infrastructure investments).

Clearly, we cannot know with certainty what the state of the economy will be this year. We do know that it is very likely that many consumer-facing businesses will suffer from a reduction in non-essential spending making life tougher for many travel and leisure, industrial, and luxury goods stocks. Many of these companies also have significant cost-bases, including wage burdens that may be difficult to control. In tougher economic times size is often key as diverse businesses with disparate market bases should be able to withstand a leaner period more easily. We therefore select larger companies in sectors that should be more predictable, regardless of their location.

We are remaining cautious with Asian exposure as the volatility tends to be higher than in Western markets. As noted above, we may assess China assets this year as its economy re-opens and growth is supported by central stimulus. We maintain a larger Indian equity position as this is a key tenet of our long-term growth strategy.

COMMODITIES

The final quarter of 2022 saw oil prices plummet to a one-year low, with rising global recession risk weighing on demand expectations. In addition, the G7 Russian oil price cap went into effect around the same time. Oil traders will be weighing up the likely demand and supply characteristics to ascertain the future price but this will heavily depend on the economic activity levels in China and the severity of potential recessions in numerous major economies.

In Europe, gas stock levels were around 90% capacity at the end of the year, ahead of a potential cut-off from Russian supplies. A milder than expected winter so far has helped to maintain these levels which hit 95% in November.

CONCLUSION & OUTLOOK

The stock market's fixation with inflation and interest rates seems to be switching to the possibility of recession and the prospect that economic deceleration may be more of a cause for concern. The situation differs from region to region and there are significant differences in the near-term prospects for the US, Europe and Asia.

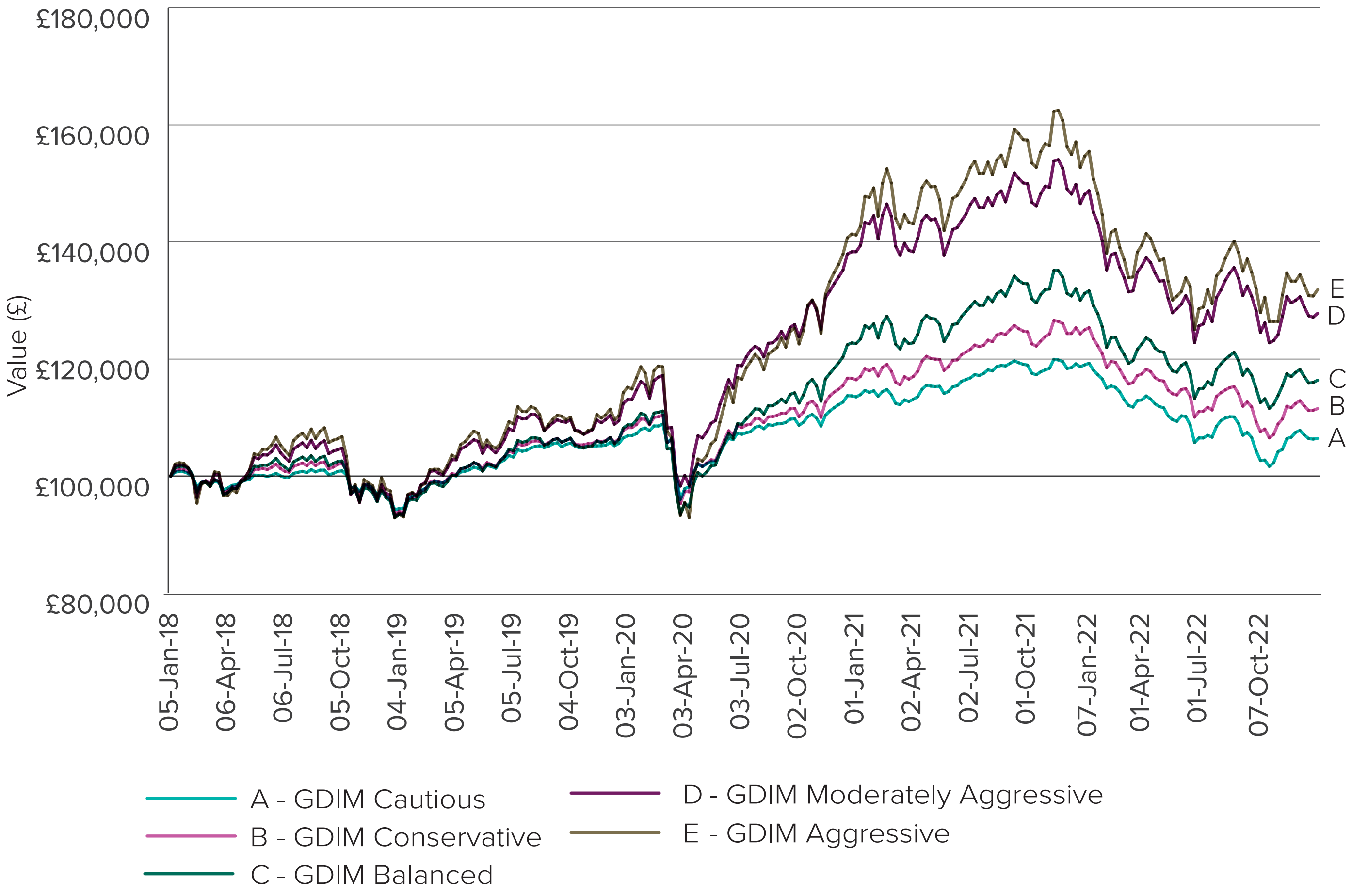
While we are still cautious regarding the inclusion of Chinese equity funds in our portfolios, they could be key to unlocking activity in a world that is struggling in recessionary times. As ever, the giant economy has the potential to kick-start growth in numerous ways, from boosts to both demand (good for exporters to China) and to supply (positive for importers of goods). There will be an optimal time to move away from the defensive strategy that we're holding, but we prefer to enact these changes gradually rather than to switch direction dramatically. The global economy has yet to process the huge changes in economic circumstances we have seen, but stock and bond markets have discounted these to some extent already so should do better, even in poorer economic circumstances.

We are, therefore, continuing to hold the stance that we implemented in October in our Balanced, Conservative and Cautious portfolios and are favouring defensive sectors (utilities, healthcare, consumer staples) and away from cyclicals (travel, leisure and consumer discretionary goods) in order to protect from an economic downturn. Our Aggressive and Moderately Aggressive portfolios continue to take a higher degree of risk in the short term in favour of targeting long-term growth, especially in thematically strong areas such as Asia and clean energy.

We would like to wish you all a very happy and prosperous new year.

Gibbs Denley Investment Committee
January 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 30th December 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 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.