Fiske

Investment Commentary

Overview

Markets began the year in a positive fashion as perhaps overly optimistic commentators suggested that the rising interest rate environment was coming to an end. This helped drive the FTSE 100 Index above 8,000 for the first time. A sense of calm set in before we were introduced to Silicon Valley Bank (SVB) and market volatility returned. Worries that the problems of this little-known American secondary bank could lead to a fresh global financial crisis panicked the market into giving up earlier gains. The enforced takeover of the long-troubled Credit Suisse added fuel to these concerns. However, central banks and regulators, perhaps showing that they had learnt the lessons of the 2008/9 crisis, acted swiftly to stem any contagion. Modest recovery, right at the end of the period, ensued.

We pointed out in our previous quarterly review that interest rates would keep rising, and they have. Increases last month took them respectively to 5.0%, 4.25% and 3.5% in the US, the UK and Europe. Inflation continues to run well in excess of 2% target rates, but some areas are doing better than others. In the US and Europe inflation has fallen back to 6.0% and 6.9% respectively, whereas in the UK it remains at 10.4% and has been consistently above 9% for the past 12 months. This has not prevented 10-year Treasury yields from easing back, with UK Gilts reaching 3.62% from 3.66% and US Treasuries falling to 3.52% from 3.89% at the end of last year.

There has been a relatively long-held belief that the global economy would fall into recession, but this has yet to occur. Anaemic GDP growth of 0.1% in the fourth quarter for the UK prevented a technical recession, while the US bounced back with growth of 2.6%. The European economy was flat over the quarter but recorded growth of 1.8% on an annualised basis. This situation has led to more positive Purchasing Manager Indices, with a return to expansion on the larger Services side. Respectively, the UK, the US and Europe recorded 52.8, 53.8 and 55.6 against figures that were all below 50 in December. However, the Manufacturing side has not fully recovered, with – in the same order – 47.9, 49.2 and 47.3 continuing to show contraction.

Index	31/12/2022	31/03/2023	Change
CBOE UK 100	747	764	2.3%
CBOE UK All Companies	13,084	13,358	2.1%
CBOE UK 250	16,363	16,548	1.1%
MSCI Private Balanced	1,665	1,701	2.2%
MSCI Private Growth	1,835	1,880	2.5%

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Macro-economic picture

In the UK the market would have closed lower for the quarter but for a 2.9% rise in the index in the final week of March. However, the distortions caused by the largest stocks have again come into play. AstraZeneca (+0.1%), Shell (-0.8%) and Unilever (+0.2%) failed to contribute, while HSBC (+6.6%) was off 15% from its quarterly high on account of banking sector weakness. More encouragingly, 35 stocks in the 100-share index were up by more than 10%. Medium-sized and smaller companies tend to underperform in uncertain times, and – true to form – the 250 index was up just 1.1%, while the smaller-cap and AIM indices fell 2.1% and 3.0% respectively.

A not dissimilar large company impact has affected the American market, where the biggest technology stocks now dominate. Strong recoveries from Apple (+25%) and Microsoft (+19%), as well as Alphabet/Google (+16%), Meta/Facebook (+75%), Amazon (+23%) and Netflix (+16%), drove the Nasdaq index up 17% and the S&P 500 up 7%. With fewer of these stocks, the Dow Jones Industrial Index rose just 0.4%. European and Japanese markets also staged reasonable recoveries, with gains of 8% and 7.5% respectively, as recessions were avoided.

The speed of interest rates rises over the past 18 months has been unprecedented, as has the extent. In the US, for instance, the Federal Funds Target Rate has risen from 0.25% to 5.0% over this period. It may prove that these rises have been sufficient to induce a recession. It certainly seems that this was part of the cause of SVB's collapse. Markets could come under pressure again if this should turn out to be the case elsewhere. At present, however, any recessions are likely to be modest. In general, companies have reported reasonably good results and issued encouraging forward-looking statements couched with terms such as "notwithstanding the uncertain economic outlook".

Outlook

It is not often that we comment on a UK Budget, especially one from a Conservative government, but on this occasion we should. Corporation tax is rising from 19% to 25%, which will prove a drag on companies' overall profitability. For individuals the annual Capital Gains Tax allowance is being reduced from £12,300 to £6,000, while the annual dividend allowance is being halved to £1,000 in the current tax year (2023/24). However, the annual ISA and JISA allowances remain unchanged, at £20,000 and £9,000 respectively. We would suggest annual subscriptions should be made as soon as practicable to take advantage of these tax-free pools of capital.

In the US, the UK and Europe, except for a relatively small number of shares in some of the largest companies, broader equity markets have now been in a bear market for 18 months or so. With interest rates likely to reach their peak in the next few months, levels of inflation already falling and market valuations at reasonable levels, we continue to favour holding a broadly diversified portfolio of equities for the long term. In the short term, as the unintended consequences of the aggressive monetary tightening we have seen adversely impact over-leveraged business models, further market volatility and financial shocks cannot be ruled out.

As mentioned in our January report, bull markets usually begin during a recession, when the background news is at its worst, and very often when least expected. It is therefore important for portfolios to be positioned ahead of the event to capture the upturn when it comes. Meanwhile – and for the first time in many years – the government bond (Gilt) market is offering reasonable returns for risk-averse investors, especially for maturities of less than five years.

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