Investment Update - July 2023

Dear Investors,

We hope you are enjoying the early summer weather we're having - it certainly helps the general mood for most people, especially in light of how the investment markets have fared over the last 18 months. It has not been easy for investors post Covid and the Ukraine war, and that applies to experienced and new investors alike (irrespective of whether someone is cautious or more adventurous in their risk tolerance). In this publication I have covered a number of areas that I hope you find both interesting and informative, as well as relevant as a Vobis investor.

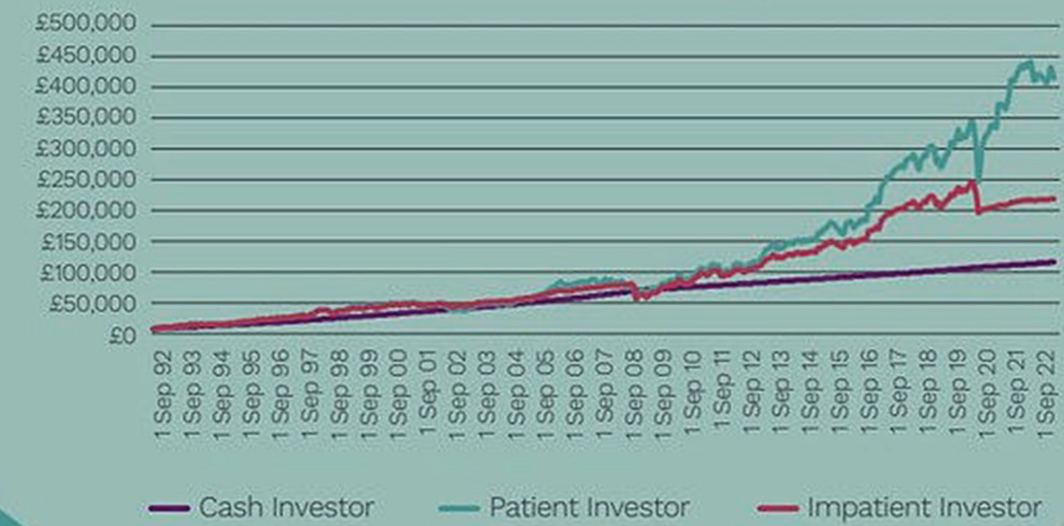
Emotional Investing

Patience can wear thin when cash rates start to rise as a result of the rapid inflation that we have experienced. It can be tempting to remove oneself from the rigours of investing and "play it safe" by investing in cash-based term deposits and other cash type products. However, this approach can result in reduced investment returns over the longer term as, more often than not, the decision-making process is driven by becoming an emotional investor rather than being a patient investor.

Research undertaken by Alliance Trust (AT) highlights the issue that people are becoming more impatient with their investment habits, showing this especially to be the case for men, while women have more patience when it comes to investing. Fintech has expedited the ability to change investments, adding a new dimension to the speed in which emotions can alter the direction of travel of investments and, when market turbulence is high, this leads to emotional investment decision making.

To ascertain the impact of making emotional investment decisions, AT took two investors with £10,000 invested in equities and added 10% of their average salary over the next 30 years.

The patient investor held on through dips, whereas the impatient investor sold 25% of their investments every time the market dipped by more than 5% in a single day and then bought back when market recovered by 10% in a single day. As you can see from the chart below, the real costs of being impatient became significant as markets became more turbulent post the 2008 credit crunch and through Covid, resulting in a £192,872 difference in value. Being out of the market at moments of stress can have a dramatic impact, as can holding cash (purple line).



Illustrative graph only. Alliance Trust Research as at September 2022.[4]

Diversification

One of the golden rules of investing is to ensure that a portfolio is made up of various types of investments, each doing different things at different times of the market cycle, and this reduces overall risk and smooths out volatility over the long term.

Diversification failed in 2022 and made the year arguably one of, if not the most challenging year for investment managers and advisers when looking at asset allocation of the two main asset classes - equities and fixed income.

The year was even worse for lower risk investors as 2022 delivered negative returns on equities and fixed income. If you look back at history and review 100 years of data (in the US), this event has only happened three times before: 1969, 1941 and 1931.

We are not reliant upon equities and fixed income alone in building portfolios, as other types of assets and investments have become available over the decades, but they are the mainstay of all risk based portfolio strategies.

Thankfully, as events such as 2022 can be considered a rarity rather than the norm, we will continue to use this approach to manage investment risk and the construction of investment portfolios.

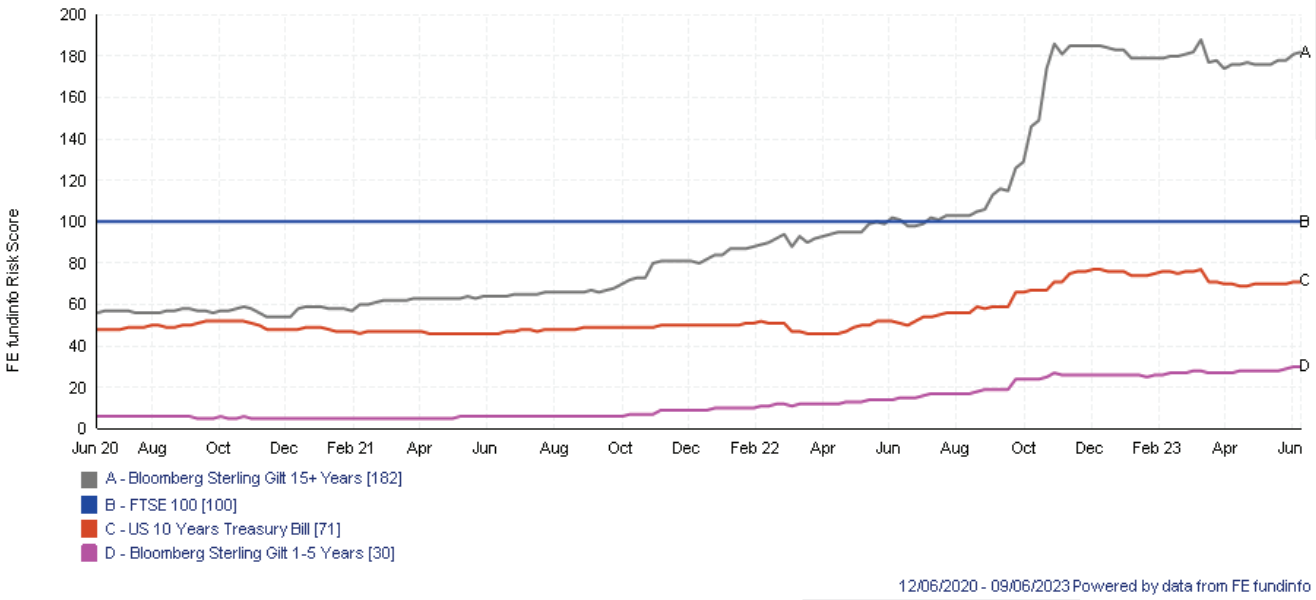
Risk Inversion

As I had mentioned earlier, 2022 was a rare year in the calendar where lower risk portfolios / asset classes did the opposite of what normally happens. This was the direct result of dramatic increases in rate rises, as well as the fall out of the UK government, or "Trussonomics" as it was referred to back in the Autumn of 2022. The following chart shows you the changes in risk levels for UK gilts (both short dated and long), 10 year US treasuries and the FTSE100, which for the purposes of this exercise, has a risk score of 100.

The 15yr+ gilt risk levels were roughly half of the FTSE100 back in 2020.

By June 2022, they had matched the risk of the FTSE100, which is equities, and by November 2022 the risk level had shot up to over 180 - nearly twice the level of risk as the FTSE100. As such long dated gilts had become riskier than emerging market equities.

The level of risk of US Treasuries also increased from a risk score of 50 to 80 and the same for short dated gilts had even risen from below 10 to over 30, which is a threefold increase. These are significant increases across the government bond market which can be construed as a once in a lifetime event.



The chart below looks at the performance of UK / US government bonds, and particularly longer dated gilts, because of the hike in rate rises and "Trussenomics". As you can see, longer dated gilts over 1 year are down nearly 27%. Remember this asset class is supposed to be a safe, low risk asset.

This fall had a dramatic effect for many lower risk investors, as many hold longer dated gilts in their portfolios through funds and investment managers. The impact on UK pension schemes, which rely upon longer dated gilts to meet their future liabilities, was catastrophic to the point where companies had to shore up the balance sheets of their pension schemes to maintain the liquidity.

You can also see why it was important to hold shorter dated government bonds, as US treasuries and short dated gilts held up OK. Thankfully, we moved our portfolios into short dated government bonds before the sudden falls last autumn.

13/06/2022 - 13/06/2023 Data from FE fundinfo2023

Current Market Conditions

There are questions and uncertainty over the direction of travel of the global economy. The US debt ceiling was finally passed, giving equities a helping hand. The US's overall outlook has worsened in recent weeks, albeit that the top technology companies and AI have propped up the US main markets and sent the Nasdaq soaring.

China's reopening has not resulted in the upturn in fortunes most expected and Germany now faces a recession.

If inflation fails to fall as fast as most hope, how quickly will central banks ease monetary policy or how soon will rates peak?

Certainly in the US, they should peak sooner than here in the UK, as they started more aggressively. That's one reason equities failed to respond more positively to what was a strong first quarter earnings season – the recent past might have been good, but the future's looking increasingly uncertain. That being said, macro events seem to occur much more frequently, and we could be looking at a very different outlook in July or August.

Question marks over the state of the global economy and how quickly inflation might fall left markets treading water during May. The US debt ceiling circus wasn't taken particularly seriously by investors, but it added to the general state of uncertainty. As a result, equities drifted back by 0.2 per cent and bonds were down 0.8 per cent on the month, both in local currency terms.

Once again, the dollar's safe-haven status came to the fore, with the currency picking up 2.6 per cent on the month, more than reversing losses run up since the start of the year. By the same token, US equities performed relatively well, up 0.7 per cent on the month – though performance was heavily concentrated in tech and communications stocks, with the sectors up 8.5 per cent and 2.6 per cent respectively. There was a broad spread of losing sectors. While real estate, materials and consumer staples all lost more than 5 per cent on the month, energy dropped 8.4 per cent with a slump in the oil market, which was down 7.5 per cent.

The standout equity market, however, was Japan's, up 4.5 per cent amid signs that the Japanese economy is finally taking off. Other markets struggled, with the UK proving the biggest laggard, down 5.2 per cent, amid concerns about how the Bank of England might be forced to respond to persistently sticky inflation. The British bond market was similarly afflicted, with gilts down 3.4 per cent on the month. US Treasury bonds also fared poorly, down 1.6 per cent.

Summary

We remain cautious in our general asset allocation and, whilst diversification had a difficult year in 2022, it is the right approach for now and for the rest of the year. If there is a significant change in market conditions we will look at the current asset allocations and make recommendations to alter the investments. For now, the portfolio changes we made earlier in the year continue to reflect our current thinking.

If you have any questions or would like to discuss our views in more detail, then please contact the team. In the meantime I wish you a wonderful summer.

Many Thanks,

RStott

Richard Stott, CEO