ALBERT E SHARP

INVESTMENT MANAGEMENT & STOCKBROKING

Market Commentary

October 2022

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Monthly returns and summary

Index	Portfolio Benchmark Risk Level	31/10/2022	1 Month	3 Months	1 Year	3 Years	5 Years
ARC Cautious	Low Risk	187.41	+2.4%	-4.7%	-8.5%	+0.1%	+3.1%
ARC Balanced	Medium Risk	227.06	+2.1%	-5.3%	-10.1%	+2.3%	+6.6%
ARC Steady Growth	Medium High Risk	267.71	+1.9%	-5.7%	-11.4%	+4.2%	+10.4%
ARC Equity Risk	High Risk	309.26	+2.0%	-6.0%	-13.0%	+6.5%	+13.9%

Source: ARC. NB: Price returns only, excluding dividends. Figures based on ARC estimates.

Index	Region / Asset Class	31/10/2022	1 Month	3 Months	1 Year	3 Years	5 Years
UK 100	UK	7094.53	2.9%	-4.4%	-2.0%	-2.1%	-5.3%
UK All Share	UK	3876.48	3.0%	-5.6%	-6.1%	-2.9%	-5.9%
Dow Jones Ind Avg	US	32732.95	14.0%	-0.3%	-8.6%	21.0%	40.0%
S&P 500 Index	US	3871.98	8.0%	-6.3%	-15.9%	27.5%	50.4%
Nikkei 225	Japan	27587.46	6.4%	-0.8%	-4.5%	20.3%	25.3%
MSCI Europe Ex UK	Europe	161.66	6.5%	-5.3%	-15.0%	5.4%	6.4%
MSCI Asia Ex Japan	Asia	523.73	-6.1%	-18.5%	-35.5%	-18.9%	-24.3%
MSCI Emg Mkts (£)	Emg Mkts	557.00	-6.1%	-9.2%	-17.9%	-1.9%	-1.4%
MSCI World Index (£)	Global	2547.72	7.1%	-7.2%	-19.8%	14.1%	25.1%
UK Conventional	Gilts	3060.55	3.1%	-12.4%	-22.6%	-22.4%	-13.3%
UK Index-linked	Gilts	4069.77	-4.4%	-17.7%	-32.2%	-24.5%	-14.9%
AES Property Index	Property	127.41	-3.8%	-7.6%	0.2%	-4.6%	-2.6%
FTSE All-Share Real Estate Investment Trust Index	Property	2026.93	3.0%	-24.2%	-29.7%	-28.7%	-23.6%
WTI Crude ($/Barrel)	Oil	86.53	8.9%	-12.3%	3.5%	59.7%	59.1%
Gold Spot $/Oz	Commodities	1633.56	-1.6%	-7.5%	-8.4%	8.0%	28.5%
£1 = US$	Currencies	1.1469	2.7%	-5.8%	-16.2%	-11.4%	-13.7%
£1 = €	Currencies	1.1601	1.9%	-2.6%	-2.0%	0.0%	1.7%
£1 = Yen	Currencies	170.54	5.5%	5.1%	9.3%	22.0%	13.0%

Source: Bloomberg. NB: Price returns only, excluding dividends

Index	Region / Asset Class	31/10/2022	1 Month	3 Months	1 Year	3 Years	5 Years
FTSE All-Share Investment Companies Index	Diversified	11,238.72	0.3%	-7.8%	-20.7%	7.0%	13.2%
Latest Weighted Average Discount	-13.1%						
Previous Month Weighted Average Discount	-16.5%						
12 Month Weighted Average Discount	-5.3%						

Source: Bloomberg. NB: Price returns only, excluding dividends

General Comments

October was quieter for financial markets than September, but Westminster continued to be volatile. However, we ended the month with markets having reacted well to the latest set of UK government U-turns, so hopefully we can now move forward in a slightly more calm and orderly fashion.

The US Dow Jones Industrial Average Index had a tremendous month, buoyed by positive earnings results from energy companies. In fact, returns in most equity indices were fairly impressive, the only exceptions being in Asia and Emerging Markets, as China, and particularly the Hong Kong market were negative.

In commodities, it was also a less volatile month but there was a significant fall in the price of natural gas (as discussed below). Elsewhere, the ferrous metals (iron & steel) also fell in price, which is likely significantly related to a sharp slowdown in the Chinese property market.

UK Commentary

UK markets were becalmed this month by Jeremy Hunt & Rishi Sunak's new policies and U-turns from the policies of their predecessors. The UK 10-year gilt yield fell 12% over the month while sterling rebounded to nearly 1.15 against the US dollar.

In the stock market, Shell announced third quarter profits had doubled year-on-year thanks to elevated oil prices. They are among many London-listed companies to be increasing their dividend this year as Link Group estimate that investors in UK companies can expect to receive an extra 5.5% of dividends versus last year, amounting to total pay-outs of around £97.5bn. This is helped by higher payments from banks and oil & gas companies as well as the lower value of the pound against the US dollar, as many of the UK's largest companies make revenues in other currencies (mostly US dollar) thanks to their international scale.

North America Commentary

Elon Musk completed his $44bn takeover of Twitter in a week where tech giants Meta (formerly Facebook), Amazon, Microsoft, Alphabet all released statements that disappointed markets. The other major player in the space, Apple, seemed to be the only one of the group to avoid this, posting strong results yet again.

The degree to which Mr Musk overpaid for Twitter looks larger and larger by the day, at least relative to current market conditions. However, perhaps the main area of focus should be on those underwhelming results from the big tech companies. Essentially, growth in ecommerce, cloud computing and advertising has slowed. These were three key drivers of these companies' revenues and of the general tech sector, so the stock price reactions were dramatic.

Europe Commentary

There was big news in Germany as Chancellor Olaf Scholz ordered an extension in the life of the country's three remaining nuclear plants until mid-April 2023. This was a dramatic reversal of policy as the country contends with an unprecedented energy crisis.

Eurozone CPI inflation hit a record high of 10.7%, but the economy did grow 0.2% in the third quarter, thus avoiding recession. Prior to this Christine Lagarde announced the ECB would raise base rates 0.75%.

There are many reasons to be cautious on Europe at the minute. However, this month companies such as premium alcohol brand house Remy Cointreau and consumer goods producer Nestle highlighted that European companies can still deliver excellent results.

Asia Commentary

China's President Xi officially secured an unprecedented third term. Everyone was reminded who was in charge during a bizarre scene where former president Hu was escorted out of the ceremonial proceedings. Xi also promoted loyal allies within the party's highest-ranking committee, further cementing his control.

The Hong Kong market had a particularly poor month, returning -14.7%. The Hang Seng Index hit 13-year lows as Chinese growth slowed and many economic indicators for China turned negative. Issues in the Chinese property market and a regulatory assault on tech companies have not helped any uncertainty that may come from the aforementioned political shuffling.

In Japan, the yen remained under pressure after Bank of Japan governor Haruhiko Kuroda vowed to keep monetary policy loose to support an economic recovery. Japan's currency briefly weakened past ¥150 against the dollar to its lowest levels since 1990. As a reminder, Japan is currently the only country in the world to still have negative yielding debt. However, their inflation numbers are far lower than elsewhere, with CPI coming in at 3.5%.

Emerging Market Commentary

Apple started manufacturing its newest iPhone in India. Production began just three weeks after the model's launch as the company seeks to diversify its supply chain outside of China. Previously, the lag between Chinese and Indian production has been many months.

On the final day of the month, Brazil elected former president Lula rather than re-electing Bolsonaro by a slender 1.8% margin. The former trade unionist has hinted at governing with centrist policies, but certainly hails from a left-wing background. State-run oil behemoth Petrobras shares fell 7% following the result, perhaps an indication there may be some slightly less (aggressive) capitalist policies moving forward.

Chart of the month - UK Natural Gas Prices

Some welcome relief for consumers and businesses alike as gas prices fell significantly in October (even briefly turning negative in Europe at one stage!). This was partly a result of the weather being warmer than expected and the fact that many storage facilities are full.

The above chart shows data for the past year. Prices are now back to the levels of June this year, roughly 70% lower than the August peak.

Investment Profile – Merchants Trust

Merchants Trust is an investment company which offers exposure to primarily FTSE 100 companies, with the aim of providing a reasonable level of income to investors. At time of writing, it offers an income yield of 5.2% per year and has returned, on average, 7.5% total return (including these dividends) over the past five years. This equates to a total return for a 5-year period of 43.5% from this strategy, outperforming the FTSE 100 index by 28.8% over this time.

Merchants has been managed by the extremely experienced Simon Gergel, Chief Investment Officer of UK equities at Allianz, since 2006. Simon and his team take pride in their portfolio being relatively better value than the FTSE 100 as a whole. Their focus on balance sheet resilience and cash flow performance has helped lead to this and means their portfolio contains many companies trading on price to earnings multiples well below the market average. This approach has helped them identify companies with resilient and growing dividends. This means the trust features on the AIC's dividend heroes list, having increased their dividend for 40 consecutive years.

Significant holdings for the strategy include oil major Shell, consumer goods brand house Unilever and metals miner Rio Tinto. Meanwhile, the trust's overall largest exposure is to financials, with names such as financial technology firm IG Group featuring in the portfolio.

Investment Team's thoughts

We are now most of the way through the earnings season in the US and the pattern has been that many of the so-called "old economy" stocks such as the energy producers have fared well, while their "new economy" peers have felt some pain. While these are silly labels as there is nothing old or outdated about the need for energy, there does seem to be a pattern that the more capital-intensive industries are producing better results than the capital-light companies which dominated the last few years.

Overall, earnings have been modestly positive, and we believe a few companies highlighted in this piece offer encouragement, as well as many others. In short, despite all the political noise and dramatic market swings of recent times, there are plenty of good assets out there performing quite well. We are very much encouraged by this.

This glass-half-full approach is somewhat of a contrast to many peers and many important figures in business, but it is not irrational. The recent Bank of American Fund manager survey highlighted professional fund managers are extremely cautious and are expressing this through holding significantly higher cash levels than usual. The Conference Board's Measure of CEO Confidence survey hit the lowest levels since the global financial crisis (GFC) of 2007-09. In fact, previous lows have come in 1991 (post oil shock), 2002-03 (tech bubble), 2008-09 (GFC) and 2020 (COVID). While we cannot say this current point in time is the "low" for CEO confidence, we can point to the significance of such a low reading. We can also point to these dates and say with certainty (albeit in hindsight) that these were excellent times to buy equities.

We try to avoid grandiose statements calling exact points in the market. We aim to invest for the long term and generally avoid attempting to time trades to find exact market lows. What we do is look for what we perceive to be high quality assets and try to purchase them at reasonable valuations. We see plenty of such opportunities today. We would also point out that while history may not repeat itself with regards to the above survey data, if it even somewhat rhymes, we feel we should be well positioned to benefit from this.