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IMAGINATIVE FINANCIAL ADVICE

Monthly Investment Update
January 2023

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Performance Update

Global stock markets failed to have a "Santa Rally", with the FTSE 100, Euro Stoxx and S&P 500 falling 1.49%, 0.93% and 6.74% respectively. Bonds fell during the month with UK Gilts declining 4.58% and UK Inflation-linked bonds down 6.50%.

Stock markets have ended the year on the back foot after hopes of a "Santa Rally" were dashed by concerns of more supply chain disruption in Chinese factories from surging Covid cases.

2022 was unprecedented. Covid restrictions were lifted, air travel resumed, masks removed, and holidays resumed. Then Russia invaded Ukraine, gas and oil prices soared, technology giants faced turmoil, and 14 years of cheap money ended. Inflation returned after 40 years, and interest rates rose. This caused both bond and equity markets to suffer crashes. It was perhaps the most turbulent year investors have ever seen.

Fortunately, Sterling fell from $1.35 to $1.20, which cushioned investments in the US by making them 11% higher when converted back to Sterling. However, Sterling had fallen by 20% at one stage and is beginning to recover.

The outlook for global markets could begin to improve if central banks pivot towards cutting interest rates to support economies in recession. Markets currently expect both the Federal Reserve and Bank of England to begin cutting in the second half of this year amid signs that inflation has peaked.

Despite all the media doom and gloom, the unusually mild winter throughout Europe is extremely positive news as this has helped reduce the price of natural gas from 369 to 186, a near 50% fall in December. The price is now down to a level before the war in Ukraine started. A typical family's energy bill is now forecast to be £500 less than previously predicted, which in turn will reduce inflation and save the Government billions in the support it promised.

The performance of the main markets we invest in over the last month, 6 months and 1 year is shown below:

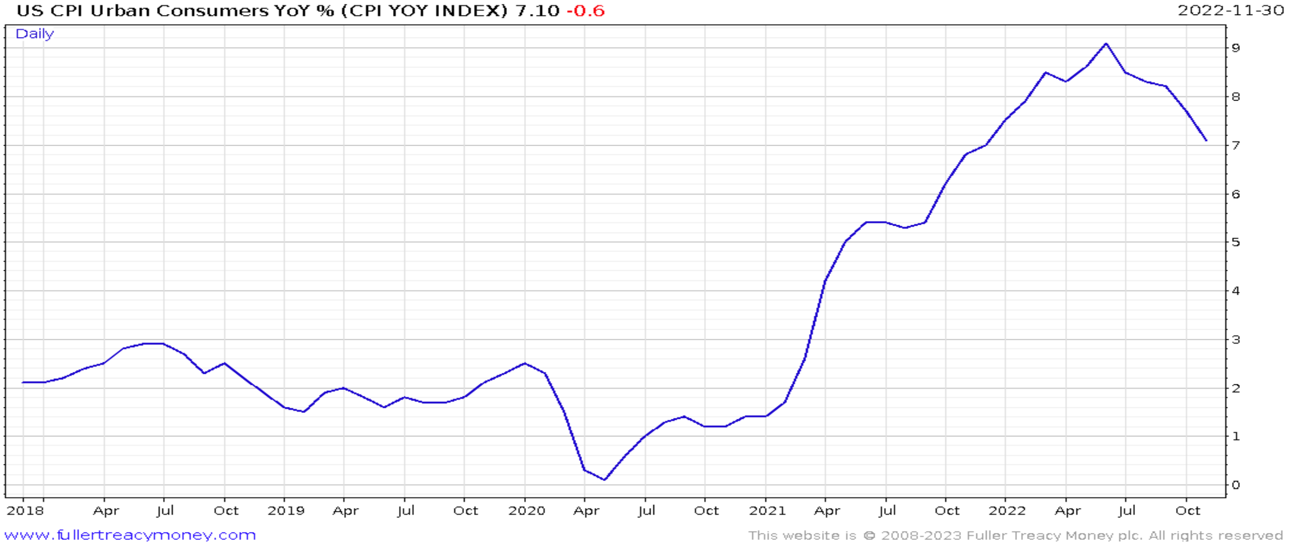
Portfolio	Performance % 1 month	Performance % 6 months	Performance % 1 year
FTSE 100	-1.49	5.73	4.70
MSCI World	-5.20	3.96	-7.83
S&P 500	-6.74	3.02	-8.25
Euro Stoxx	-0.93	11.10	-6.66
Nikkei 225	-1.59	3.54	-10.59
Emerging Market Equities	-2.39	-2.06	-10.02
UK Corporate Bonds	-1.57	-4.07	-16.09
UK Gilts	-4.58	-10.93	-23.87
Gold	2.31	0.64	11.99

*All figures are sourced from Financial Express to 31.12.2022 and converted into Sterling.

Investment Overview

We have had a profound movement upward in bond prices for the last 40 years. 2022 broke this trend as we saw bonds having one of their worst-ever years. The number of times in which bonds and equities trended downwards in tandem in a given year is frighteningly small so we don't have a lot of precedent for these kinds of moves. This is why there is still so much negative sentiment around. The biggest question for 2023 is *'how far will Central Banks raise interest rates?'*.

The answer to that question depends on how high inflation will remain (it has begun to fall globally) and how much central banks want to kill it off, even in the height of a recession. The chart below shows US inflation has started to fall. Please note that the data is lagged and we only have until the end of November but it is easy to see the trajectory.



One possibility that is being discussed is that the forthcoming recession will cause inflation to fall significantly, and central banks cut interest rates towards the end of 2023. This will almost certainly cause bonds to rebound and should see equity prices rise over the year as well (as long as the recession is not too deep).

The Santa Rally didn't happen in 2022, as concerns that the spreading of Covid in China will cause further supply chain disruption. China has abandoned its Covid-zero policy as it has realised that it is impossible to stop the spread and eventually it will rip through the country. Official Government estimates are that 3.7 million people are being infected each day, with unofficial estimates at 37 million each day. The worst economic and healthcare fallout will be in this quarter and then the infection rate should start to lower.

Asset Class Review

This section will give you an insight into our current thinking. This month we look at the major movers of 2022.

Low-Risk investments fall significantly

Globally, interest rates rose significantly in order to combat inflation. This caused yields (the level of income) on bonds to also rise, as the yield on a bond is closely linked to longer-term interest rate expectations. As bond yields rose, we saw the price of bonds fall. The chart below shows the performance in 2022 of UK Corporate Bonds, Government Bonds and Inflation-Linked Bonds. Cautious investors tend to hold more in bonds, and this caused many lower-risk portfolios to fall significantly.

FTSE 100 outperforms the FTSE 250

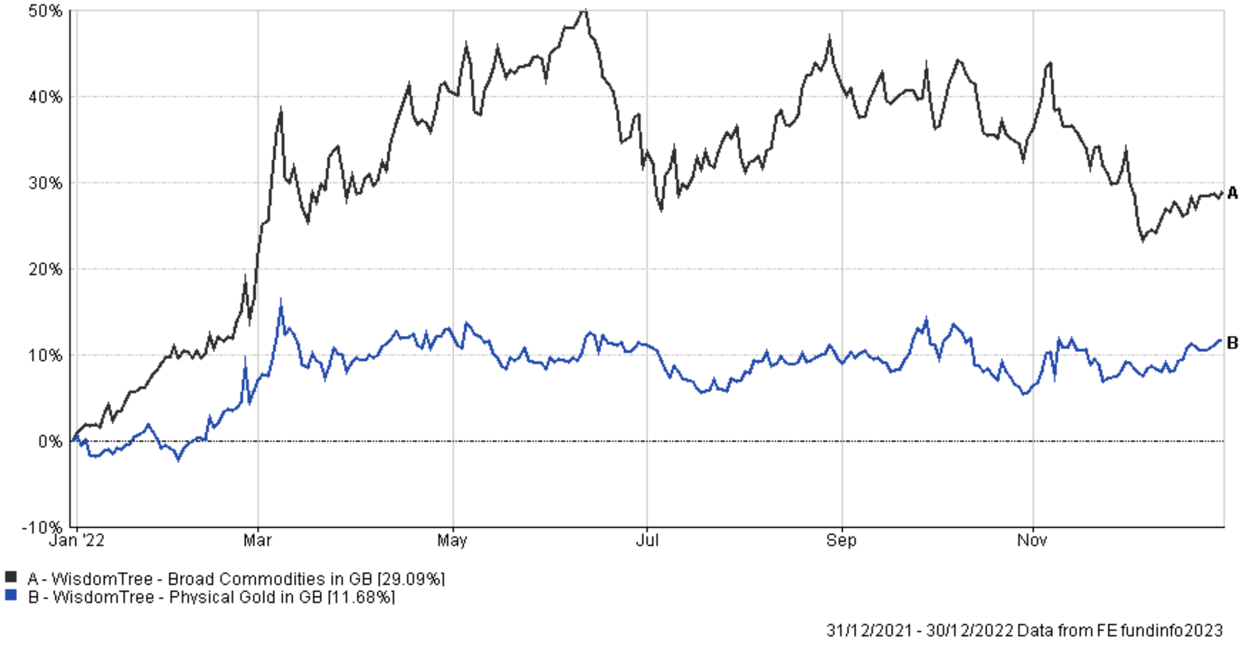
The FTSE 100 was the only major market to deliver a positive return in 2022. It benefitted from a falling pound, which boosts companies that earn money abroad as well as a strong performance from energy and defence stocks including BP, Shell, and BAE Systems which all benefited from the invasion of Ukraine. However, the FTSE 250 which tracks the performance of smaller UK companies fell significantly and in line with most other global markets.

US Bear Markets

At one stage the main US stock market (S&P 500) had fallen by more than 20% during 2022, which signals a bear market. It subsequently recovered to fall 18.1% for the year. The technology-laden Nasdaq 100 lost 32.3% over the year which does compare favourably to 2008 (down 41.57%), and 2002 (down 37.58%). Fortunately for us, Sterling also fell significantly, and this helped reduce the losses from the S&P 500 to 7.8% and the Nasdaq 100 to 23.8%.

Commodities rally but only in the first half

Putin's invasion of Ukraine was the catalyst for commodities to rise significantly and in turn, push interest rates to a higher level than expected. The broad commodity index (which includes oil, gas, copper, gold, soy beans and corn amongst others) rose 29.09% but was up 50% at one stage before falling back in the second half of 2022. Gold was also a positive performer rising 11.68% in Sterling. However, most of this gain was simply from Sterling depreciation as gold only rose 1.4% in US Dollars.



In Summary

We saw significant losses in both bond and equity markets in 2022, as we entered an unusual global economic slowdown (probably a global recession) in which interest rates were forced to rise to combat inflation. Usually, interest rates are cut during a recession which ensures that bonds rise in value, helping offset some of the equity market losses.

Lower Lows, Lower Highs

2022 was a disappointing year for investing as most markets moved lower. What will 2023 have in store for us? Will there be a change in direction, and could there be a strong rebound this year? One way to spot a change in the direction of markets is to look at the recent lows and highs of a market. If we are experiencing a sequence of lower lows and highs, then we can say that the market is consistently moving lower and vice versa. The S&P 500 is currently displaying a clear sequence of lower highs and lower lows indicating that we are very much still in a downward phase:

If the S&P 500 moves above 4100 in this rebound, then we will have a higher high and the downward phase would be broken. We have some major markets that appear to have broken out of the downward phase, most notably Europe:

Whilst we appear to have broken the downward phase, this does not mean we immediately go into an upward phase. It simply means that the consistent downward phase has been broken. The chart over the page is of the Nasdaq 100 and it shows that we have broken the consistent lower lows pattern and now appear to be in a ranging pattern in which the market moves sideways:

Why do we get lower lows and highs and vice versa?

Very simply it is all about simple demand and supply, giving the market a rhythm. When markets start to fall, we have more sellers than buyers. At some stage, the optimists step in and believe that the market will bounce back so start buying. This creates a low and then the market rallies for a bit. However, the sentiment remains negative, and the number of sellers drowns out the buyers again. This creates a lower low. Once again, the optimists step in creating another high but the pessimists use this small rally to once again sell. This creates a lower high. This circle carries on until we see the number of buyers and sellers even out and we get a ranging motion similar to what is probably happening in the Nasdaq 100. For a change to occur into a positive phase, the pessimists either have nothing left to sell or are converted to optimists and demand exceeds supply. We then see higher highs and higher lows develop.

Summary

Most of the major equity markets remain in a downward phase in which we are still experiencing lower lows and highs. Some markets are probably ranging and have broken the consistent downward pattern. However, there are some markets that look like they have changed direction such as Europe. Perhaps the best example of what could happen to equity markets in 2023 is India in which we have seen the downward phase move very quickly back into the upward phase.

Final Comment

2022 will go down as one of the most volatile periods for investment markets, especially with bonds "crashing" and nearly destroying the UK pension industry. Fortunately, Sterling also fell significantly, and this helped protect the portfolios somewhat. The fall in the price of gas by 50% in December has not been widely reported in the mainstream press and is a significant change. This should result in lower inflation, lower Government expenditure, and possibly lower future taxes which could be the catalyst to spark a recovery.

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