CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

April 2023

A blink of sunshine

While consumers struggle with food price increases, and Opec+ puts the squeeze on the West with oil production cuts, likely leading to inflationary price rises, it is useful to recall that markets have a habit of discounting events before they happen. At present, inflation predictions in the UK forecast a rate of just over 4% inflation in a year's time; the figure for inflation in the US based on forward market prices is just under 3%. This suggests that Rishi Sunak may be safe with his prediction of inflation halving over a year, but just the wrong side of the Budget prediction of 2.9% in a year's time.

A key determinant of market outcomes in both equity and bonds is whether the recent bank crises in the US and Europe have been contained. There is still a degree of unease about systemic risk in the sector and, while the rise in interest rates has destabilised sectors further afield such as real estate, (particularly in the US), positive signs are beginning to emerge. Industrial REIT (Real Estate Investment Trust), a UK property trust, has attracted a cash bid at a 40% premium to its pre bid closing price. Brokers Jeffries describe current REIT valuations to be on a "Reduced to Clear" basis. That may be optimistic, but our well capitalised banks are beginning to stir as well. What is good for that sector tends to have a multiplier effect in the economy.

Overseas, there is evidence that China is starting to build up a head of steam. For this reason, we are looking closely at Asian funds, although their relatively modest allocation in the global indices tempers allocations.

Equities tend to do quite well when interest rates can be contained at or below 5%. After the sharp sell off in growth and technology stocks in the US, we are beginning to see growth stocks start to pick up their feet again.

At this point we cannot really tell whether inflation can be brought under control or not. A positive option, particularly for general accounts, but also for tax sheltered SIPPs and ISAs, *is to invest in very short dated Index Linked Gilts*.

One suspects that the privilege of gains in Gilts being tax exempt is because the authorities did not want to permit losses that arise in a rising interest rate climate being used to offset gains elsewhere. However, we have the rare prospect of “Linkers” rising in value in a tax-exempt manner over the next year or so, which are likely to look attractive compared to cash deposits.

This is particularly true when the vast majority of total return comes from the rise in capital value that arises from the indexation effect of the link to the Retail Price Index - leaving only a nominal amount of income vulnerable to taxation. Compared to potentially high levels of income tax on cash deposits, this looks most attractive for the defensive base of a portfolio.

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