CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

July 2023

The Impact of Inflation on Interest Rates

We are now halfway through 2023 and a number of commentators are looking at the promises made by the Prime Minister in January this year. Perhaps the one drawing most attention is whether the rate of inflation will halve over the next six months. As inflation in the service sector has proved stickier than areas such as energy, bond market yields have drifted up to and beyond the levels seen at the time of the Truss mini budget. Higher mortgage interest rates have become significant, and this is flowing through to a heated rental market as well.

With inflation slightly less entrenched in the US, and additional interest rate increases expected to arrive in Europe, we are looking to maintain overseas weightings in portfolios. We saw a wide range of funds at our administrative partner's Raymond James, annual conference last week and were particularly impressed by the prospects for Japan. Stirring from their decades long bear markets, we find valuations attractive and plan to overweight this area. While the re-opening of the Chinese economy has been initially disappointing, this should benefit satellite countries and enable investment benefitting from this trend…with some overspill to Japan as well.

We have also been evaluating the impact of rising Gilt yields on quasi bonds such as Infrastructure, Renewable, and Real Estate Investment Trusts (REIT) funds. The latter, in particular, have seen price weakness and we have reviewed loan maturities, gearing, and occupancy levels to try and establish vulnerability as well as in dividend security. Dividend yields look steady, with surplus cover, and this income is contributing well to gross funds where no tax is paid.

Against a backdrop of higher interest rates, Sterling as a currency looks fairly robust. Less than a year ago, it stood at \$1.07 to the £ and now the US\$ has drifted to \$1.28 to the £. This relative strength because of the UK's perceived weakness regarding inflation is in practice helping restrict input costs from abroad. With expectations low, any help with inflation reduction would be very welcome in bond and equity markets.

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