CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

October 2023

Is that a Train in the Tunnel?

Or is it actually light at the other end of what has been a difficult period in world markets? We have taken the view that markets anticipate events, and as often happens, there have been some false starts. Now, however, there is a chance that events could move quite quickly, as a decline in inflation could start to ease the pressure on interest rates.

Could the UK, in particular, enjoy a reappraisal of its prospects? Lagging the developed world on a number of key metrics, it at least starts from a position of being more lowly rated in equity markets than its peers. Predictions have focused on a drift into recession, but recent revisions to forecasts suggest that the UK has been trading more positively than recently thought. On the consumer front, real wages have turned positive from the second quarter of this year. Not surprisingly, consumer confidence is on the rise, and at a considerable rate, and there still remains a cushion of savings from the period of Covid restrictions.

We expect that markets are going to be pleasantly surprised by a drop in UK inflation to 4% by the end of the year; there is even an outside chance the final figure could have a 3 at the front according to one particular forecaster. The concentration of power in the hands of the major supermarket groups has seen high food price inflation but, as commodity prices ease the scope to benefit from that trend has diminished. Similarly, despite the cartel influence of Russia and Saudi Arabia in restricting energy supply, restrictive economic policies in the West are curbing demand.

While it looks highly likely that Labour will win the next general election, their strategists have been pulled into the middle ground to the extent that they have accepted the cancellation of the HS2 extension. The benefit of having a pragmatic and financially sophisticated Prime Minister in Rishi Sunak for another year is that he can make tough decisions that benefit the country in the long term. Labour would have found it very difficult to resist public sector wage claims to the extent he has and, whilst still difficult, settlements can be agreed against a lower inflationary background.

We started by mentioning lower equity valuations in the UK and the extent of these is considerable. Total distribution yields in the Banking sector are set to increase for several years as they benefit from higher profit margins in a higher interest rate environment; additionally, they are buying back their own shares at a fast rate and this enhances the returns for a smaller shareholder base. Immediate yields are attractive at over 6% and are going to improve further.

Elsewhere, many capital intensive industries are set to benefit in a higher interest rate world. The list here is large as this builds a defensive moat around existing market leaders with hotel and pub operators, for example, gaining market share as competition reduces. Airlines and retailers are all benefiting as are specialist engineers, as competition withdraws.

With our additional research base we will look to enhance returns in promising areas not just in the UK but also abroad. We have overweighted exposure to Japan where prospects look promising and are, on the other hand, reconsidering weightings in Europe and the United States where arguably politics and (in the US) market valuations are still influenced by a low interest rate environment. Anomalies can persist but why should US oil companies have a rating 50% higher than our own oil majors?

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William Forsyth, Executive Chairman & CIO

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