MONTHLY UPDATE

Latest views from the investment team

Time for gilts to shine?

Where recessions occur, they generally start on average around 2½ years after the first central bank rate hike which places the start of a potential recession somewhere in the first half of next year. Of course, not all recessions are created equal, and certain asset classes can manage recessions fairly well. Whilst we are not necessarily forecasting a recession (specifically in the US) – there is an asset class attracting attention – gilts.

As multi-asset investors, different areas of our portfolios should fire at different times – helping smooth returns over the longer term. An attractive area of the market, at present, is (in our view) government bonds and highly rated corporates, that are offering attractive yields of between 5-7%.

We see exceptional value and opportunity in UK Government bonds, known as Gilts. After a decade yielding next to nothing, while interest rates were held close to zero, gilts are now an eminently sensible investment – with yields near 5% across maturities (short to longer dated). Considering the credit risk of gilt investing is low (unless the UK were to default), we believe this is highly attractive, especially in the current climate. As we have mentioned, the path for equity markets is somewhat unclear over the coming months, and so it is difficult to pass by an opportunity to essentially lock-in a return at this level. As a result, we have increased our allocation to gilts in our portfolios, seeing value at all durations. In addition, the opportunity to buy some short-dated gilts at a discount provides an interesting opportunity and tax efficiency as capital gains on gilts are exempt from capital gains tax, increasing the attractiveness of their return.

Whilst we see particular value in the government bond space, we also see opportunities in fixed income more broadly. Investment grade corporate bonds can offer yields of around 7% at a level of risk which should be considerably lower than equity markets. We have chosen to allocate with a more conservative duration in this space, conscious of the potential risks of increasing credit spreads in the event of a recession. At a shorter duration, any potential capital losses are somewhat mitigated while the yields remain at these levels. Moreover, there are opportunities in inflation linked bonds, in the event that inflation remains stickier than the market is expecting the potential returns of these bonds could be attractive. We also maintain allocations in tactical bond funds which have the scope to allocate to bonds across durations, qualities, and geographies. This may include some allocation to high yield bonds which pay attractive yields with an elevated risk.

Bottom Line

As we arrive at what is likely to be the peak of this aggressive rate hiking cycle, how long rates stay elevated will be the next question for investors. Central banks will wish to quell any inflationary embers that may remain. We are cautiously positioned in portfolios, seeing a recession probability as finely balanced – favouring bonds over equities. Within equities, we favour defensive sectors of quality and lower volatility stocks.

Month by numbers

Change in various markets over the month:

Asset		Change	Value
Equities			
UK	↓	-2.53%	
Europe	↓	-2.43%	
US	↓	-1.74%	
Emerging Markets	↓	-4.68%	
Japan	↓	-0.02%	
Bonds / Rates (* Absolute change (%))			
UK Base Rates	↑	0.25%	5.25
Fed Funds Rate	–	0.00%	5.5
UK 10-Year Yield	↓	-0.04%	4.36
US 10-Year Yield	↑	0.06%	4.1
Currencies			
GBP / USD	↓	-0.70%	$1.27
GBP / EUR	↑	0.44%	$1.17
DXY (USD Index)	↑	1.29%	103.62
Commodities			
Gold	↓	-0.22%	$1,940.11
Oil (Brent)	↑	2.30%	$86.86
Noteworthy			
abrdn	↓	-28.81%	

Q&A

What's on your mind?

What's behind the resurgence of M&S?

Iconic retailer Marks & Spencer is once again a member of the index of the 100 most valuable British public companies, marking a comeback after a four-year absence. The resurgence of M&S has been notable, with its share price rising 82% since the beginning of this year. Much of this success can be attributed to strategic initiatives implemented by CEO Stuart Machin, who assumed the role in May 2022. Under the new leadership, M&S has made a concerted effort to enhance the perception of its products' 'value-for-money' among consumers. This commitment has paid off, evidenced by robust sales growth in both its food and clothing departments this year, despite the prevailing trend of many shoppers turning to traditionally 'cheaper' retailers as the cost-of-living soars. Additionally, M&S has worked on enhancing its online presence, boosted by a strategic partnership with Ocado.

More than vowels being lost at abrdn?

abrdn is fast losing investor confidence as the business continues to struggle with its identity. The company, which was previously known as Standard Life Aberdeen, has seen its share price decline since the merger of Standard Life and Aberdeen Asset Management in 2017. Over the past five years, abrdn's share price has gone down by 54%. After seeing the share price tumble 29% in August, abrdn finds itself knocked out of the index of the top 100 most valuable British public companies. Such an event can cause further downward pressure on the shares, there are two main reasons for this. Firstly, large index tracker funds are no longer required to hold the company and are, in essence, forced sellers – as they need to align to the index constituents – in this case selling abrdn and buying the promoted firms instead. Secondly, there's a negative connotation with getting demoted.

What to expect as the US Presidential Primaries get underway?

The race got underway in the marathon US presidential election with the first Republican primary debate held towards the end of August, more than fourteen months from polling day. Despite this, the nominees for both the major parties are almost certain with Joe Biden and Donald Trump the favourites to lead their respective parties into the election. Investors should look out for instability in key sectors such as energy and healthcare as both will likely be regulated very differently under either administration. Historically, volatility in the stock market is elevated in the months leading up to a close-run election, as the market hates the inherent uncertainty that elections bring. Markets often prefer a scenario where neither party has sufficient control to make sweeping changes an outcome which looks likely given the increased political polarisation in the US.

For more information, please contact your adviser.