Investment Committee Report

May 2023

Introduction

In this review I have decided to include a section that looks how returns can vary over different time frames and how positive and negative periods can cluster together. However, before looking at this in detail I wanted to provide you with a closer look at the importance of market "breadth" as well as focusing on what is happening with UK interest rates.

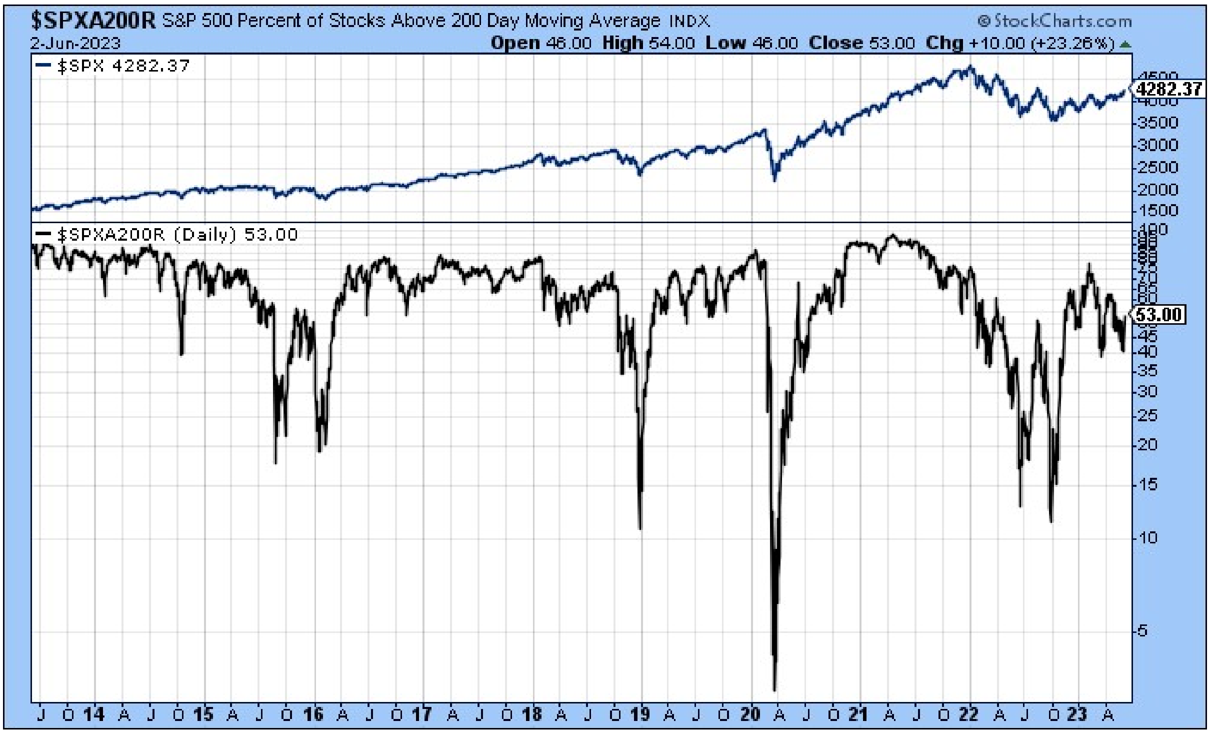
Key Factors to Watch

Market Breadth

In my view, market breadth is a way to check on the health of the underlying trend for the stock market. There are several ways to analyse this and see how strong the current trend is and whether it is likely to prevail or is it at risk?

For a strong uptrend to be healthy we would want to see positive signals for a wide range of shares and sectors; if all of these are rising then the trend is healthy. I have picked the US Stock Market to demonstrate this analysis as we are currently seeing the exact opposite!

Whilst the index is moving upwards only 53% out of the 500 shares in the S&P 500 index are above their 200 day moving average.



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The advance-decline for the NYSE (New York Stock Exchange) shows us the number of stocks advancing in price and the number declining; here we see a clear divergence between the top chart with the S&P500 rising and the NYSE Advance-Decline below falling.

This gives us a clue that not all is well, but why is the US stock market going up? To establish this, we need to look at little closer at the sectors and stocks that make up the index.

Sector performance demonstrates that market breadth has been "narrow" with the rise in the S&P 500 driven by the Communications and Consumer Discretionary Sectors. The Nasdaq 100 technology index is the stand out performer and some of the best performing shares in the S&P 500 are also in this index.

Sector	1D % Chg	1W % Chg	1M % Chg	3M% Chg	6M % Chg
S&P 500	-0.5%	1.6%	2.2%	3.3%	-1.1%
Russell 2000	-0.8%	-1.0%	1.2%	-9.1%	-10.1%
Nasdaq 100	3.7%	0.5%	10.7%	15.6%	18.7%
S&P 500 Comms	-0.5%	1.6%	7.6%	18.5%	17.0%
S&P 500 Cons Disc	0.3%	2.5%	5.4%	3.5%	1.5%
S&P 500 Cons Staples	-1.5%	-2.0%	-5.1%	-1.8%	-9.7%
S&P 500 Energy	-1.4%	-2.6%	-7.7%	-8.7%	-17.5%
S&P 500 Financials	-0.5%	-0.5%	-2.1%	-12.4%	-15.1%
S&P 500 Healthcare	-1.1%	-2.4%	-4.0%	-2.9%	-12.6%
S&P 500 Industrials	-0.7%	-0.3%	-0.8%	-5.1%	-7.4%
S&P 500 Materials	-1.1%	-1.6%	-4.9%	-9.7%	-12.0%
S&P 500 Utilities	-0.9%	-2.4%	-6.1%	-3.6%	-13.7%

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Looking closely at those shares in the S&P 500 and the Nasdaq 100 we can see that the largest six shares in the S&P 500 by market capitalisation (total worth) are also the top six in the Nasdaq 100.

In fact, these six shares make up a whopping 27% of the S&P 500 index and have been the main drivers of its performance in 2023. This does become dangerous though as all trade on high price earnings (PE) ratios that mean they can be considered expensive – the percentile rank shows that by this metric they are in the top 20% of the most expensive with Amazon and Nvidia in the top 1%.

Name		**Market Cap**	**% Of Total Market Cap**	**P/E**	**PE Percentile Rank**
Apple Inc	$	2,846,108,480,000	7.2%	30.58	84.40%
Microsoft Corp	$	2,493,862,560,000	6.3%	35.57	88.40%
Alphabet Cl C	$	1,590,045,280,000	4.0%	27.7	80.60%
Alphabet Cl A	$	1,582,935,040,000	4.0%	27.55	79.80%
Amazon.com Inc	$	1,274,848,960,000	3.2%	149.72	99.00%
Nvidia Corp	$	971,376,896,000	2.5%	181.6	99.40%
Total	**$**	**10,759,177,216,000**	**27.2%**		

Putting all this together means that the US Stock Market's current bull market is being driven by a small number of shares and narrow market breadth – with other shares declining it is only a few leading shares keeping the index moving forward. The risk is that these shares are becoming increasingly expensive and if sentiment towards them starts to change then the risk for the broader stock market is huge.

UK Interest Rates

Over the last weekend we have seen a significant number of mortgage lenders pulling long term fixed rate mortgage deals as uncertainty over long term interest rates increases.

It was only just over a year ago that you could obtain a 10-year fixed rate mortgage at under 2%; today, the lowest rates for any type of mortgage is circa 5.5%. The table below puts this into context and what it means for borrowers with a 25-year repayment mortgage – a 45% increase in their monthly payments.

	2% Interest	**5% Interest**	**Difference**	**% Increase**
£100,000	£423	£614	+£162	
£200,000	£847	£1,228	+£322	45%
£300,000	£1,271	£1,842	+£483	

This is important not only for new borrowers but also those with mortgages already; the Sunday Time (4th June 2023) reported that 116,000 households are coming to the end of current fixed rate deals at the end of June and face a huge potential rise in costs.

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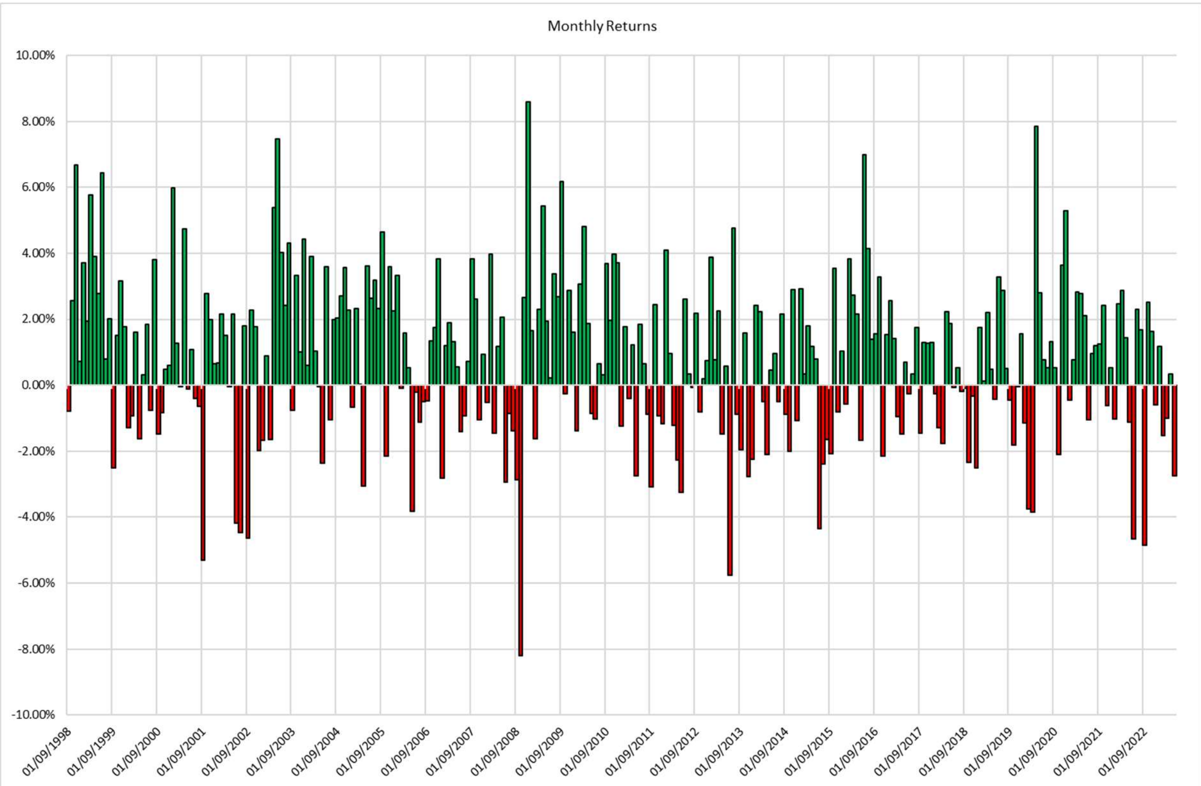
The reason for this uncertainty is that UK inflation, whilst slowing, remains stubbornly high in comparison to other nations. The drivers of this are food inflation at over 19% and a strong jobs market with unemployment still under 4% that puts upward pressure on wages.

Whilst inflation continues to remain high the Bank of England will need to look strong on fighting rising prices and the only way to do this is to raise interest rates.

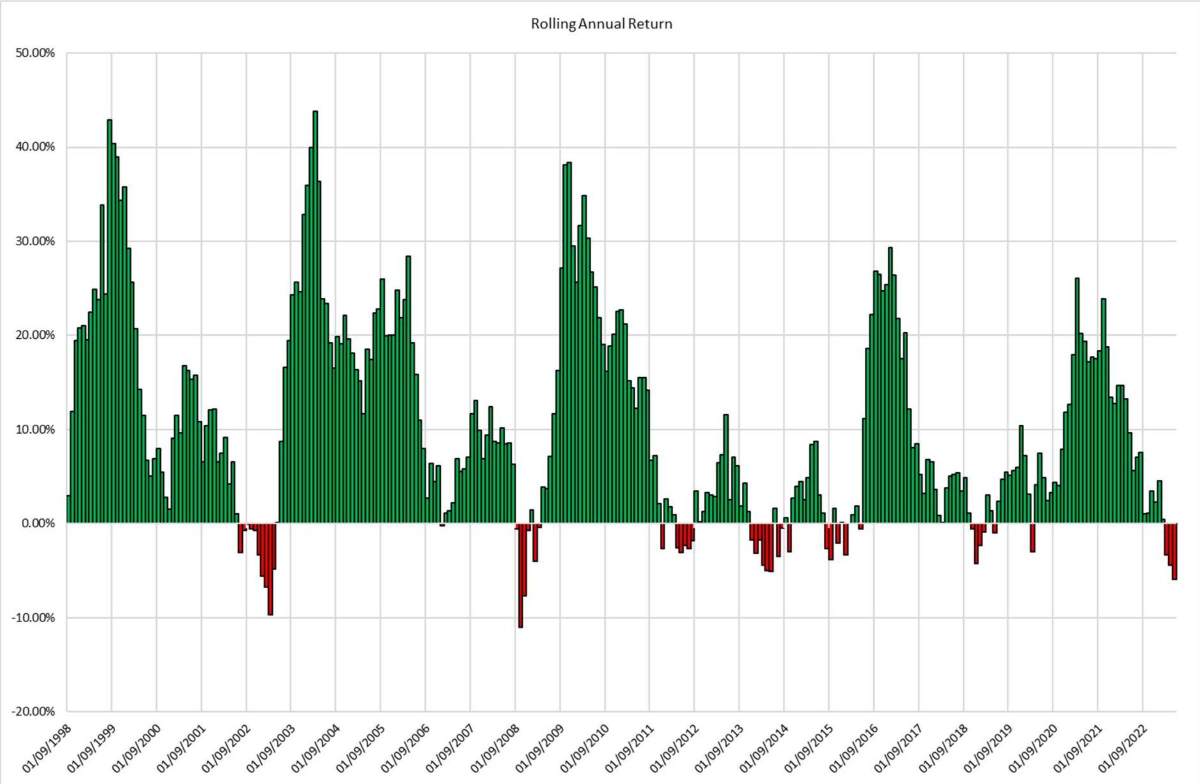
Investment Strategy

Whilst our strategy remains unchanged it is important to understand the expected shape of returns, particularly in difficult periods such as those that we currently face.

Looking at one of our model portfolios we can see that monthly returns are variable with a range of +8.59% to -8.20%, the average return is 0.82% and historically 64% of months have been positive and 36% negative.



If we then look at rolling annual returns over the page (each bar represents total performance over the preceding twelve months) we can see that returns are within a wider range +43.78% and -11.04% with an average of 10.5%. Historically returns are positive in 86% of twelve-month periods and negative 14% of the time – looking at a longer-term picture is important as it removes a lot of the "noise" of month-to-month performance.



Interestingly for both charts we see that positive and negative periods cluster together – its more obvious in the rolling annual return chart.

The main points here are that we cannot expect to positive in all periods and that positive and negative periods can persist for a prolonged period.

It is also important to note that where you start has a huge impact on the returns to date and that the longer you remain "in the game" the greater the chances are of achieving the average return.