Direct Equity Portfolio Valuation Commentary

October 2023

Executive Summary

Whilst rates remain high, expectations for the peak are now lower and we may be nearing that zenith now.

Economies remain robust, but there are signs that this will change. Our long-term view of investments has never been more important as geo-political uncertainty and market noise make investors nervous.

However, all is not doom and gloom and we look forward to opportunities to add high quality positions to portfolios.

Reading back over last quarter's note and, to be frank, the note before that as well, we are struck by how little has actually changed with regards to the key drivers of market sentiment. It is perhaps the downside of writing to you every three months, when one has a long-term view on portfolio constituents, that we are always seeking out a note of change. Change rarely comes that quickly.

That is not to say that markets have been uneventful, of course. However, the key factors of inflation, interest rates, and geopolitical worries remain. On the latter point, the recent events in Israel evidence just how difficult this point has become for investors to judge and interpret. Our general market commentary reflects on the possible consequences for markets, so will we not repeat this analysis here.

Returning to purely monetary developments, Central Banks have continued to cautiously tread a difficult path in terms of interest rate rises and the messaging that accompanies those rises (the messaging often being more important than the move itself). In turn, investors have had to adjust their views on where that rate path will lead. In that respect, we are in a 'better' position than when we last wrote to you, given that expectations for 'peak' rates are lower now than for some months. The flipside is that investors, especially in US markets, have been waking to the fact that rates are likely to remain higher for longer than they had previously expected. That has required an adjustment to the valuation of many assets. This was led by a fall in bond prices, then a firming of the US Dollar, and ended up with an unwinding of some of the rather exuberant equity valuations we discussed last quarter.

The phenomenon of 'higher for longer' has been something we have been urging caution about and discussing internally for some months now. In July's note, we discussed how higher rates must ultimately have an impact on world economies and corporate profits, such that an adjustment to overly positive forecasts would need to be made. We have certainly seen some retrenchment over recent months, but we feel there is likely more to come.

Economies, however, do remain relatively robust for now. The hoped for 'soft landing' in the US remains a definite possibility, although we continue to feel the prospects of that are slim. To repeat our July comments, for global equities to progress meaningfully, it would require both a positive surprise for earnings per share and a decline in the discount rate. Neither look immediately likely as we write. In fact, we are starting to see a number of profit warnings and downgrades in the more cyclical sectors of the market.

However, we again can't stress enough that trying to judge short term news against a portfolio that we hope is structured for quality, long term, structural growth is folly. Valuations will fluctuate, sometimes quite wildly, but if the underlying thesis for buying a stock remains, one must ignore the short-term noise. As we have sadly had occasion to state far too often in the past couple of years, 'price is not value'. Price is merely an amalgamation of all the news, emotions and, often irrational, buyers and sellers on any one day. What one must absolutely be alert to is if the original reasons a position was established have changed, then one must act. If not, just leave well alone.

Regular readers will know our love of a Warren Buffet quote. Less often do we quote his right-hand man, Charlie Munger. However, Charlie sums up our approach rather eloquently with his comment that 'the first rule of compounding is to never interrupt it unnecessarily'.

Clearly, much easier said than done, but we try.

On a more positive note, in amongst all this 'noise' there are pockets of value emerging. We have seen the valuations of several of our high quality 'compounders' devalued by investors over recent weeks. As a result, we are starting to get quite excited at the prospective returns on offer from some names. We will continue to monitor, of course, but certainly cautious additions to some portfolio positions, in order to take advantage of these moves, are likely.

It has also been interesting to note the increased activity from certain investors with 'private capital'. For example, some of the large private equity houses have continued to raise huge amounts of capital for their latest funds and are starting to prowl listed markets looking for acquisitions. We have seen a number of approaches across markets. This tells us that, whilst the immediate news may remain poor as those interest rates bite deeper, rates are likely towards their peak and, in some sectors at least, these buyers are spotting emerging value. All is not doom and gloom, despite our propensity to view a glass as only ever half full.

David Wilcox, Investment Director
David has worked at City Asset Management for over 15 years, where he is Investment Director. His role is to manage clients' portfolios, provide input into investment processes and work with the financial planning team. He also runs the AIM portfolio service and provides input on real estate investments. David has always enjoyed helping our clients secure their financial futures and gets a strong sense of satisfaction in letting clients know they can achieve their goals. Outside of the office, David enjoys hill walking, cycling and martial arts.

Matthew Groom, Investment Director
Matt looks after the day-to-day management of our investment portfolios for private clients, their trusts, pensions and charities. He enjoys trying to understand how economies and corporates operate and using this knowledge to build portfolios that provide the outcomes our clients need. Matt is a Chartered Wealth Manager and has over 30 years' experience in portfolio management, including as Head of Private Clients (London & South East) for Sanlam Private Investments. In his spare time, Matt likes cooking (and eating), fishing and tending the veg patch.

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