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investing ON THE go

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[INTRODUCTION]

Staci West (SW): Welcome back to the 'Investing on the go' podcast brought to you by FundCalibre. Darius and Juliet are here once again to offer their opinions on the second quarter of 2023, tackling the big themes of recent months - artificial intelligence and inflation - before giving their views on the best and worst performing asset classes so far in 2023.

Sam Slator (SS): I'm Sam Slator from FundCalibre, and today I've been joined by Juliet Schooling Latter and Darius McDermott. Good morning.

Darius McDermott (DM): Morning.

Juliet Schooling Latter (JSL): Morning.

[INTERVIEW]

SS: So, we are looking back at the second quarter of the year, the first half of the year, if you like. Let's perhaps start with Artificial Intelligence. It's been making the headlines with ChatGPT etc. The hype has increased exponentially over the last couple of months. So, is it a fad? Is it here to stay? Should we worry about it? Or is it something you think we should be embracing?

JSL: Well, I'm not sure either Darius or I could be considered experts on AI. Our colleague James is a bit more of a techie, so he probably has a better understanding, but I think it's here to stay. And over a long time it's undoubtedly going to disrupt. So, probably better to embrace it rather than fear it. We recently met with Chris Ford, Manager of Sanlam AI [Global Artificial Intelligence fund] and if anyone can convince you to embrace it, he's the man. He was talking us through the exciting opportunities that AI is throwing up to businesses that do choose to embrace it. And in fact they use AI in the management of the fund, which is quite interesting.

DM: Yeah, I mean you're absolutely right. I'm definitely not an expert on it. What I can say is, we've seen other industrial revolutions, if you like, happen in the past couple of hundred years, and they have generally been beneficial; they have given increased output and GDP growth. I think like a lot of these things, I don't think it's as new as people think it is. I think machine learning or ability for a machine to improve on its output has long actually been part of our lives, but it's just getting cleverer, quicker and smarter and I think it will have an impact going forward.

What I'm not yet sure of is exactly which companies or which type of funds will be the winners. Now, there has already been an explosion on the winners in the S&P 500 that are deemed to be the sort of AI stocks, and some of them are up 100%-200% this year. So, if you've managed to buy or own any of those, very well done, NVIDIA [Corporation] being the standout. But it will definitely cause disruption and it will definitely, to my mind, have benefits to economic growth. But it's far too early to say who the winners and losers will be. I think if you are a big business and you are not thinking about AI, you probably ought to be. But yeah,

it's very early post the recent release of the latest phase of AI. It's very clever, but it still doesn't actually own an opinion. It can do all sorts of very, very clever things, particularly with regard [to] writing and stuff like that. You can ask it to write a song in the style of Oasis or the Beatles and it will have a damn good go, but how we monetise that yet going forward is yet to be seen.

SS: And the other story that's still making headlines is inflation, it just won't seem to go away. Interest rates went up again last month - my mortgage payments keep increasing. What's your view on this and how it's all going to play out? You know, we've got one-year savings accounts are hitting about 5% now. Is it worth investing in anything else at the moment? Or is cash actually a really good asset class?

DM: Well, cash is always a good asset class when you get a decent return, and you can compound it. Anything that gives you 5% [or] north of 5% is a good starting place for long-term compounded savings.

I think it is quite tricky out there at the moment. But you can now get sort of 7%-8% on corporate bond funds, which, you know, you're getting that sort of 2% or 3% premium on top of a cash-type of rate. I'm not saying I think that you'll make a straight line positive return of 8%, but, because of course as we know, bonds are linked to future rate expectations and if rates are going to continue to go up as they now look, then you know, corporate bonds won't give you a positive capital return, but at least you're getting paid 6%, 7%, 8% in income to wait for those type of returns. So, I think corporate bonds broadly are interesting and maybe even shorter duration bond funds. Those are funds that invest in shorter or sooner-to-mature corporate bonds. They have less interest rate sensitivity and actually, the risk / reward in that area seems to be about sort of, you know, fairly reasonable because you're not taking that duration or rate sensitivity that we still might get with future rate rises.

[I'm] not a massive fan of equities on valuation basis if economies slow down. That said, I've never been any good at timing markets, I think timing markets themselves is near on impossible. I have made no changes to my personal portfolio, other than what we do on the VT Chelsea Managed funds on which we advise to, because that's what I own. So, we've been buying some very boring corporate bonds on a risk-adjusted basis.

JSL: Yeah. I don't like to say this, but I agree with Darius. So, corporate bonds are looking attractive at the moment. And don't forget, the thing that you need to remember is whilst 5% looks like a really good rate, you know, given rates in recent years, that actually if inflation is running at 8%, which it is in the UK, you're still losing 3% in real terms. So, you know, you have to bear that in mind. And, you know, inflation looks to be coming down in the US where it's sort of 4% versus 6% in Europe, and as I say, 8% in the UK.

What's interesting is that services are booming, so, although manufacturing isn't, which means people are spending on experiences not goods, and this is keeping employment high, which is making things all rather difficult to forecast. Central banks obviously have been hiking interest rates aggressively, but inflation tends to lag these rate rises. So, I think it's possible that inflation could fall back sharply, but I wouldn't want to hang my hat on when exactly that will be.

DM: Yeah, I mean it's definitely been more durable. I think almost everybody's got inflation wrong. It was deemed transitory by all the central banks 18 months ago and, had they raised rates sooner and more aggressively, we might have seen a more quick falling of inflation, but it has been sticky. It was very high in Germany again this month, so it's certainly not just a UK phenomenon. Inflation is high in lots of parts of what would've previously been Eastern Europe, certainly in the double digits, you know, so 13%, 14%, 15%. So, [it's] certainly not just a UK phenomenon and core inflation has been very annoyingly sticky and high.

And so that's why I think rates may… well, they're definitely going higher and may well, … I don't think we're going back to 0.5% interest rates anytime soon.

JSL: Well, I think it's also fair to say, isn't it Darius, that managers are quite divided. It's quite difficult, I think to forecast at the moment, you know, when inflation will come down and I think they're pretty divided on a) when inflation will come down and b) whether we're going into recession.

DM: You are absolutely right. I mean, if one was to look at the strategic bond sector, any fund that's at the bottom over 1 and 3 years has been wrong on inflation. They thought inflation was coming down sooner and they are positioned for inflation to continue to come down quicker than the market expects. So, you know, that sensitivity to interest rates and inflation is a huge part of what a fixed income fund manager has to do.

SS: And, speaking of fund managers, we've had a few retirements announced in the last few months as well. One that stands out, Richard Buxton, who's manager of the Jupiter UK Alpha fund. We've also got the proposed merger of Liontrust with GAM Asset Management. What should investors do in these circumstances; do you stick with funds? What kind of things should they be considering?

JSL: Well, in these circumstances from our point of view, what we tend to do is to just sort of move a fund to a 'hold' until we've seen the new manager and had a chance to grill them on their process and changes that they'll be making so that we can assess whether we stick with them or not. But if investors are concerned, you know, there are other good UK and European funds out there that they can find on the FundCalibre website.

DM: Yeah, look, there's no right or wrong. This is [an] art not science. It's not like, you know, managers retire should you stay, should you go? Companies get bought … for us it's who's managing the fund? Was the manager somebody that we knew, respected and thought were good investors? [This] tends to be the main factor and the likes of Richard Buxton has worked with the two guys on his fund for, well, probably for the best part of 20 years, let alone 10 years. So, I think the likes of them, that they will be very well placed to run money in a similar style. But as I say, there's no right or wrong answer.

SS: And then looking back sort of at the best performing sectors of the first half of this year, we've got technology, Latin America, Japan, and Europe. Can you perhaps talk us through them one by one?

DM: Yeah, you go Jules.

JSL: <Laugh>, sorry. Technology's been the outstanding winner, which is up almost 25%. And I think that's largely been driven - as you were talking about - you know, the excitement around AI that's driven that sector up.

I think the other sectors [are] probably a case of bouncing back, having sold off on fears of global recession, which hasn't sort of materialised yet. Would you say that's fair Darius?

DM: Yeah, I would. The thing about technology as well though, people forget, it was massively sold [off] last year. Some tech stocks were down 50%. So, they've just brought their valuations back into sort of a reasonable sphere. The big or, as they're called I think, it's the Super seven stocks* that have driven not just technology, but pretty much the whole US stock market. Some of them are deemed those AI winners, so you're absolutely right on that, but some of these big tech companies, you know, when I started my career, they were high growth, and they didn't really make any money. Now, the likes of Microsoft and Apple, just to pick on two, they make millions of pounds every day in the products and services that they sell and provide. So they're actually hugely cash generative, stable companies, but yet we've seen them halve and double <laugh>. So, the share price can still be quite volatile.

*(*NVIDIA, Meta [Platforms, Inc.], Tesla [Inc.], Apple [Inc.], Alphabet [Inc.], Microsoft [Corporation] and Amazon [.com, Inc.])*

Europe, I think, has had a good run off the bottom. Japan has also done very well; Japan particularly, I think looked quite cheap and to steal one of our Elite Rated manager's words - which is Carl Vine at M&G - so,

Japan had some fairly easy self-help. So, it just had things within its power, and by this I sort of mean companies that are just working better for shareholders as opposed to, [in the] historic Japanese way of, you know, companies being for the workers, as opposed to the shareholders. But anything that's up 20% or so this year in the first half of the year, not that that would make me wary, but I'd be surprised if they could do similar returns for the rest of the year.

SS: And the worst performers were China, commodities, the UK and US government bonds. So, when I say UK, UK bonds too. What's happened there?

DM: Bonds, again, quite simply, if interest rates go up more than the market expects, bonds go down. It's a fairly simple relationship and, as we've already discussed, inflation just won't go away. And now the UK interest rate is expected to be at 6.2%, whereas a quarter ago we thought it was … well, the market was saying 4.6%, so that in one quarter is a huge difference, 4.6% to 6.2%, [and] that's why bonds are doing badly. And if you believe inflation is going to stay higher for longer, and that further rate rises above 6% are required, then it's probably still potentially too early to be a buyer of bonds.

The UK stock market actually did very well last year. It was one of the few, because it's quite an idiosyncratic stock market, full of oil companies and banks and some healthcare and commodities, and those were a couple of the sectors that did very well last year. So, the UK's actually underperformed this year having done very well last year. Whereas the US - which we've touched on - mostly driven by tech stocks, has done very well this year. Whereas last year the S&P was down about 20% and the NASDAQ was down over 30% last year. So, again, as I say, timing is extraordinarily difficult and hence, I do think, you know, swinging the bat with respect to asset allocations is never a good idea. You can edge into a theme or edge out of a theme based on valuations or your outlook for a sector, but a lot better people than me have tried to time markets and not done so well, so, being invested for the long term and expecting bumps on the way is generally the natural course of things.

JSL: Yeah, and on China, you know, there's been a lot of nervousness about investing in China. You know, concerns about its investability, with geopolitical concerns and Chinese policy risks, and the anti-China rhetoric in the US continues to grow. I met with a manager recently, who spoke about how sentiment sort of becomes more negative the further West he went. And he was talking about how the Chinese are out spending, and restaurants are full - you know, since lockdown restrictions were lifted - but the confidence still hasn't sort of quite bounced back and property hasn't bounced back - and property transactions were down 40% last year.

SS: And just to end sort of crystal ball gazing, any thoughts on what the rest of this year could hold?

JSL: Yeah, that's <laugh> that question. I hate this question. I think I sound like a bit of a stuck record because I keep saying, you know, the outlook isn't very clear, inflation, recession, etc. so, stay diversified and buy on dips … But I would say, as we've mentioned earlier, that bond funds look attractive here. I'm even about to buy some in my pension, which must mean that hopefully they're attractive. And we are seeing value in oversold alternative investment trusts, some of which are trading at large discounts. But I think, as always with investing, you know, you might have to be patient. UK mid- and small caps continue to look cheap on a long-term basis, but you know, if we go into recession, they could get cheaper.

DM: Yeah. And it's this recession that hasn't quite happened. To my mind, 2022, last year, certainly in the UK felt like a recession. I think technically we avoided it by 0.01%'s worth of growth in the fourth quarter. But last year felt hugely [like] a recessionary environment and with the squeeze on people who own property who are coming off fixed-rate mortgages, I still think we could see a slowdown, not just in the UK, but potentially across the developed markets. So, I think Jules's point of buying the dips, having a bit of cash to fund those dips, I think is fairly sensible.

And, as I've said a couple of times already, actually timing the markets itself is just notoriously difficult. So, maybe a lot of these things depends on your attitude to risk and when you may need to crystallise either your ISA or your pension pot, if that is a while away, I suggest probably the best thing to do is to do nothing in the short term and, as Juliet suggested, to buy the dips as markets potentially do come off, having had a very strong start to the year.

SS: Well, thank you very much. That was very interesting. And if you'd like to find out more of our views, please go to FundCalibre.com.