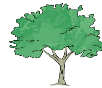
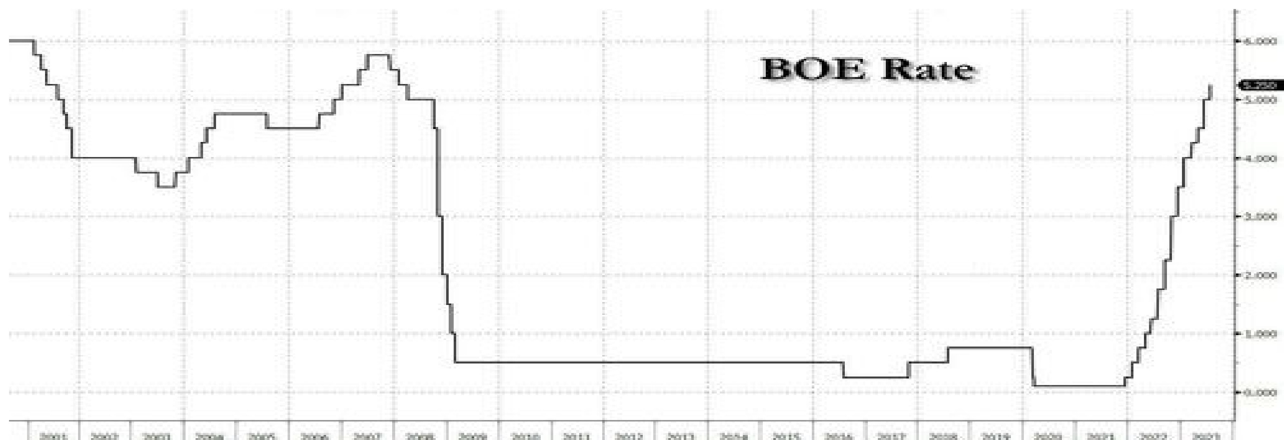


TIM
UNDERWOOD

Monthly Report – July 2023

Once again all eyes are on the central banks. In the last week of July the US central bank raised rates again by 0.25% to the range 5.25 to 5.50 % the highest level in 22 years. The ECB followed raising their rates to 4.25% and the Bank of England meeting on 3 August raised rates to 5.25% the highest since April 2008. With about one third of homes in the UK on floating or short term fixed mortgages many are going to see huge monthly increases. This chart is going to cause pain.



All these rate rises have the objective of reducing inflation which rose in the aftermath of government's CV19 policies. But as mentioned last month and in earlier newsletters the bond market is pricing longer duration bonds to yields lower than the central bank's over night rate. The market does not see rates staying at these current levels for long. What would cause a change of mind by the central banks? Simple: lower inflation. But with their rapid rate hikes, all done in just 18 months, they may well cause a recession.

While these rate hikes continue certain parts of the US stock market are bubbling. The latest craze is companies linked to Artificial Intelligence (AI) such as Nvidia Corp. The share price of this company has gone from $110 last October to $440 today and puts it on a price earning ratio of 231 as earnings per share are less than $2. Pay today $440 and benefit from $2 pa. seems like a very poor deal, but such is the lure of AI companies. Reminds me of the dotcom era which ended badly.

While capital growth is what investors all aim to achieve it is worthwhile to remember that income is also attractive. Capital gains can be quickly lost when market return to trend but an income stream is actual cash paid to the investor. One of the ways to achieve this is to focus on high dividend paying companies but also via bonds. In 2022 the bond markets had a difficult time as interest rates rose and bond values fell. However that has made them become more attractive this year, especially if the rate hiking cycle is coming to an end and especially if western economies slip into recession. Then central banks will cut rates which will be supportive for bond prices.

Best wishes

Tim 4 August 2023

Disclaimer - This is not financial advice.

See www.timunderwood.com for details and reports

Contact - tim@timunderwood.com