Quarterly Review

Autumn 2023

Issue No. 94

INVESTMENT RISK

Investing in ordinary shares and other assets that will be included in your investment portfolio entails risks to your capital and the income that it might generate. The paragraph below is an important reminder, please always remember that:

The value of investments and the income you get from them may fall as well as rise and there is no certainty that you will get back the amount of your original investment. You should also be aware that past performance may not be a reliable guide to future performance.

The second half of this Review gives information on the Church House fund portfolios that we manage for clients. Some, or all, of these funds feature in most portfolios and the risk warning above is pertinent to each of them. We use these funds in the construction of clients' portfolios, each has a specific 'building block' role and, specifically, they form part of our risk management process. This approach helps to ensure a proper diversification and that we know in detail the risks that we are undertaking on your behalf - not something that we are happy to delegate to others.

These funds are individually authorised by the Financial Conduct Authority under the Collective Investment Schemes regulations, they are all 'UCITS' Schemes. We are required to point out that the main risks faced by them arise from market price and interest rate risk; that they have no borrowings, or unlisted securities of a material nature (so there is little exposure to liquidity or cash-flow risk) and that we review the policies for managing these risks on a regular basis.

We do not make any specific 'ESG' or other claims for our funds, we find many such claims to be spurious and of dubious value. We do consider that investing in companies with properly sustainable practices and business models and run by people of integrity, is an important part of what we do. We are signatories to the:

Church House Investment Management

Church House Investments Limited is authorised and regulated by:

The Financial Conduct Authority

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Contents

The Economic & Market Background 5

The UK Economy and Interest Rates 6

Credit Market Commentary – Jeremy Wharton 8

UK Equity Markets 10

International Equity Markets 12

Foreign Exchange 13

Commodities 14

Commentary, Cranley Macfarlane and James Edgedale 15

CH Investment Grade Fixed Interest 16

CH UK Equity Growth 18

CH Balanced Equity Income 20

CH UK Smaller Companies 22

CH Esk Global Equity 24

CH Tenax Absolute Return Strategies 26

Swiftonomics 28

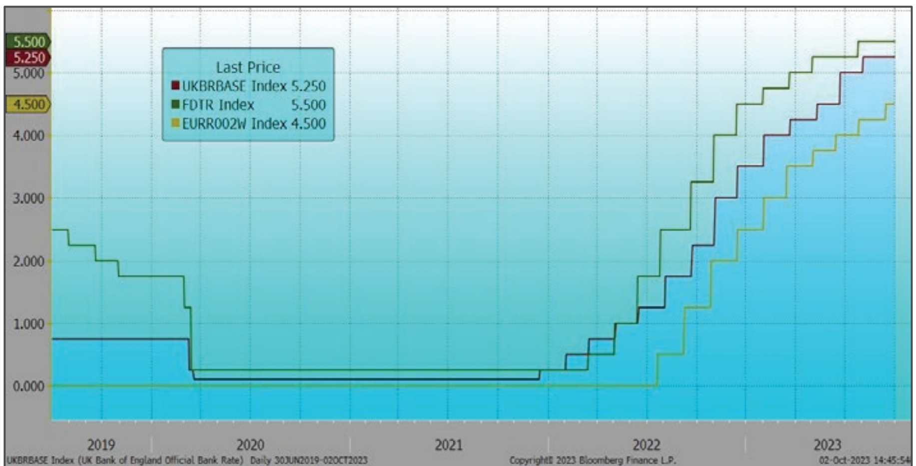
With apologies, I am repeating the same two charts that featured last time as they remain relevant. Having appeared to be such a laggard three months ago, our inflation statistics have taken a turn for the better and no longer look quite so out of step with the US and Europe:

UK Inflation (red) **with US** (green) **and Eurozone** (yellow) **– Since June 2019**

Source: Bloomberg

Central banks on both sides of the Atlantic have continued to put up their base interest rates. At least, these are now showing some signs of flattening out after the steep increases of the past eighteen months:

UK (red), **US** (green) **and Eurozone** (yellow) **Base Interest Rates – Since June 2019**



Source: Bloomberg

The Economic & Market Background

2023 is turning into a long year. Three months ago, I observed that these markets required patience - ours continues to be tried, economically and, ever more, with geo-politics. Investment opportunities really do abound now…

The Bank of England can hardly be said to be demonstrating a clear direction, their recent decision on the Base Rate was split, at least they came down on the side of not inflicting more pain. Inflation is still too high but at least the direction of travel continues to improve. The Bank expects inflation to be back down to 2% by Spring 2025, which should be at the pessimistic end of expectations, but geopolitics says to take care with predicting the future.

Central bankers are pushing the line that the best we can expect for base interest rates is a “Table Mountain” plateau until it is clear that inflation has been squeezed out of the system. The US Treasury market (the equivalent of Gilts here) took fright over the past few weeks, pushing up interest rates for longer time periods in recognition of this. This was reflected in all bond markets (increasing longer-term interest rates = falling prices for bonds). The irony here being that increasing longer-term interest rates does the central banks’ job for them, applying more constriction to economies.

Meanwhile, as the US Presidential Election looms, their politics and Government appears to be getting ever more sclerotic. The recent ‘fix’ to avert a government shutdown being followed by the sacking of House Speaker McCarthy, leaving one to wonder now what? Former President Trump appeared to be relishing his court appearances until the most recent, which may have touched a nerve, his purported ‘business acumen’ appears to be his Achilles heel (time for Nikki Haley to step up!)

Last time we talked about the unusual period that we were going through with short-term interest rates higher than long-term rates and suggested that this would not last for long. So far, this has levelled out with lower short-term rates and higher long-term (Gilts with longer time to maturity have fallen). We cannot be sure that the Bank of England (and the other central banks) have got to the end of their base rate increases but they are certainly close.

We remain firmly of the view that there has been a complete transformation in the attraction of the Gilt and fixed interest markets (we called it a generational shift). I hesitate to say, ‘buy now while stocks last!’ but the income yields that we can establish for clients now are a pleasure to behold after so many years of parsimony.

James Mahon *October 2023*

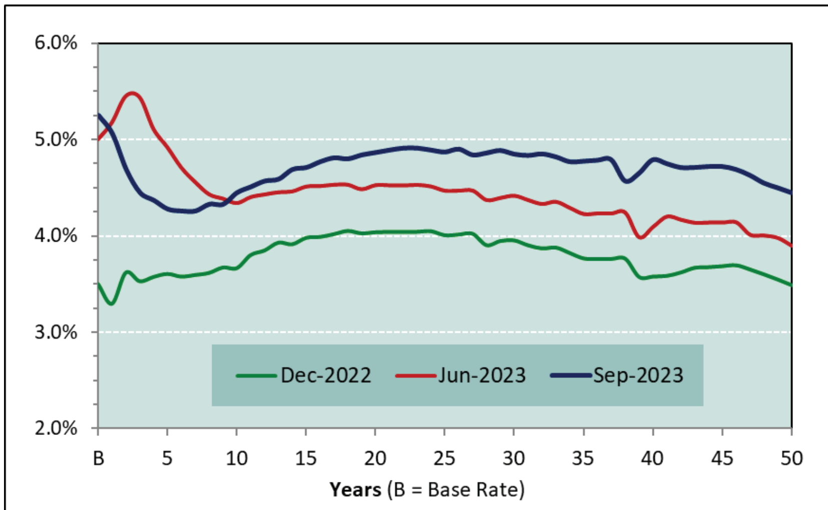
A truly frightful conflict has just broken out in the Middle East as Hamas (a terrorist organisation) caught Israel napping (distracted by internal political squabbles). I hope (vainly, I guess) that Israel might not escalate this into a full-scale invasion as to do so appears to me to fall further into Hamas’ trap and risk a much wider conflagration.

THE UK ECONOMY AND INTEREST RATES

The monthly release of Gross Domestic Product (GDP) data is producing some ‘noisy’ statistics, largely thanks to strange weather and strikes. The Office for National Statistics (ONS) figures showed a sharp fall in GDP for July and modest recovery in August. Overall, it is hard to get away from the feeling that our economy is stuck in low gear, while the outlook is distinctly cloudy. Indicators of output for both manufacturing and services point to a contraction and house prices are falling. Unemployment has increased again, though it is still a long way from the levels seen after the 2009/10 recession (and the freakish figures during the COVID lockdowns).

The Monetary Policy Committee of the Bank of England increased the Base Rate to 5.25% in August but then held it at this level in September in a split decision decided by the Governor’s vote: “the current monetary policy stance is restrictive... the decision had become more finely balanced…”. The pattern of interest rates from the Base Rate out to fifty years has changed markedly though. Market rates in June (the red line on our chart below) clearly pointed to further increases in the Base Rate, now this has reversed (the blue line) with a ‘flattening’ of rates across the curve:

UK Interest Rates – The Yield Curve (Base Rate and the income yield from Gilts)



Source: Church House, Bloomberg

Short-Term	Base Rate	SONIA*	2 years	5 years
Interest Rate	5.25%	5.2%	4.7%	4.3%
Longer-Term	10 years	20 years	30 years	50 years
Interest Rate	4.5%	4.9%	4.9%	4.5%

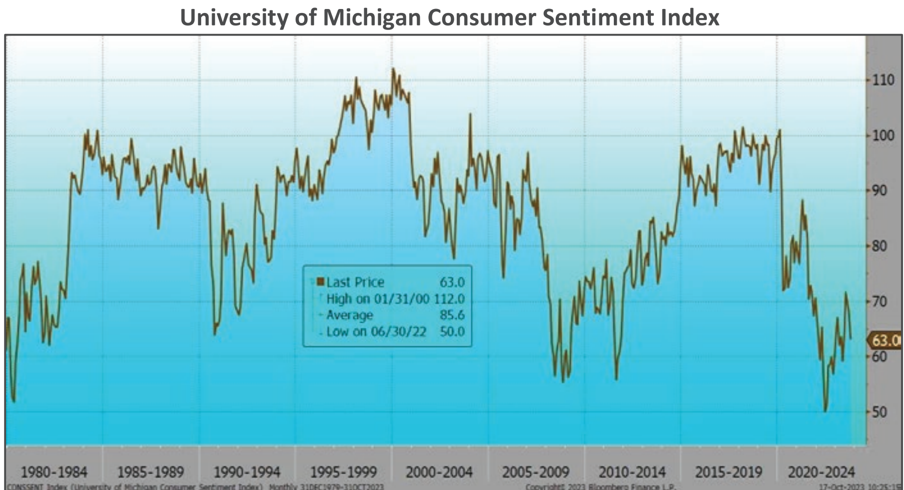
*Source: Bloomberg *Sterling overnight index average.*

Meanwhile, it turns out that our economic recovery post-COVID was not as dire as the ONS had been suggesting, in fact it was in-line with most of Europe after the ONS had applied some serious 'revisions'. From the end of 2019 until June this year, the official statistics had shown a decline of more than 8% in the UK economy as compared to declines of around 3.5% for France and Germany and 2% for Japan. Figures for most countries have seen upward revisions, but the UK was the real outlier: now they show modest growth for most economies with the UK in line with France and Japan and ahead of Germany. I am surprised by how little criticism the ONS has faced over this.

I was quite encouraged to read in *The Economist* that it is not just us feeling perplexed about the state of our economy. They produced a great chart of US consumer sentiment v. current actual spending from 1980 to date. The result shows that the two moved hand-in-hand from 1980 until the pandemic hit in early 2020, with sentiment and spending falling during recessions and picking-up again as the economy recovered. But, since the pandemic, the relationship has completely broken down. Sentiment has hit new lows, but spending has carried on. Ask people about their own finances and the state of the economy and they take a pessimistic line, before returning to the shops...

As *The Economist* points out, the longest running of the consumer sentiment surveys is that from the University of Michigan, which started after the Second World War. This series produces almost identical results to *The Economist*'s figures. A brief recovery in sentiment after COVID was followed by a descent into pessimism, hitting a low point in June last year. Meanwhile, consumer spending has carried on against a backdrop of steady employment figures. Here is their data from 1980:

University of Michigan Consumer Sentiment Index



Source: University of Michigan, Bloomberg

Credit Market Commentary – Jeremy Wharton

Geopolitical event risk has risen but appears to be relatively contained from a market perspective. The real story for financial markets leading into the fourth quarter was the continuing falls in Gilts at the longer-dated end of the market, taking their interest yields up to the levels for shorter periods (flattening the yield curve, a 'bear steepening'!). Major western Central Banks are pausing their increases in base interest rates left, right and centre amidst hopes that we have found terminal rates, although recent data hasn't necessarily gone their way. Unfortunately, we look set for 'higher for longer', but this is better than 'higher and higher'.

China's situation forced them to the front of macro considerations as their post COVID restrictions rebound has not materialised, and there is speculation about the potential for exported deflation. Their overheated property sector, 25% of the Chinese economy, is starting to look increasingly precarious and **Evergrande** (the biggest Chinese property developer who defaulted on $300bn of debt), filing for bankruptcy in the US coincided with **Country Garden** (the second biggest Chinese property developer) suspending payments on thirteen bonds, putting their $150bn debt pile in jeopardy too. The Chinese Central Bank's response has been to tinker with rates in a meaningless way, which will not resolve the situation. We remain thankful that these debt obligations are largely held internally.

The reality of funding the US budget deficit is hitting home. The $6tn needed from the sale of Treasury Bills is a huge number. However, simply funding through T-bills is not possible, so the longer end of the Treasury market (the US equivalent of UK Gilts) has had to bear the brunt of a trillion dollars of new bond issuance. Whilst this has been taken reasonably well overall, the last auction of thirty-year Treasury bonds was weak, and the net effect has been to push thirty-year interest yields higher by half a percent, which equates to a fall in capital value of almost 9% for bond holders.

US housing market activity has fallen off a cliff as thirty-year fixed mortgage rates have risen to 7.9%. A major part of the supply of housing is stifled by existing mortgage holders having no wish to move and refinance at these higher levels. Before the recent Federal Reserve meeting, US five and ten-year Treasury yields hit their highest levels since 2007, pre the Global Financial Crisis, influenced by rising oil prices and a worrying Canadian inflation print. The Federal Reserve kept their funds target rate unchanged but still with a tightening bias just to keep everyone on their toes. We still appear to be on course for a further hike before the end of the year, but presumably this remains 'data dependent'. The Fed sounded noticeably more optimistic on economic activity for 2024, their forecasts only predicting the potential for just one 0.5% cut in their rates next year and then to remain on hold until 2025/2026. These forecasts are liable to move as we know, but either way the US economy looks resilient and might well achieve a 'soft-landing'.

The picture in the Eurozone is much more fuzzy. The ECB did deliver a 'dovish hike' of 0.25% to a 22-year high of 3.75% (against economists' consensus for a pause), to then hold at their next meeting. The ECB have probably found their terminal rate and weakening growth in major EU economies will be top of their minds, as too will be stubbornly high near-term inflation data (although underlying inflation pressures are easing, and forecasts show a more rapid fall). They did not change their stance on selling-down their bond holdings, being content to stop reinvesting maturing bonds under its Asset Purchase Facility, but still reinvesting maturing principal payments under the PEPP (the pandemic one). It's all the same balance sheet in my view. The Eurozone economy remains asymmetrically reversed as the olive oil economies still have solid growth, while Germany flounders. Greece regained investment grade status; they've come a long way since 2011.

The Bank of England held rates with better prints for CPI at 6.7% and GDP at 0.2%. To cover our budget deficit we need to raise £238bn through new Gilt issuance over the year, a fair proportion from our long end too. One year on from last year's Truss/Kwarteng muppet show and the long end of the Gilt market is seeing greatly reduced volumes (an 'illiquid ghost town' is the word), exacerbated by greatly reduced Liability Driven Investment activity.

The UK economy does not present a particularly pretty picture as we printed weaker July GDP numbers than expected, mainly due to a surprise drop in the contribution from services. The drop in industrial and construction activity was expected. Subsequent GDP numbers were a shade better. Unemployment increased slightly and it looks as though private sector wage growth has found a level, but overall average earnings growing at 8.5% remains punchy. A surprise and welcome drop in August inflation numbers, in particular a healthy drop in the core rate to 6.2%, almost putting us in range of other major economies, must have been a major contributor to the MPC's surprise 5/4 split vote to hold rates at 5.25%. The picture was also clouded for a while by a rally in energy prices (largely prompted by industrial action in Australia and US oil inventory data), which fell back for a while, but are now rising again due to fears of a major escalation of Middle East tensions following the unfolding Israeli/Palestinian situation.

The Sterling primary market has been unusually busy as a few foreign issuers took advantage of favourable cross-currency swap rates to issue in sterling and some high coupons have printed. We even saw some non-financial issuance from quality A-rated issuers such as Caterpillar and John Deere, which were well received with healthy order books and strong performance in the secondary market. Issuance across all currencies remains healthy but Friday has almost become a 'non-primary' day as we saw the 33rd zero-issuance Friday this year.

Jeremy Wharton *October 2023*

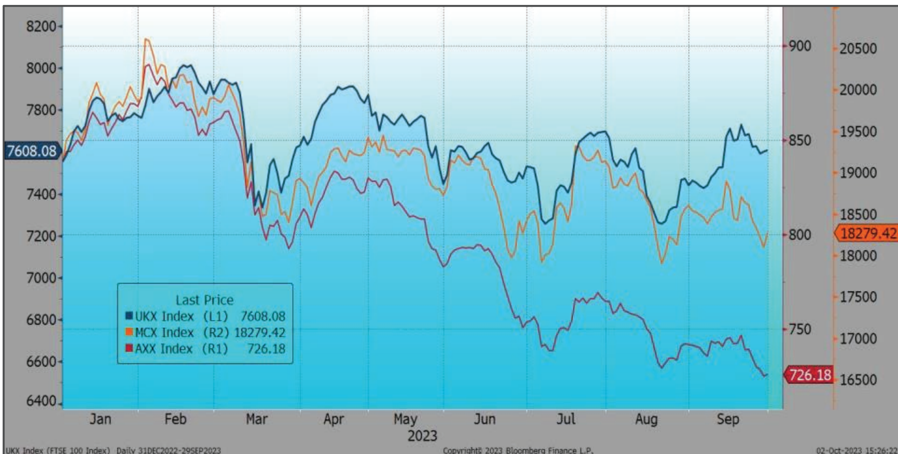
UK Equity Markets

Index:	29 Sep 2023	30 Jun 2023	Quarter
FTSE All-Share	4127	4096	+0.8%
FTSE 100	7608	7532	+1.0%
FTSE 250	18279	18417	-0.7%
FTSE Small Cap	6098	6094	+0.1%
FTSE AIM All-Share	729	754	-3.3%

Source: Bloomberg

The headline indices in London were up modestly over the quarter, mainly thanks to the big oil companies following the oil price higher but, of the leaders, **GSK** and **HSBC** also gained along with **Glencore** and **RELX**. Further down the scale it remained dull and smaller companies are still completely out of favour:

FTSE 100 (dark blue), FTSE 250 (orange) and AIM Indices –2023



Source: Bloomberg, FTSE International

Fred Mahon writes: UK investors continue to have their patience tested as the clouds overshadowing our equity market are stubbornly refusing to part. Since the infamous Brexit vote of June 2016, the headline UK equity indices (the FTSE 100 for the largest businesses, FTSE 250 for mid-sized) have made no progress, but they sure have been volatile over the intervening years – the FTSE 250 is flat over this time but has been 24% down (COVID) and 38% up (post-lockdown excitement). It has been a period where popular media has consistently concluded that the UK is a basket case and politicians have seemingly done their best to make this the case! We show the bruises but still believe; we are not throwing in the towel in UK markets – there are plenty of excellent businesses listed in London and the rule of law continues to reign. History has taught us time and again that patient and disciplined investment in strong businesses pays off and *this time* is no different.

Looking at the third quarter of this year, it was all about a rally in the oil price and correspondingly strong share price performance from **BP** and **Shell**. For all the theorising that one can do on what moves commodity prices, nothing moves oil like politics and it just so happens that the Saudi Government is looking to sell $50bn of their shares in oil giant **Saudi Aramco** – coincidence that supply has been limited recently to push up the price? We will let you decide.

Rolls-Royce was a standout performer, up 46% over the quarter, boosted by recovering jet engine orders as tourists return to the skies, but do not forget that RR shares are still comfortably below where they were in 2019. At the other end of the spectrum, the largest fallers were asset managers (**St James's Place** and **abrdn**) and betting companies (**Flutter** and **Entain**). Since Standard Life Aberdeen changed its name to **abrdn** in July 2021, the share price has fallen by 45% - possibly management should have been focusing on more important things than their name?

No market is an island and hopefully readers of this report will gain a sense of the importance that bond markets and interest rates have in underpinning equity markets globally. The FTSE is unlikely to make material progress until Gilts stop being beaten up by central bankers. This is not a reason to avoid UK equities, in fact it gives an opportunity to pick up shares in leading businesses at decade-low valuations. Patience will pay-off and, in the meantime, there are healthy divided yields on offer to keep the income coming in.

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Fundamental Valuation Indicators

Estimates of corporate earnings for the year ahead have slipped back. It would be surprising if this isn't repeated in the final quarter; like mortgage holders, companies are having to pay significantly more interest to service their debts, and many are seeing a slow-down in activity. Dividend estimates have moved ahead again, indicating a healthy yield on the market, but that brings the 'cover' back to two times so this dividend growth is also likely to slow soon:

FTSE All-Share Estimates*	**29 Sep 2023**	**30 Jun 2023**	**30 Dec 2022**
Earnings (per Share)	399.1	416.3	415.4
Price / Earnings Ratio	10.3X	9.8X	9.8X
Earnings Yield	9.7%	10.1%	10.2%
Dividends (per Share)	199	188	169
Dividend Yield	4.8%	4.5%	4.1%
Dividend Cover	2.0X	2.2X	2.5X

**Bloomberg aggregate earnings estimates for the year ahead*

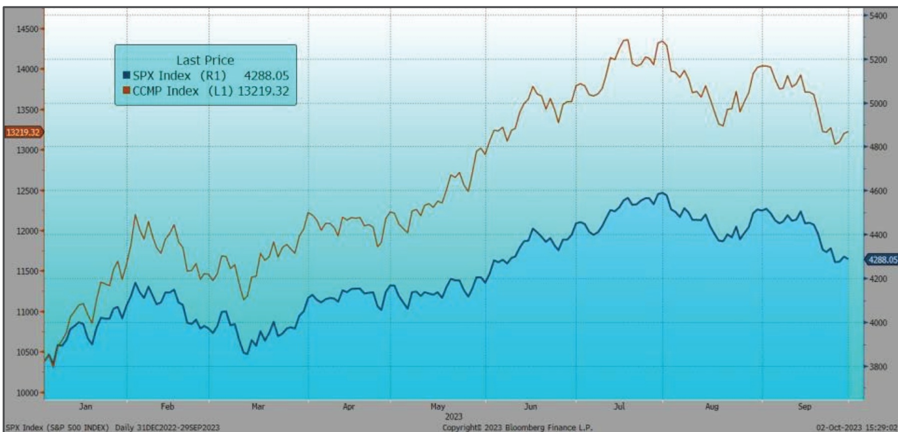
INTERNATIONAL EQUITY MARKETS

Index:	29 Sep 2023	30 Jun 2023	Quarter*
US - S&P 500	4288.1	4450.4	-3.6%
US - NASDAQ	13219	13788	-4.1%
UK – FTSE All-Share	4127.2	4096	+0.8%
Germany - DAX	15386	16148	-4.7%
France - CAC 40	7135	7400	-3.6%
Switzerland - SMI	10964	11280	-2.8%
Japan - TOPIX	2323	2289	+1.5%
Brazil - Bovespa	116565	118087	-1.3%
China – Shanghai Comp.	3110	3202	-2.9%
Hong Kong – Hang Seng	17810	18916	-5.8%
Australia – ASX 200	7048	7203	-2.1%

*Source: Bloomberg *Change in local currency*

Stock markets around the world retreated in the face of higher-for-longer rates, even US technology faded. Japanese stocks gained a shade more, adding to a good year, though, for international investors, the decline in the yen rather takes the shine off this move. The Hang Seng is now down by 10% over the year as China's property woes drag on. Car companies saw stark contrasts, German stocks fell sharply, notably **Porsche** and **Volkswagen**, while the Japanese **Honda** and **Toyota** leapt. The staple goods companies weakened everywhere, **Pernod Ricard** being a particular casualty. The US banks traded lower but in Switzerland, **UBS Group** was a feature gaining 25% as they move on from their takeover of **Credit Suisse** last year.

S&P 500 (dark blue) **and NASDAQ Composite** (orange) **Indices – 2023**



Source: Bloomberg

Foreign Exchange

	Cross Rate:	29 Sep 2023	30 Jun 2023	Quarter
£	US $ / £ sterling	1.221	1.271	-3.9%
	Euro € / £	1.154	1.164	-0.9%
	£ Exchange Rate Index	80.6	82.3	-2.1%
$	US$ / € euro	1.058	1.092	+3.2%
	Yen ¥ / US $	149.4	144.5	+3.4%
	Renminbi / U S$	7.30	7.25	+0.7%
	$ Exchange Rate Index	106.1	102.9	+3.1%

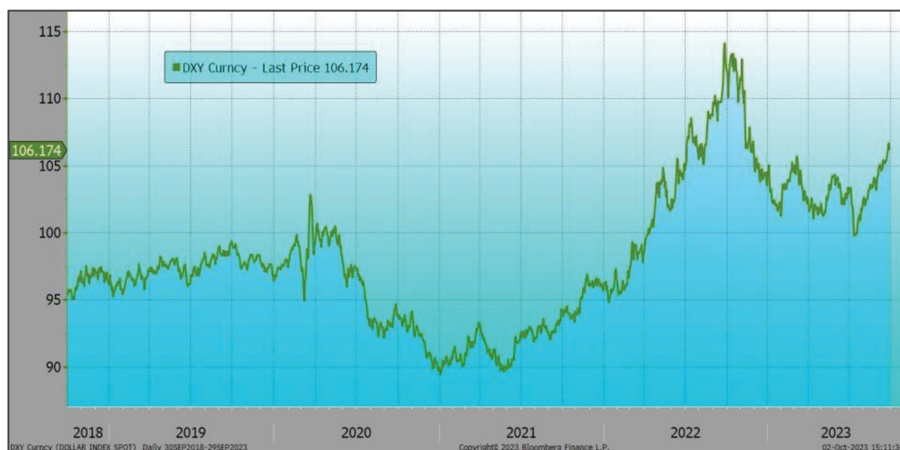
Source: Bloomberg

As European economies slow and the Chinese 'recovery' fails to materialise, the contrast with the strength of the US economy and the view that US rates will stay higher for longer have combined to renew strength in the US dollar. This has been the dominant theme of the quarter and the US currency has gained against all the rest.

The US jobs market remains stubbornly strong, with the most recent figures undermining some earlier signs of easing. A further increase in the Federal Reserve's base rate in November is still a strong possibility. The contrast with the Eurozone, which appears to be contracting (most notably, Germany) and the European Central Bank, which is definitely 'on pause' now, is plain to see.

With the UK economy holding steady at best and the Bank of England split over further rate increases, there is little to lift sterling from the general trend to the dollar. The chart shows the renewed gains for the US dollar on its index against major world currencies (the DXY):

The US Dollar Index – June 2018 to Date



Source: Bloomberg

Commodities

	29 Sep 2023	30 Jun 2023	Quarter
Oil – Brent (barrel)	$95.4	$74.9	+27.4%
Natural Gas	$2.93	$2.80	+4.7%
Gold (troy ounce)	$1855	$1918	-3.3%
Copper* (25 tons)	$8218	$8316	-1.2%
Milling Wheat (50 tons)	€236	€231	+2.0%

*Source: Bloomberg   *3-month forward contract on the London Metal Exchange*

Once again, we are worrying about the price of oil. Saudi Arabia's unilateral supply cut in the summer served to tip the balance of supply and demand back, and the price has responded with something of a squeeze. Given the unfavourable backdrop in world economies we would normally expect this to run out of steam soon, but now we have a horrendous outbreak of war on the Israel/Gaza border, throwing the Middle East into confusion again. Presumably this will also make any sort of rapprochement between America and Iran a much more distant prospect.

Base metal prices have been drifting down again, probably influenced most by the non-recovery in China. Copper prices are now lower than at the start of the year, as is the price of nickel (quite dramatically). Despite the recent recovery in the price of aluminium, it is also cheaper to acquire than at the turn of the year. This is reflected in the poor performance of the miners, **Anglo American**, **Glencore** and **Rio Tinto** over the year to date, though Anglo's 30% fall is rather more to do with the price of diamonds (they own De Beers).

The Price of Oil – Past Five Years

Source: Bloomberg

THOUGHTS FROM *CRANLEY MACFARLANE AND JAMES EDGEDALE*

In the UK, we lack the tech behemoths of the US, and during the last quarter waved goodbye to one of our few stars, **Arm Holdings**, which listed in New York. Those seven behemoths in the US (such as **Alphabet**, **Microsoft,** etc) make up a third of the S&P 500 Index, and their strong performance over the year to date has skewed the performance of that index, which is up 11%. Remove them from the equation and the S&P 500 has in fact fallen 2%.

This puts a different perspective on the FTSE 100 Index' performance so far this year (+2%) and over the quarter (+1%). Those companies that have performed well, have largely been beneficiaries of geopolitical developments. OPEC's production cuts in June prompted the oil price to rally 20%, with **Shell** and **Chevron's** share prices following a similar trajectory. Despite the first signs of faltering support for Ukraine, defence budgets are still likely to increase over the coming years, continuing to support **BAE Systems**.

Geopolitics aside, inflation and the path of interest rates continue to dominate the outlook for bond and stock markets. A surprise drop in the rate of inflation in the UK prompted the Bank of England to pause interest rate increases and they may not move higher from here. While recent employment figures in the US have brought the prospect of further rate increases back into consideration for the Federal Reserve. Clearly, there remains significant uncertainty about how long interest rates will be kept at these levels. Nevertheless, we feel that the COVID-inspired burst of inflation has sparked the traditional economic cycle back into life after more than a decade of low inflation and ultra-low interest rates.

The income yields on offer in relatively short-dated and high-quality fixed interest assets can provide portfolios with genuine ballast without extending risk. Those investors who have lengthened the maturity of their bond holdings in anticipation of rate cuts have been disappointed. When sterling broke below 1.22 in late September, the last remaining reason we had for holding US Treasuries over Gilts for sterling investors had gone. We have locked-in yields of 4.5% on UK Gilts maturing in 2032, while our own Fixed Interest fund has a redemption yield* of over 6% from investing in sterling investment-grade bonds (an ordinary income yield of 5.2%). Something to consider for those still holding cash.

Companies that are currently resilient in the face of high interest rates, may struggle as their customers and balance sheets come under increasing pressure the longer this rate environment persists. In equities, we believe it is critical to focus on both quality and valuation to be best prepared should equity markets start to crack. And if they do not, we will be well-positioned to benefit from the relief rally.

Cranley Macfarlane *October 2023*

**See footnote on page 27 for explanation of 'redemption yield'*

Church House Investment Grade Fixed Interest

	29 Sep 2023	30 Jun 2023	Quarter
CH Investment Grade* - Inc.	103.4	101.8	+1.6%
iBoxx AA Corporate 5-15 year	74.1	73.1	+1.4%
CH Investment Grade - Accum.	170.3	167.0	+2.0%
iBoxx £ ABS 5-10 year TR**	310.5	300.7	+3.3%

*Source: Bloomberg *bid price to bid price, excluding income. **Total Return Index.*

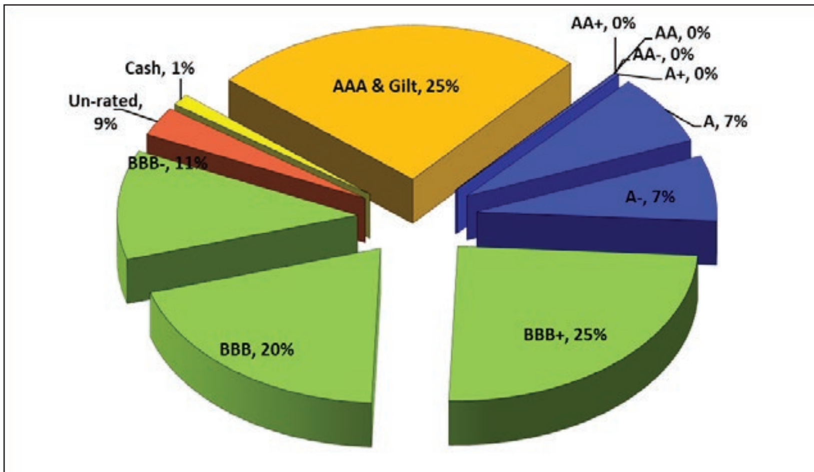
The Investment Grade Fixed Interest portfolio benefitted from its positioning at the short-dated end, where the markets were much calmer (see the volatility figure below), avoiding the drama in long-dated securities:

CH Investment Grade Fixed Interest	Sep 2023	Jun 2023
Short-dated Securities (less than 7 years)	73%	72%
Medium-dated Securities (7 to 15 years)	23%	23%
Long-dated Securities* (over 15 years)	4%	5%
Duration of Portfolio	2.9	3.0
Volatility** (past year)	3.7%	6.5%
Number of Holdings	92	90
Yield (historic)	4.4%	4.0%
Portfolio Value	£249m	£237m

**Long-dated includes infrastructure holdings*

***Volatility is annual standard deviation expressed as a percentage*

CH Investment Grade Fixed Interest – by Credit Rating – 29 September 2023



Source: Church House

Top 15 Holdings - 29 September 2023	
Deutsche Pfandbriefbank 7.625% 12/2025	2.8%
Bank of America 7% 7/2028	2.7%
Goldman Sachs 7.25% 4/2028	2.5%
SSE Hybrid 3.74% 2026/2049	2.4%
M&G 5.625% 10/2031	2.1%
EIB (SONIA) 6.097% 01/2027	2.1%
CPPIBC Float 6.201% 06/2026	2.1%
TSB Covered (SONIA) 5.869% 09/2029	2.0%
BP Pnc 4.25% 3/2027	1.8%
Lloyds 6.625% 6/2033	1.8%
Soc Gen 6.25% 6/2033	1.6%
Santander UK 7.098% 11/2027	1.6%
United Overseas Bank Covered 6.033%	1.6%
Canadian Imperial Bank (SONIA) 5.983%	1.6%
Bayerische Landesbank Covered 5.125%	1.6%

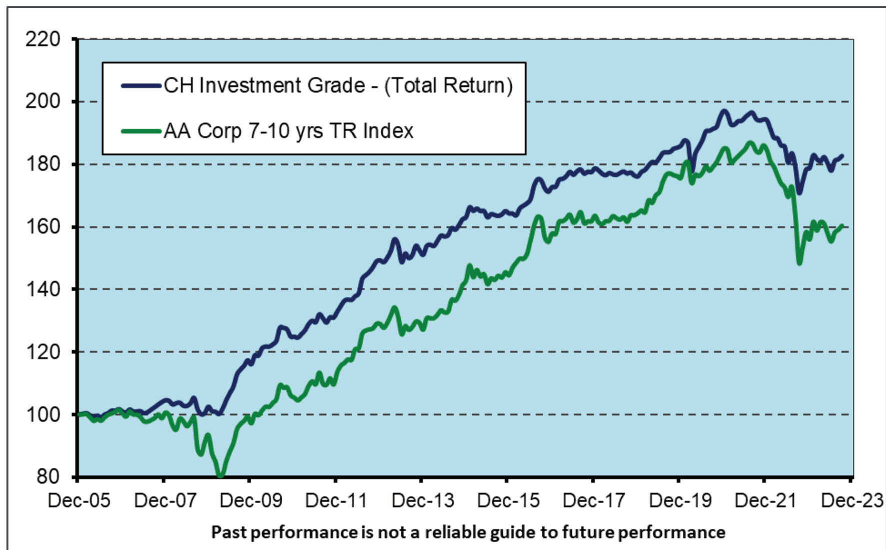
Here is the list of the top holdings in the portfolio (bonds don't really present a 'consumer friendly' picture…) It is little changed from last quarter though the '**TSB** Covered (SONIA) 5.869% 09/2029' – a floating rate note – is new to the list, having come to the market in early September. They all reach maturity (pay back) between 2025 and 2033, with the possible exception of the **SSE** bonds, which are 'hybrid' and can live longer.

Calendar Year Performance:

YTD	2022	2021	2020	2019	2018
+1.6%	-7.9%	-1.5%	6.0%	5.6%	-1.5%

Source: Church House, bid price to bid price, accumulation units.

CH Investment Grade Fixed Interest vs AA rated Corporate Securities (Total Return)



Source: Bloomberg, Church House

Church House UK Equity Growth

	29 Sep 2023	30 Jun 2023	Quarter
CH UK Equity Growth*	184.2	188.1	-2.1%
FTSE All-Share Index	4127	4096	+0.8%
FTSE 250 Index	18729	18417	-0.7%

*Source: Bloomberg * Bid to bid price, excluding distributions of income (capital performance)*

Fred Mahon writes: Over the third quarter, we took the opportunity of depressed market levels to top-up our holdings in several of the core positions in the portfolio. It is rare that such impressive businesses trade on discounts, particularly across multiple sectors. This is a wonderful time to be putting new money to work. In the Industrials space, we added to our holdings in steam-engineers **Spirax-Sarco** and maker of niche scientific instruments **Judges Scientific**. In Materials, we were buyers of **Croda**, the Yorkshire-based supplier of natural active ingredients to the cosmetics industry. If you have ever splashed out on expensive skin-care products, then it is more than likely that this contained Croda's lanolin.

Within Financials, shares in **London Stock Exchange Group** and **Experian** came back into buying range and we duly added to both. This is a classic case of the market turning against a whole sector due to macroeconomic concerns, when in fact both LSEG and Experian have, time and again, proven their ability to grow through good times and bad. Experian, after all, make their money by selling data on individuals to the institutions that offer those people credit (think banks, health insurance, retailers) – in tricky times these institutions need to be even more diligent than ever to ensure their credit lines are tight.

To fund these additions, we sold two positions – **Heineken** and **Genus**. We purchased Heineken shares in the depths of COVID on the basis that the brand was bullet-proof and that times could only get better. What has changed is that it looks to us like the next generation will, on balance, drink more spirits and less beer than the baby boomers – one can already see this happening in America with the decline of previous stalwarts like Budweiser and Coors vs increasing sales of tequila and rum. This should be good news for our investment in **Diageo**, but not so for Heineken. Meanwhile, we felt that **Genus** (who sell to pork, beef and dairy farmers globally) were fighting an uphill battle in their key Chinese market against both swine fever and geopolitics that was not going away any time soon.

On a more cheerful note, **InterContinental Hotels Group** have been enjoying an impressive run over the past couple of months, with customers returning and their shares having now more than doubled since the first COVID lockdowns. IHG continue to open new hotels and we see plenty more growth to come.

Top 15 Holdings - 29 September 2023	
RELX	6.6%
Diploma	5.7%
Spirax-Sarco Engineering	4.7%
Halma	4.6%
Dechra Pharmaceuticals	4.4%
Diageo	4.2%
Unilever	4.0%
Croda International	3.7%
Microsoft	3.6%
Greggs	3.6%
AstraZeneca	3.4%
Judges Scientific	3.1%
Ashtead Group	2.9%
London Stock Exchange	2.9%
Auto Trader Group	2.9%

Regular readers will see that our top holdings remain consistent, reflecting the long-term nature of our approach. Of particular note this quarter, **RELX** (our largest position) continues to surprise us positively and their shares are hitting new all-time highs.

Dechra Pharmaceuticals still appear in this list though, sadly for us, this excellent UK pet pharmaceuticals company has succumbed to a bid, despite our grumbles. This is a cash bid, which is scheduled to complete at the end of the year, so the holding should not appear next time.

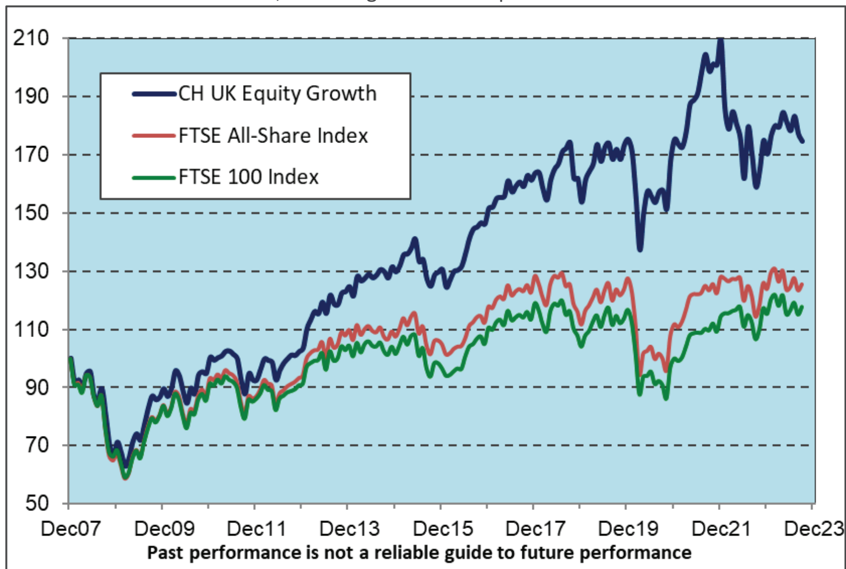
Calendar Year Performance:

YTD	2022	2021	2020	2019	2018
2.7%	-18.6%	19.7%	0.4%	15.7%	-5.1%

Source: Church House - bid price to bid price, accumulation units.

CH UK Equity Growth vs FTSE Equity Indices

Bid Prices, excluding income – Capital Performance



Source: Church House, Bloomberg

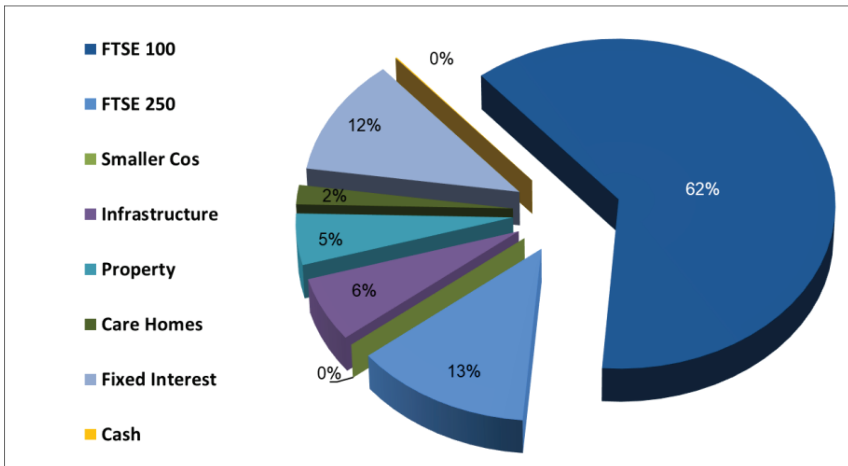
CHURCH HOUSE BALANCED EQUITY INCOME

	29 Sep 2023	30 Jun2023	Quarter
CH Balanced Equity Income*	166.9	165.1	+1.1%
FTSE All-Share Index	4127	4096	+0.8%
FTSE Higher Yield Index	3585	3455	+3.8%
FTSE Index-Linked All Stocks	475	499.5	-4.9%
Composite Benchmark**	110.9	109.5	+1.3%

*Source: Bloomberg *Bid-to-bid price, excluding income payments (capital performance)*
***45% FTSE All-Share, 42% FTSE Higher Yield, 13% FTSE Index-Linked All-Stocks Indices.*
The management fee in CHBE is split 50/50 between capital and income.

The Balanced Equity Income portfolio made modest gains over the period, including gains for the fixed interest and some of the property holdings (a pleasant change), but the infrastructure holdings continue to struggle. This was the disposition at the end of the period:

CH Balanced Equity Income – Disposition – 29 September 2023



Source: Church House

Among the big companies, detractors from performance included **Halma**, which fell around 15%, no one issue to point to but they have reported 'de-stocking' from manufacturers and healthcare, and **Diageo**, down around 10%, where it appears that the all-important US spirits markets has gone off the boil for them (see also comments from LVMH later). More positively, there were good gains for **Howden Joinery** and **BAE Systems** along with the housebuilders, **Bellway** and **Berkeley Group**, which might come as a surprise. **Greggs** were down around 4%, unfairly in our view, their growth continues unabated; a similar fall for **Kingfisher** (B&Q et al) was more justifiable after they reported dull figures.

Top 15 Holdings - 29 September 2023	
AstraZeneca	6.2%
Unilever	4.5%
RELX	4.3%
BAE Systems	4.1%
GSK	4.1%
Diageo	3.3%
Sage Group	3.3%
Bunzl	2.7%
Reckitt Benckiser	2.7%
Barclays	2.7%
Aviva	2.6%
National Grid	2.5%
Halma	2.3%
Barclays 3.75% 11/2030	2.3%
Rio Tinto	2.2%

The top holdings are very little changed. **GSK** had a much better quarter with some encouraging new drug approvals coming through. **Sage Group** had another good quarter and **RELX** has been mentioned in earlier commentary. The infrastructure companies remain under a cloud with higher long-term interest rates only adding to the pressure. **Target Healthcare** appears to have 'found a level' and has gained modestly this quarter. All of the conventional fixed interest holdings gained a few percentage points, while the index-linked issues were marginally lower overall.

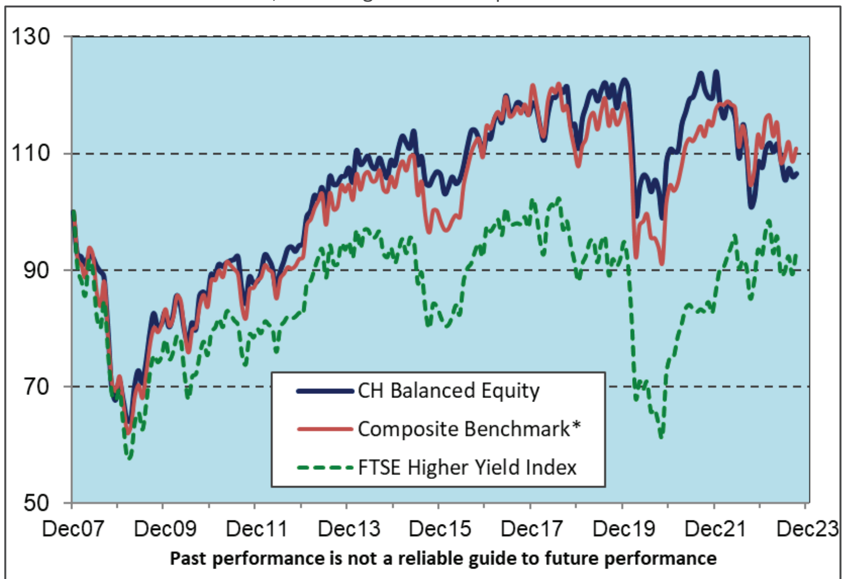
Calendar Year Performance:

YTD	2022	2021	2020	2019	2018
0.8%	-10.6%	14.9%	-7.0%	14.2%	-3.6%

Source: Church House, bid price to bid price, accumulation units

CH Balanced Equity Income vs Composite Index* & Higher Yield

Bid Prices, excluding Income – Capital Performance



*Source: Church House *45% All-Share, 42% FTSE Higher Yield, 13% Index-Linked All-Stocks*

Church House UK Smaller Companies

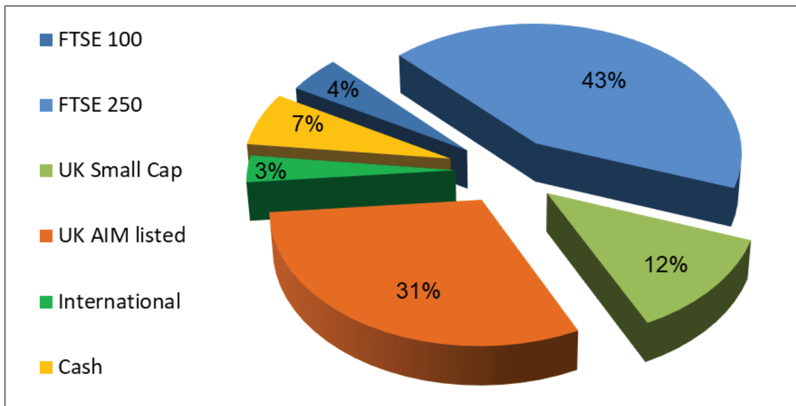
	29 Sep 2023	30 Jun 2023	Quarter
CH UK Smaller Companies*	128.7	129.9	-0.9%
FTSE All-Share Index TR	8773	8611	+1.9%
FTSE AIM All-Share TR	865.9	894.5	-3.2%

*Source: Bloomberg *Bid-to-Bid 'A' Accumulation Shares, all Indices are Total Return*

Rory Campbell-Lamerton writes: The UK small-cap market is continuing to bear the brunt of negative investor sentiment, with the bellwether AIM All-Share index off 12.3% over the year to date. However, the market is full of ripe opportunities, with many stocks at favourable valuations with strong fundamentals and all the quality growth attributes that we look for. These conditions, and attractive entry points, have encouraged plenty of acquisition activity, particularly from private equity, as has been the case in our portfolio.

One such piece of sad news (and I say sad as we loathe to see it go from the portfolio) is the bid for **Ergomed** from **Permira**, the European private equity firm**.** Ergomed is a true unheralded UK healthcare star, it runs early-stage drug trials and pharmacovigilance. These are multi-year contracts with high quality recurring revenue streams and Permira are bidding to buy the business at £13.50, below the share price peak of almost £16 in late 2021. It's a shame to see businesses like this go, when they're yet to realise their full potential, but sadly this is another sorry indictment of the lack of support for the UK equity market in general.

CH UK Smaller Companies – Disposition – 29 September 2023



Source: Church House

It is not all glum news in the portfolio though. Over the course of the summer, we initiated a new position in **Ashtead Technology PLC**. Ashtead Technology (AT) provides equipment rental, advanced underwater technologies, and integrated support services to the global offshore energy sector (sorry, quite a mouthful).

AT's service is critical to many offshore energy activities, including wind, oil and gas installations. Just over a third of their revenue comes from offshore wind projects, an area that is growing rapidly. AT have made seven acquisitions since 2017 and have a fleet of rental assets at their disposal. Revenue for 2022 was just over £73m (they should breach £100m this year) with basic earnings of £20m. They have a clear growth strategy, both organically and through acquisitions, and we feel is a strong fit for the portfolio.

Top 15 Holdings - 29 September 2023	
Judges Scientific	5.7%
Diploma	5.1%
Greggs	5.0%
Ergomed	4.6%
Beazley	4.5%
Porvair	4.2%
Young & Co's Brewery	3.9%
Softcat	3.4%
Cranswick	3.3%
Somero Enterprises	3.3%
Bioventix	3.3%
Fevertree Drinks	3.2%
Trainline	3.2%
Fuller Smith & Turner	3.1%
Keyword Studios	2.9%

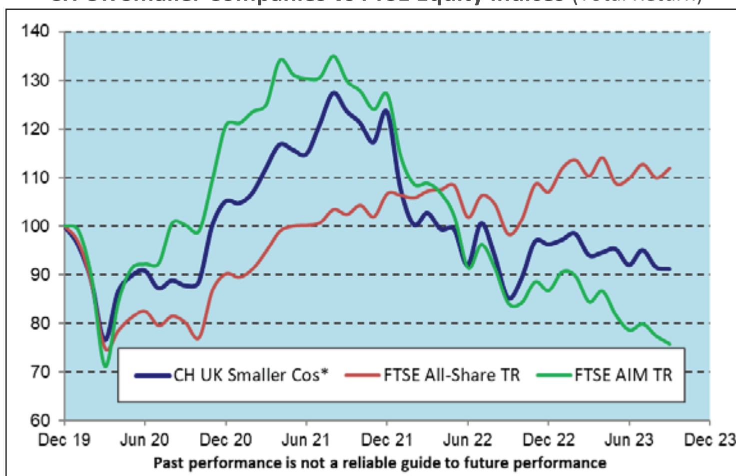
We have added broadly across the fund, during this period, adding to digital solutions developer **Kainos**, continued adding to **Porvair**, **Young's** and **Rathbones** and finally, we topped up **Primary Health Properties**, the owner of GP practices and primary health centres across the United Kingdom and Ireland.

Calendar Year Performance:

YTD	2022	2021	2020
-5.3%	-22.1%	17.5%	5.1%

Source: Church House - bid price to bid price, 'A' accumulation shares

CH UK Smaller Companies vs FTSE Equity Indices (Total Return)



Source: Church House, Bloomberg *The chart shows the performance of the Deep Value Investments portfolio initially, 2020, the new name and policy was adopted in August 2020.

Church House Esk Global Equity

	29 Sep 2023	30 Jun 2023	Quarter
CH Esk Global Equity*	408.5	414.0	-1.3%
CH Global Index in £	1326.8	1324.7	+0.2%
MSCI World in $	2856	2967	-3.7%
FTSE 100 Index	7608	7532	+1.0%

*Source: Bloomberg *Bid-to-bid price, excluding distributions of income (capital performance)*

The Global Equity portfolio had a quiet quarter overall, dipping with world markets, though this time it benefitted from the strength of the US dollar. The proportion invested in America has just crept over 50% after solid performance from some of the bigger holdings (**Alphabet** and **Intuit** were notable) and the addition of two new holdings in the US healthcare sector, **Cencora** and **UnitedHealth Group**.

Top 15 Holdings - 29 September 2023	
Microsoft Corp	5.0%
Alphabet	4.9%
Mastercard	3.8%
LVMH	3.6%
Apple	3.6%
Stryker Corp	3.3%
Amazon.com	3.2%
Johnson & Johnson	3.1%
RELX	3.0%
L'Oreal	2.9%
Oracle	2.9%
Intuit	2.7%
Roche Holding	2.6%
Nestlé	2.5%
Investor AB	2.5%

The top holdings are little changed though the positions have shuffled a touch. **Alphabet** was strong after their second quarter earnings report in July, knocking **LVMH** (Louis Vuitton etc.) back to fourth place after a rough quarter for the luxury goods companies, worrying about the Chinese non-recovery, which also knocked **Hermès** off the list. None of this is apparent in LVMH's figures, which showed double-digit revenue growth in all areas except for wines and spirits. This latter also being reflected in poor performance from **Rémy Cointreau**. **Intuit**, the US accounting software company (QuickBooks etc.), had a strong period and returns to the list. **Apple** weakened as iPhone sales disappointed and China banned their use by government officials, while **Oracle** fell back after their steep jump in June as they reported record revenues but a lacklustre outlook for their 'cloud' revenue growth. Among the healthcare investments, **GN Store Nord** produced one 'update' on their profits too many for us and we sold the holding. **Lonza Group** fell back sharply as they announced the departure of their Chief Executive to be replaced, pro tem, by their Chairman Albert Baehny. We regard this as a positive move and have added to this holding. The two new US healthcare holdings where we have established modest-sized initial holdings are **UnitedHealth Group**, which organises and manages health plans for employers (including Medicare, Medicaid etc.), and **Cencora** (until recently, **AmerisourceBergen**), which is a distributor of pharmaceutical and over-the-counter healthcare products with close ties to **Walgreens Boots Alliance**.

Novozymes has slipped again this quarter, we await news of the proposed merger with **Chr. Hansen Holdings**, another Danish company, to see if this might provide a catalyst for some better performance. The financial holdings had a much better time of it. Among the banks, **Sumitomo Mitsui Financial** gained almost 20% while **Nomura Holdings** also rose and **Standard Chartered** gained around 11%. The reinsurance companies were strong: **Berkshire Hathaway** and **Swiss RE** both gained but the feature was a 9% gain for **Everest Group** (formerly Everest RE).

Other Portfolio Statistics:

Number of holdings	45
Portfolio Value	£63.8m
Volatility*	6.3%
Income yield	0.4%

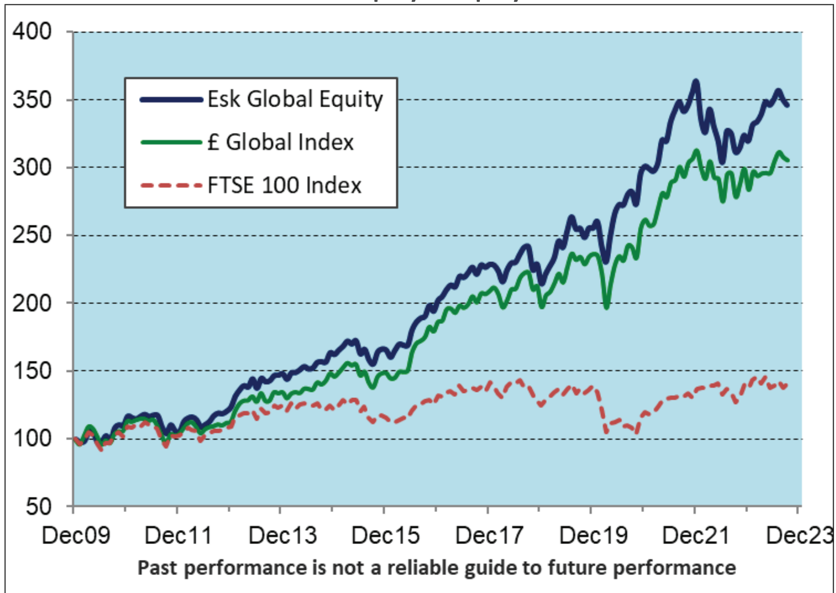
**Annual standard deviation of monthly capital returns expressed as a percentage, past year*

Calendar Year Performance:

YTD	2022	2021	2020	2019	2018
8.3%	-11.7%	20.9%	18.1%	20.2%	-5.6%

Source: Church House - bid price to bid price, accumulation units

Esk Global Equity vs Equity Indices



Source: Church House Bid prices of income units (i.e. capital return, excluding income)

Church House Tenax Absolute Return Strategies

	29 Sep 2023	30 Jun 2023	Quarter
CH Tenax Absolute Return*	153.6	151.7	+1.3%
Cash Return (SONIA)**	106.2	104.9	+1.3%

*Source: Bloomberg *Bid-to-bid, Tenax 'A' accumulation shares **Compounded SONIA (BoE)*

The Tenax Fund had a quiet quarter. There were no major changes to the allocation, just a continuation of the trend away from 'floating rate' investments to those that pay a fixed rate of interest as rates moved higher. The asset mix within the Fund is shown below along with the changes since the beginning of the year. The Fixed Interest proportion is approaching half of the portfolio but has a shorter time to maturity at a higher 'redemption yield':

CH Tenax Fund - Allocation to Asset Classes – Year to Date

2023	30-Dec-22	31-Mar-23	30-Jun-23	29-Sep-23	Year Change
Cash	0.5%	0.4%	0.3%	0.2%	-0.3%
Treasury / T-Bill	0.0%	0.0%	0.0%	0.0%	0.0%
FRN (AAA)	25.5%	22.1%	22.3%	20.0%	-5.4%
Floating Rate	0.0%	0.0%	0.0%	0.0%	0.0%
Fixed Interest	42.8%	44.6%	45.1%	48.4%	5.7%
Index-Linked	1.5%	1.9%	2.0%	0.5%	-1.0%
Infrastructure	6.3%	6.0%	5.8%	5.6%	-0.7%
Convert / ZDP	8.9%	9.6%	8.8%	9.1%	0.2%
Alternative / Hedge	0.0%	0.0%	0.0%	0.0%	0.0%
Property / Real	2.9%	3.4%	3.7%	4.1%	1.2%
Equity	11.6%	11.9%	12.1%	12.1%	0.4%

Source: Church House

We have also reduced the Index-Linked section with a sale of the **Heathrow** 3.334% Index-Linked due in 2039, considering that we had better opportunities in conventional fixed interest investments.

We are down to just one zero dividend preference holding in the Convert/ZDP section as we saw an attractive opportunity to switch out of the **NB Private Equity** issue that we first invested in at issue in May 2018. With only a short time left in this zero dividend preference share we were seeing better opportunities in straightforward bonds. But we have been adding to our holding in **Primary Health** 2.875% Convertible due in July 2025, following further meetings with their management, so this section has increased overall.

The infrastructure area of the portfolio (and the market) continues to struggle for all the reasons that we set out in July. Reported asset values are under pressure from valuers applying higher discount rates, while the pool of natural buyers for these companies has been severely diminished by current regulations. As we have observed before, the result is messy and the pricing of many of these assets is losing touch with reality, but there is, as yet, little sign of this situation improving.

In the Fixed Interest area, we have added short-dated sterling bonds from **KFW** (Kreditanstalt Fuer Wiederaufbau - German government guaranteed), **Whitbread** and a new issue from **Yorkshire Building Society** of 7.375% bonds due in 2027. We have also added to the US dollar issue that we hold from **Beazley**, the 5.5% issue due in 2029, that we were able to purchase at less than 90c. Overall, the redemption yield** of the floating and fixed rate portion of the portfolio (around 68% of the whole) has reached 7.1% at a duration* of 2.8:

2023	30-Dec-22	31-Mar-23	30-Jun-23	29-Sep-23
Overall Duration*	2.6	2.9	2.9	2.8
Redemption Yield**	5.7%	5.8%	6.7%	7.1%
Fixed Int. Duration	4.1	4.3	4.3	3.9
P/folio Running Yield	3.7%	4.1%	4.5%	4.7%

Source: Church House

We remain of the view that these sort of returns at such a short duration are very attractive for the Fund. We can't be certain when the current uncertainties and pressure on interest rates will subside, but we can have a high degree of confidence that these bonds will pay their interest and make their maturity payments, which equates to attractive returns for the Fund over the next few years.

Calendar Year Performance:

YTD	2022	2021	2020	2019	2018
0.6%	-7.5%	1.4%	3.8%	3.4%	-1.7%

Source: Church House, NAV to NAV, 'A' accumulation shares

**Duration represents the number of 'periods' that it will take to repay an initial investment in a fixed interest security. It is not the same as the life of the bond or time to maturity, which will be longer. It can also be viewed as a measure of the sensitivity of the price of a bond to a change in interest rates.*

***Redemption Yield represents the total return expected from the bond(s) taking into account interest received and capital gain as the bond(s) move to 'par value' (100p) at maturity.*

Swiftonomics

© Getty Images

Rose Taylor writes:
Taylor Swift's 'Eras' tour is expected to gross US$1bn next year, making it the biggest tour in music history. An additional $5bn in consumer spending is predicted in the US, with fans paying US$1000 for ticket re-sales on the secondary market. Hotel occupancy rates in Chicago reached an all-time high of 96.8% during her concerts there in June, shaking off a tough few years for the city's tourism industry and returning revenues to pre-pandemic levels.

Swift is currently re-recording her first six albums after ownership of the master recordings was sold to the private equity firm Shamrock Capital in 2020 for US$300m, giving them the rights to all profits of her songs. Pre-sale tickets for her tour film sold out swiftly, taking US$100m in the first 24 hours. The film was released on 13th October and is being shown in over 100 countries.

Church House Investment Management

www.ch-investments.co.uk

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