Pavis Premier Model Portfolios

October Quarterly Rebalance

At the end of each quarter, a rebalance takes place to bring all our Premier Model Portfolios back in line with the desired allocations. This is to ensure that the portfolios are always positioned to deliver the level of risk and return that investors expect and will result in reducing the holdings where prices have performed most strongly and buying those which have become more attractively priced.

As you are invested in the Premier Models, your portfolio will be rebalanced on 28th October 2022 and you will receive contract notes reflecting the sales and purchases that result.

Equity Weightings

We reduce our weighting to equity markets that appear expensive. We use a rules-based approach to measure markets based on the ratio of price to average earnings. This is known as the 'Cyclically Adjusted Price Earnings' (CAPE) ratio.

Below is a summary of the resulting positions for the next quarter:

Region	*Move this Quarter*	*Current Position*
UK	No Change	In line with long-term weighting
North America	No Change	20% below long-term weighting
Europe excl. UK	No Change	10% below long-term weighting
Japan	No Change	10% below long-term weighting
Developed Pacific (ex. Japan)	Change	In line with long-term weighting
Emerging Markets	Change	In line with long-term weighting
Developed World (i.e. Global)	Change	10% below long-term weighting

The main movements in CAPE were across Developed Pacific, Developed World and Emerging Markets which all reduced sufficiently to adjust the weightings. The UK, North America and Europe also reduced, but not sufficiently to alter the current weightings.

The CAPE ratio is a comparison of a stock or index price to its total earnings, which is used to tell whether its's over or undervalued. It's an extension of the traditional price-to-earnings ratio (P/E) that monitors a ten-year period to account for variations in profitability due to economic cycles.

Pavis Chartered Financial Planners

Investment Commentary October 2022

Economics

During the quarter we decided to send an ad hoc update to investors 220926-Important-investment-update.pdf (pavis.co.uk) to highlight what was happening in financial markets and particularly in the bond and fixed interest markets. The mini-budget announcements by the Chancellor were not welcomed by investors and a lack of detail explaining the unfunded tax cuts meant that the pound and the UK gilt market fell substantially. In many ways 2022 has been exceptionally challenging and recent events have only made this worse.

To put this in context, roughly 100% of the gains made in bonds and fixed interest over the last 8 to 10 years has been completely lost in the last 8 to 10 months. If this was happening to shares or property it would be headline news. For those of you with a good memory you might recall our update from January 2021 when we said:

"We believe that 2022 will be dominated by interest rates and inflation"

Whilst bonds and shares are both traded on the world's financial markets there is a fundamental difference. Bonds, in virtually all circumstances, have a known future value. In 2022 bond prices have fallen significantly as they move in opposite directions to interest rates. Putting this simply, if a bond has a duration (or term) of 5 years then a 1% increase in interest rates sees the price fall by 5% and a 1% reduction in interest rates sees the price increase by 5%. As the markets have factored in UK base rates heading towards 5% and a typical bond has a term or duration of about seven years this has resulted in capital losses of typically 35%.

Shorter duration bonds have lost less money and longer dated bonds have lost more. These price fluctuations impact the future return and whilst we can't do anything about recent market movements, we can take some comfort that investment grade UK corporate bonds now expect to provide a return of circa 7% per annum. Yields at these levels have not been seen since before the global financial crisis in 2008 and 2009. These rates are also reflected in the cash market where term deposits for 1-3 years can now be secured in the region of 4% per annum.

Investment Markets

Equities

For Q3 2022, shares in UK companies were relatively flat with the FTSE 100 index starting on the 1st of July at 7168 and finishing on the 30th of September at 6893. UK smaller companies struggled with losses of circa 9% for the quarter. Our larger companies have performed better due to their overseas trading activities. When these overseas earnings are converted back into £GBP they boost their profits. Smaller domestically focused companies don't have the same benefit.

Looking at global markets, the US markets had a more challenging quarter with the S&P 500 down about 6%. The main European markets experienced similar performance. Looking further afield, losses in the Hong Kong market were closer to 14% and since Jan 2021 the market has lost 45% of its capital value.

Fixed Interest

On a global basis bond prices were approximately 5% lower for the quarter, but UK investment grade bonds suffered losses of more like 13% with much of this triggered by falling bond prices after the mini budget. During the quarter yields on virtually all government and corporate bonds has increased significantly and this is demonstrated in the figures below:

Government Bonds (10 year)	Q2	Q3
US	3.00% pa.	3.91% pa
UK	2.13% pa	3.95% pa
Germany	1.25% pa	2.22% pa
Japan	0.25% pa	0.25% pa
Corporate Bonds		
UK Investment Grade Bonds	4.6% pa	6.60% pa
US Investment Grade Bonds	5.1% pa	5.72% pa
Global High Yield Bonds	7.0% pa	8.13% pa

The yields that we are now seeing in the bond markets, are arguably the most favourable for about 10 years. These relatively high yields now provide investors with a better return than they've seen for many years. The recent falls in the bond markets are no reason to panic and investors who remain committed should be rewarded accordingly.

Pavis Portfolios

Our Balanced Portfolio lost 3.8% for Q3 but this compares favourably to the -4.1% for its benchmark. We saw similar returns across our other portfolios with Cautious down 4.1% compared to -4.6% and Adventurous at -1.7% versus -3.6%.

We have fared better than many and with markets at current levels we are now starting to increase our equity weightings in the Pacific, Emerging Markets and Developed World regions.

Outlook

We are convinced that with relatively high bond yields and equity dividends, the future return for investors looks particularly good. The yields and dividends provide an underpin of c. 4% pa to our future returns. In addition, equity markets are typically a good hedge against inflation and capital growth in these markets would further boost returns.

Kind regards,

The Pavis Investment Committee