LOWES
INVESTMENT MANAGEMENT

Mixed Investment 0-35% Shares

Quarterly Report to 31 December 2023

Objective

To provide a total return over the medium to long term, mainly through income generation, which is sufficient to provide some capital growth, after inflation, but with a focus on keeping a low level of volatility.

Strategy

The portfolio invests in a diversified range of funds across multiple asset classes, such as equities, fixed interest and direct commercial property. Investing in line with the parameters of the Investment Association Mixed Investment 0% - 35% Shares sector, this portfolio will never have more than 35% of its assets invested in equity funds and will also tend to have a bias towards the UK to reduce the effects of currency fluctuations. The lower equity content will hopefully reduce the volatility exhibited by this portfolio in all but the most extreme market conditions, but still produce sufficient returns to protect capital against the effects of inflation in the medium to long term.

Market Commentary

After a difficult month of October most asset classes ended the quarter in positive territory. Stubborn inflation data, coupled with the potential that interest rates could remain higher for longer, initially caused concern that the global economy could potentially see a harder landing than some commentators were expecting. This had a negative impact on both equity and fixed income markets, with both asset classes remaining positively correlated.

During November, however, we started to see some sign of hope that inflationary pressures maybe starting to ease, particularly in the US, which gave asset markets reason for cheer. This was confirmed somewhat in December, when we saw a change in rhetoric from the US Federal Reserve regarding the outlook for interest rates in 2024. The latest dot plot, which plots the interest rate expectations for policy setting committee members, showed that the median expectation for 2024 was for three interest rate cuts. This caused not only fixed income prices but also equity prices to rally. Whilst the Bank of England and European Central Bank were more stubborn in their policy stance, insisting that they needed further evidence that higher inflation had been beaten, the market gave their view little credence, and priced in rate cuts anyway.

UK fixed income markets therefore posted a strong return for the quarter. Returns were particularly strong within investment grade and UK government bonds (gilts), given their higher interest rate sensitivity. The longer the duration, the stronger the return. Despite their lack of interest rate sensitivity, high yield/non-investment grade bonds also performed positively. Their return is more sensitive to changes in the credit outlook and, for now, this appears to be relatively stable, with little change in current or forecast default expectations.

In local currency terms it was US equities which led the way. The Nasdaq posted a strong return for the quarter, with the ‘magnificent 7’ companies of Apple, Amazon, Alphabet, NVIDIA, Meta, Microsoft and Tesla, continuing to deliver. Their dominance, however, was not as strong, with smaller companies head of the pack, the Russell 2000 index outperforming the Nasdaq and S&P 500. The latter performed strongly on the back of the interest rate cut expectations, which increased hope that the US economy may be able to avoid a hard landing. It was a similar picture in the UK, where the mid-sized outperformed large sized companies.

There were also positive returns for European and Japanese equities. Woes continued to be seen further east, however, with the Hang Seng posting a negative return. The market failed to be buoyed by the rally seen in western markets.

This was despite economic growth for the third quarter being above expectations, and year on year almost in line with the official annual target of 5%, coupled with a benign inflation outlook. Concerns remained that the property sector issues were still to take full effect.

Performance

The portfolio outperformed the IA Mixed Investment 0-35% Shares sector average during the quarter, with returns of 6.60% and 5.62% respectively.

With bond yields falling during the period, it was those funds with the longest duration positioning which were the strongest performers. Top of the table was the Janus Henderson Strategic Bond fund, posting a return of almost 10%. This fund has been holding a long duration position for some time now in the expectation that interest rate and inflation expectations were too high. The fund managers also hold a particular concern that the impact on the economy will be more detrimental than others expect. Duration also favoured funds such as Schroder Sterling Corporate Bond and Invesco Monthly Income Plus.

Another strong performer was the Gravis UK Infrastructure Income fund. Higher bond yields had made the underlying holdings of this fund less attractive. With bond yields falling, however, the yield on offer again caught the investors eye. There were positive returns for all funds with the exception of one, being the L&G UK Property Feeder fund, which was marginally in negative territory. Despite the fall in bond yields investors were not tempted back into this asset class. More defensively positioned funds were, in general, weaker performers, such as Tellworth UK Select and Premier Miton Strategic Monthly Income Bond but were positive performers all the same.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

There were no changes made to the portfolio during the quarter. As a result the portfolio will be rebalanced, taking the funds back to their original allocations. We continue to monitor and evaluate the asset allocation and fund selection within the portfolio, reviewing in context with current and forecast market expectations, along with the economic outlook. An appropriate level of diversification is also necessary, ensuring that the portfolio remains within the desired risk rating.

Investors appear to be more convinced than they were previously that inflation is indeed on track to move back closer to the desired objective. This is certainly something which was seen during November and particularly December. There remain some elements to inflation, however, which are proving to still be ‘sticky’ and therefore we believe that it is too early to make the call that it has indeed being defeated. Whilst the forecast is for rate cuts to be delivered in 2024, we are still potentially yet to see the full impact of the hikes we have already seen on economic growth. We, therefore, believe it is too early to hold the review that some sort of recession/economic slowdown has been fully averted or indeed that higher inflation has been contained. The portfolio therefore remains suitably diversified as further clarity is sought.