LOWES
INVESTMENT MANAGEMENT

Mixed Investment 20-60% Shares

Quarterly Report to 31 December 2023

Objective

To provide a total return from a combination of income and some capital growth over the medium to long term, sufficient to allow a low level of income to be taken whilst protecting capital against the effects of inflation.

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 20% - 60% Shares sector, this portfolio will always have at least 20% of its assets invested in equity funds but never more than 60%. The slightly higher equity content should provide for some capital growth even when taking a modest level of income, whilst the balanced nature of the different asset classes should provide a lower level of volatility compared to portfolios with a higher equity content.

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 20-60% Shares sector average during the quarter, with returns of 6.07% and 5.65% respectively.

There were strong performances from a number of funds within the portfolio during the period. In general, it was those funds with longer duration assets which performed the strongest during the period, driven by the fall in bond yields. This included funds such as Janus Henderson Strategic Bond, Invesco Corporate Bond and Schroder Sterling Corporate Bond. In general, fixed income funds were strong performers during the period. Even those with shorter duration positions, such as L&G Short Dated Sterling Corporate Bond Index, generated a return of close to 5%. The strongest performing fund was Liontrust Sustainable Future Defensive Managed. This is a multi-asset fund with a meaningful exposure to UK assets, including longer dated fixed income assets.

Despite lower bond yields, commercial property was unable to catch a break. The L&G fund ended the quarter in marginal negative territory, with abrdn Global Real Estate faring better with a return of just under 2%. Tellworth UK Select, with its market neutral approach, was also a laggard to other funds, although it posted a positive return in absolute terms. In general, it was fixed income funds which were the strongest performers during the quarter, outperforming equity funds held.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

There were no changes made to the underlying funds in the portfolio during the quarter. The portfolio will therefore be rebalanced in January. 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.

Investors appear more convinced than they were previously that inflation is indeed on track to move back closer to the desired objective. 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.

Within fixed income funds that means an allocation to funds which prefer exposure to credit, whilst others prefer government bonds. There are also some who prefer shorter duration positions, in the belief that inflation might not quite be done yet and therefore central banks will not be as quick to move as market participants anticipate. Others meanwhile hold positions which gives them a greater level of interest rate sensitivity in the belief that a harder economic landing can be expected. Specialist fixed income funds are also allocated to.

Within equities the preference remains for funds which are looking to generate an income. Compounding income is sometimes known as the eighth wonder of the world. Companies which can pay and grow their dividend through slower economic times can provide important ballast to the equity element of a portfolio.