LOWES
INVESTMENT MANAGEMENT

Cautious Managed

Quarterly Report to 31 December 2023

Objective

To provide capital growth over the medium to long term, mainly through income producing funds, making it suitable for those looking to make regular withdrawals, and with a focus on lower cost investments.

Strategy

The portfolio has been constructed so that asset allocation is in line with the investment restrictions of the IA Mixed Investment 20%-60% Shares sector. The portfolio invests in equity, fixed interest, property and multi-asset funds, with a focus on lower cost options, where appropriate, but not at the expense of flexibility or an increase in internal risk.

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 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 underperformed the IA Mixed Investment 20-60% Shares sector average for the quarter, returning 4.64% and 5.65% respectively.

The strongest performing funds were those fixed income funds with longer duration, including L&G Active Sterling Corporate Bond and Vanguard UK Investment Grade Bond Index. Their greater level of interest rate sensitivity meant that they performed well on the back of falling bond yields. Shorter duration bond funds, such as L&G Active Sterling Corporate Bond, generated a positive return but not as strong as those above.

Weaker performers were equity funds allocated to. HSBC FTSE All Share Index and Vanguard FTSE UK Equity Income Index have a large cap bias. Whilst they were positive returning, there were stronger returns available from mid and small cap companies during the period. Vanguard Global Equity Income also lagged. The weakest performance however came from property funds. Commercial property failed to catch a significant lift despite lower bond yields.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

There were no changes made to the portfolio during the period. The portfolio will be rebalanced in January in line with the rules governing the Managed Investment Portfolio proposition. This will bring the underlying fund allocations back to their original level.

This portfolio is managed against an additional mandate of focussing on lower cost investment solutions. This tends to lend itself to passive investing, but we are aware that active management can be achieved when there are, for example, funds offering a founder share class which carries with it a lower fee. There are certain areas where active management is already used within the portfolio, such as property and high yield bond investing, where we believe investing passively here is not necessarily the correct route.

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. Within the fixed income exposure we continue to maintain a blend of funds with shorter and longer duration. Whilst inflation certainly looks like it is headed in the right direction, it could still be too early to call that it has been defeated. This, coupled with the still higher yields available at the shorter end of the yield curve, means that bonds with lesser time to maturity still look more attractive than they have for some time. Markets have already priced in a significant level of interest rate cuts for 2024. The key question is has the market got it right or has it got ahead of itself.

We are currently reviewing the level of property exposure within the portfolio given the recent performance despite lower bond yields. Within the equity allocation we are reviewing the market capitalisation exposure. There was previously an allocation to UK mid-cap stocks via an index tracking fund. This was removed in favour of global equity income, which proved the right call to make, but thought is now being given to perhaps adding some exposure back given the change in interest rate outlook.

Disclaimer

The portfolio is managed on a discretionary basis therefore the investment manager may make changes to the investments held without notice. Investors are agreeing to the investment model as recommended by an Adviser and may not be investing into the specific assets included in this report.

Past performance is not a guide to future performance. The value of investments and any income from them can fall as well as rise and are not guaranteed, so you may get back less than you invested. If you invest in currencies other than your own, fluctuations in currency value will mean that the value of your investment will move independently of the underlying asset.

Consideration should be given to whether it is felt that the outcome of any risk assessment is accurate and advice should be sought for factors such as investment objectives, the investment term, attitude to risk, capacity for investment loss and the level of inflation.

This illustrative document is intended for investors where advice has been given by Advisers. Models are prepared in accordance with the stated objective and not client circumstances. Information from given sources is taken to be reliable and accurate, which Lowes Investment Management Ltd cannot warrant for accuracy or completeness.

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