LOWES
INVESTMENT MANAGEMENT

Changing World

Quarterly Report to 31 December 2023

Objective

To provide capital growth over the long term by investing in funds which take exposure to what are perceived to be global megatrends.

Strategy

The portfolio has been constructed to invest in funds with exposure to themes that are perceived to be major trends which will shape the world in the future. These are trends which will be driven by demographics, technology, the environment and social behaviour. The portfolio will therefore contain exposure to themes such as technology, alternative energy, food supply, water supply, biotechnology and healthcare, along with companies that offer significant growth prospects, with an emphasis on companies operating in industries with potential for structural change and innovation.

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

During the quarter the portfolio outperformed the IA Global equity sector average, posting returns of 8.17% and 6.84% respectively.

Given the strong performance of the Nasdaq and therefore the S&P 500 during the period it is perhaps no surprise that the strongest performing fund during the period in the portfolio was Polar Capital Global Technology, posting a double digit return. The fund has a high exposure to the 'magnificent 7' with the exception of Tesla. The fall in bond yields also positively impacted Baillie Gifford Global Discovery, a fund which looks to invest in companies that offer significant growth prospects, with a focus on those operating in industries with potential for structural change and innovation.

There were only two funds within the portfolio which underperformed the IA Global equity sector average, although both posted a positive return in absolute terms. The weakest performer was Polar Capital Healthcare Blue Chip. Whilst the thesis behind healthcare long term still prevails, especially given aging demographics, investors were not captured by this sector given its more defensive characteristics. The second weakest performer was Guinness Sustainable Energy. However, medium to longer term, the desire, political and public will to move to decarbonised energy sources should mean that the underlying holdings in the fund continue to see demand from end user for their products and therefore investors due to the positive demand outlook.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

During the quarter there were no changes made to the underlying funds. The portfolio will therefore be rebalanced in January, which will bring the underlying fund exposures back in line with their original allocation. In an ever changing world we continue to monitor fund offerings available which may provide exposure to what could be considered the next megatrend. The fund continues to invest in areas such as artificial intelligence, robotics, ecommerce, clean energy, the battery value chain and biotechnology.

During shorter timeframes there may be periods of heightened volatility or even underperformance relative to global equities, given the nature of the themes and funds being invested in. In times such as these it is important that investors who are looking to gain exposure to these megatrends are able to look through that volatility.