
# Defensive Growth

Quarterly Report to 31 December 2023

## Objective

To protect capital values against the effects of inflation over the medium to long term, whilst minimising the effects of market downturns.

## Strategy

The portfolio is constructed so that at least sixty percent will be allocated to Targeted Absolute Return funds which seek to generate positive returns in all market conditions with significantly less volatility than equities. This means that these strategies can include a greater use of derivative based strategies by the underlying fund managers. The remainder of the portfolio will include an allocation to funds from other Investment Association (IA) sectors where it is believed that they contribute to the overall portfolio objective.

## 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 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 posted a return for the period of 4.49%, outperforming the sector average of 2.94% for the IA Targeted Absolute Return sector. Performance was particularly strong during November and December, on a relative and absolute basis.

Stronger performing funds during the period tended to be those which are mixed asset in terms of asset allocation. The strongest performing fund was CT Dynamic Real Return. This fund does not look to hedge equity or fixed income positions through derivatives, etc. The positioning in UK fixed income was particularly beneficial during November and especially December. Positive returns from equity markets were also a benefit to the fund. There were also strong performances from M&G Episode Allocation and Rathbone Total Return, with all three funds returning in excess of 6%. The latter benefitted from its higher exposure to fixed income, which sits within a ‘liquidity’ bucket, which is close to the top end of the permitted allocation range.

Weaker performances came from those funds which look to hedge away or remove market risk, such as the long/short equity funds which are allocated to within the portfolio. This included funds such as Tellworth UK Select, Janus Henderson Absolute Return and BlackRock UK Absolute Alpha. All funds posted a positive return, however, during the period.

*Source: FE Analytics, Bid-Bid, Total Return*

## Portfolio Activity and Positioning

Changes to the portfolio were made during the third quarter, which saw the concentration to two funds reduced, with the proceeds reinvested into a new fund. There were, therefore, no changes made during the quarter. Given that the portfolio was rebalanced following this change, one does not need to be made at the end of this quarter.

We continue to monitor the portfolio in terms of fund selection and the underlying, look through asset allocation which this provides. For now we remain comfortable with this and the balance between funds which are looking to achieve their return through diversification of assets and those which are deploying hedging techniques. Whilst the portfolio is monitored against the IA Targeted Absolute Return sector we remain comfortable with the inclusion of funds from outside this sector given their risk/return profile.