LOWES
INVESTMENT MANAGEMENT

Cautious Managed (Bond)

Quarterly Report to 30 September 2024

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 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. This portfolio does not invest in direct property, to make it more suitable to be held within a Bond wrapper.

Market Commentary

From an economic perspective concern clearly shifted from inflation to economic growth. For now, inflation appears to be behaving itself. In the euro area the rate has fallen below 2%. In the UK, consumer price inflation has now held steady at 2.2% for two consecutive months. In the US, meanwhile, we have also seen a move down towards target, falling most recently to 2.5%. Whilst there are still some components of the inflation basket which remain sticky, such as housing rents, concerns are dissipating.

Narrative is now more closely focussed on economic growth and how central banks protect it. Whilst the most recent forecast from the Organisation for Economic Co-operation and Development (OECD) remains relatively positive, investors are keen to understand how western central banks will navigate from the current higher interest rate environment to one more commensurate with lower inflation. There was concern that the US Federal Reserve (Fed) had left it too long after a weak August jobs report. This triggered them into action, with their first move being a 0.5% reduction. The market also priced in a number of subsequent cuts in quick fashion. It has not been uncommon for the market to get ahead if itself, a point in case being the fourth quarter of last year. It may have done so again this time too, following a stronger than expected employment report for September which appears to have reinforced the soft landing thesis.

The Fed, European Central Bank (ECB) and Bank of England are all expected to continue their path of cutting moving forward. The exception to the rule is the Bank of Japan who appear to be in hiking mode. They caught the market off guard with their most recent hike at the end of July, which sent equity markets into a downward spiral. Whilst the hike was only a small 0.15%, it was enough to unsettle investors.

With US interest rates moving one way and Japanese in the other, we saw what appears to be a partial unwinding of the carry trade in early August, the carry trade being where investors borrow in a lower yielding currency, i.e. the Japanese yen, to invest in higher yielding currencies/assets. No one is quite sure exactly how large the positioning in the carry trade is, with some wide ranging estimates. The general consensus is that positions in the carry trade still exist and therefore a keen eye will likely be kept on the Bank of Japan.

The weakness in markets was met this time with investors keen to get back into the market at lower valuations. Liquidity is certainly abundant, with the Investment Company Institute reporting $6.46 trillion in money market funds in the US. The question is, is this money likely to make its way into investment markets or stay parked where it is. Plenty to monitor as we enter the final quarter of 2024.

LOWES INVESTMENT MANAGEMENT

Performance

The portfolio posted a return for the period of 2.63%. This was ahead of the IA Mixed Investment 20-60% Shares sector average return of 2.28%.

The strongest performing fund during the quarter within the portfolio was the Vanguard FTSE UK Equity Income Index fund. Income yielding assets were generally stronger performers in a period where the expectations for interest rate cuts rose. UK equity income outperformed global equity income.

Another strong performer during the period was the Baillie Gifford High Yield Bond fund. With the outlook for corporates in terms of earnings, etc, remaining strong, we saw little change in the credit outlook for this asset class, along with no meaningful pick up in default rates. This allowed the fund and asset class to perform well, with investors again attracted to the higher level of yield which it offers.

An improvement in the economic outlook for the UK meanwhile meant that we saw mid cap stocks outperform their larger cap counterparts. We saw an upgrade in the economic forecast from organisations such as the OECD who now expect the UK economy to grow 1.1% in 2024 compared to the previous forecast of 0.4%. We therefore saw a stronger performance from the HSBC FTSE 250 Index holding, which outperformed the holding which tracks the broader FTSE All Share. The latter has a higher weighting to large cap stocks.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

During the quarter the HSBC FTSE 250 Index fund was re-added to the portfolio. This was funded by a reduction in the exposure to the HSBC FTSE All Share Index fund. The UK economy has proven more resilient, with stronger growth seen so far this year and the International Monetary Fund (IMF) upgraded its forecast for this year. This was subsequently followed by the OECD. Whilst the absolute level of growth remains low, the positive earnings revision should benefit those companies more tuned to the UK economy, which we feel favours companies within the FTSE 250 index.

The tilt towards UK equity remains within the portfolio, although exposure to global equities is made through the Vanguard Global Equity Income fund and through the multi-asset funds allocated to. The UK equity market remains one of the cheapest from a valuation perspective, both relative to its own history and other developed equity markets.

Within the fixed income allocation we continue to monitor the balance between credit/corporate and government bond exposure. In the absence of any real pick up in defaults, we are happy with this positioning for now. We recognise however that the additional yield which you earn for holding corporate over government debt, also known as the credit premium, is close to historic lows. This can remain the case for some time as long as corporate earnings remain healthy and the all in yield is high. Should we see a deterioration in corporate earnings we may look to diversify to provide a greater exposure to government bonds. This could of course be influenced by what we see in terms of future government spending and the impact this would have on supply.

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.

Lowes Investment Management is authorised and regulated by the Financial Conduct Authority (192938).