LOWES
INVESTMENT MANAGEMENT

Global Select

Quarterly Report to 30 September 2024

Objective

To provide capital growth over the medium to long term through a diversified portfolio of funds investing in global equities.

Strategy

Investing only in equities, the portfolio is designed to maintain a global exposure and focusses on funds whose remit is to invest in areas of the world's equity markets which, although possibly more volatile, we believe offer the prospect of higher long term capital growth. In line with the desire to maintain a balance of investments around the globe, UK equities will usually represent at most 20% of the portfolio.

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.

Performance

During the quarter the portfolio posted a return of 0.89%, which was ahead of the IA Global sector average return of 0.15%. The return profile by no means straight line. As discussed above, there was a sharp fall in equity markets at the beginning of August on what appears to have been a partial unwound of the carry trade. This was met with a sharp bid by investors, although there was a further bout of volatility at the beginning of September.

The strongest performing underlying funds during the period were the two Asian equity funds held, namely Jupiter Merian Asia Pacific and FSSA Asia Focus. These two funds had been in the doldrums for much of periods, only coming to life in the final few weeks of September. This was on the back of the release of stimulus measures from the Chinese authorities with a view to supporting the economy and reigniting consumer confidence. There was a strong positive response from Chinese equities. This also had a positive impact on the performance of the Lazard Emerging Markets fund.

Another strong performer with the portfolio was Schroder Recovery, which invests in the UK equity market, to a value style bias. The prospect for further interest rate cuts was a positive for the economic outlook for the UK. This provided impetus for consumer discretionary stock share prices to push higher, the largest sector exposure within the fund. Lower interest rates are also a positive for banks, helping to improve their profit margins. This was again a positive for share prices, with financials being the second largest exposure.

Finally, the portfolios newest holding, the Vanguard Global Small Cap Index fund, also performed well on the back of expected economic growth resilience. This area of the market was also supported by the prospect for lower interest rates, with more floating rate loans typically being held by smaller companies.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

In July there were a number of changes made to holdings in the portfolio. The first saw the removal of the FSSA Japan Focus fund. This followed a period of weaker performance, much of which can be attributed to the investment style of the fund, which was not in favour with investors. Whilst we could foresee a turnaround here in a different investment environment, the fund was put on internal review by FSSA due to dwindling assets. The decision was therefore made to exit the position.

In its place a position in the Fidelity Japan Index fund was taken. This tracks the MSCI Japan Index and therefore provides exposure to both large and mid-cap stocks. At the same time the exposure to Japan was reduced. This follows a very strong period of performance. The potential for further yen carry trade reversal also remains as long as the Bank of Japan is in rate hiking mode. This would be positive for the currency, which has historically been a negative for the equity market.

As mentioned earlier, a new position was added to the portfolio in the form of the Vanguard Global Small Cap Index fund. Global small cap companies, from a valuation standpoint, potentially offered an attractive entry point. Across the US, Europe ex UK and the UK they were trading at a discount to their long term average valuation. At the same time, Smaller companies in the US and Europe were trading at a lower valuation than their large cap counterparts, something which is against the norm. Interest rates coming down should be a positive for small cap equities, along with a soft rather than hard economic landing.