LOWES
INVESTMENT MANAGEMENT

Mixed Investment 0-35% Shares

Quarterly Report to 30 September 2024

Objective

To provide a total return over the medium to long term, mainly through income generation, which is sufficient to provide some capital growth, after inflation, but with a focus on keeping a low level of volatility.

Strategy

The portfolio invests in a diversified range of funds across multiple asset classes, such as equities, fixed interest and direct commercial property. Investing in line with the parameters of the Investment Association Mixed Investment 0-35% Shares sector, this portfolio will never have more than 35% of its assets invested in equity funds and will also tend to have a bias towards the UK to reduce the effects of currency fluctuations. The lower equity content will hopefully reduce the volatility exhibited by this portfolio in all but the most extreme market conditions, but still produce sufficient returns to protect capital against the effects of inflation in the medium to long term.

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

The portfolio posted a return of 3.29% for the quarter, outperforming the 2.46% posted by the IA Mixed Investment 0-35% Shares sector average. Twelve of the fund holdings within the portfolio outperformed this sector average during the period. All funds allocated to post a positive return.

Those funds investing in long duration assets within the portfolio were the strongest performers. The strongest performing fund was the Janus Henderson Strategic Bond fund. This fund has a duration position of over 9 years, meaning that its performance is more sensitive to changes in interest rate expectations. The 0.5% cut announced by the Fed, along with the pricing in of further to come, was highly beneficial. Other fixed income funds to benefit from this were Nomura Global Dynamic Bond and Artemis Strategic Bond.

VT Gravis UK Infrastructure Income was also a strong performer. As the yield from cash falls, that available from the underlying infrastructure projects in which this fund invests becomes more attractive. Some also offer contractual, inflation linked income and therefore provide an element of security. The yield of over 6% was enough to tempt investors. For the same reasons we saw a positive return from the L&G Property fund.

There was no real pattern into who the weaker performers were in the portfolio over the quarter, with Royal London Sustainable Managed Growth and Man GLG Income being towards the bottom of the table.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

During the quarter there were no changes made to the underlying funds within the portfolio. The portfolio was rebalanced in July, which will return the allocation to each fund to its original level. Whilst we continue to monitor closely the funds allocated to and the asset allocation which they provide, we remain comfortable with the current balance between the main asset classes of equities, fixed income and alternatives, the latter including areas such as property, infrastructure and long/short equity.

Within the fixed income allocation, the preference is to be allocated to strategic bond funds. This is due to the flexibility which they have within their mandate. This gives them the ability to invest across a wider range of fixed income asset classes and have greater control over the interest rate sensitivity of the portfolio through duration management. An investment grade only corporate bond fund is allocated to but here the investment process and philosophy is highly active in terms of looking to identify mis-priced investment opportunities, where the fund managers believe that the market has the financial and credit outlook for the company wrong.

The allocation to the current suite of fixed income funds gives us a bias towards credit, or bonds issued by companies, rather than government bonds. We would add here that the strategic bond funds in particular have the ability to adjust this at their discretion. In the absence of any real pick up in defaults, we are happy with this positioning for now. We do 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. Should we see a deterioration in this position, or a hard rather than soft economic landing becomes evident, we may look to diversify to provide a greater level of 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.

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