Mixed Investment 20-60% Shares

Quarterly Report to 30 September 2024

Objective

To provide a total return from a combination of income and some capital growth over the medium to long term, sufficient to allow a low level of income to be taken whilst protecting capital against the effects of inflation.

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 20-60% Shares sector, this portfolio will always have at least 20% of its assets invested in equity funds but never more than 60%. The slightly higher equity content should provide for some capital growth even when taking a modest level of income, whilst the balanced nature of the different asset classes should provide a lower level of volatility compared to portfolios with a higher equity content.

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 3.00% for the quarter, which was ahead of the IA Mixed Investment 20-60% Shares sector average return of 2.28%.

Given the increased expectation for interest rate cuts it was perhaps no surprise that the strongest performers were those funds/assets with longer duration and therefore increased sensitivity to interest rate movements. The Janus Henderson Strategic Bond fund was the strongest performer within the portfolio. This was due to the fund having a duration position in excess of 9 years. The fund manager is contrarian to the consensus view at present, believing that we will see a hard landing in the economy. Three of the top four performers in the portfolio were fixed income funds, the others including Nomura Global Dynamic Bond and TwentyFour Dynamic Bond.

The top performing equity fund during the quarter was the Evenlode Global Income fund, which was pleasing to see after a previous period of weaker performance. A focus on high quality dividend paying companies, displaying sustainable real dividend growth along with high returns on capital and strong free cash flow, stood the fund in good stead in what was a volatile August in particular.

Another strong performer during the period was the Aegon Diversified Monthly Income fund, benefitting from its fixed income positioning. The fund's exposure to specialist income also stood it in good stead, with this area being supported by the prospect for lower interest rates.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

During the quarter we made one fund switch within the portfolio. Firstly we excited the Liontrust Sustainable Future Defensive Managed fund. From a performance perspective the fund has underperformed relative to its sector peers. Furthermore, from an asset allocator perspective the fund tends to stick to the traditional areas of equity and fixed income only and we were looking to add a fund which was more progressive on asset allocation decisions.

In its place we allocated to the Aegon Diversified Monthly Income fund. As well as allocating to traditional equity and fixed income markets it also invests in an area which it calls specialist income. This can cover a wide array of alternative asset classes, such as property or infrastructure plays, helping to diversify the income stream which the fund earns. Within the equity and fixed income allocations the fund managers invest in sub-portfolios which have been specifically designed to meet the needs of the fund, with in-house Aegon fund managers running on their behalf. The Aegon fund has a lower ongoing charge figure than the Liontrust fund and typically has a strong income yield, often in excess of 5%.

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. 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. Should we see a deterioration in this position, 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.