Managed Portfolio Service

Quarterly report – Q4 2023
Annual report – 2023

Introduction

The stock market concluded 2023 on a high note, providing strong returns to investors. Despite the assumption that cash would reign supreme, stocks emerged as the best performing major asset class, surpassing the returns from the highest yielding bank accounts.

Bonds, after a challenging start, ended the year strongly in anticipation of interest rate cuts in 2024 which led investors to flock to bonds to secure the relatively high yields on offer. Gold continued its impressive performance throughout the year, despite generally weak commodity prices.

All in all, this was a far kinder year for investors than 2022, where most investments struggled against the sharp increase in inflation which led central banks to raise interest rates far faster than they had expected.

So, what enabled investments to prevail over the last few months? A lot comes back to interest rates, with the threat that higher rates might persuade investors to take the road less travelled of lower but more stable returns. However, 2023 exposed the risks of that strategy; investors flocked to bonds to lock in the relatively high yields on offer in anticipation that interest rates will be cut during 2024.

2023 saw inflation trend downwards and its continuation along that path was a major theme of the final quarter, particularly in the UK. Over the course of the year, agricultural and energy commodities declined by around 10% each, with energy proving to be particularly weak during the final quarter of 2023.

The UK's energy price cap, together with the government's support, sheltered households from the most severe rises as experienced in European gas markets. However, it did mean prices rose sharply in October 2022 and therefore contributed to the seemingly outlandish inflation rate reported in the UK. As the one-year anniversary of those increases passed, UK inflation has declined more significantly.

The decline in inflation, particularly the element relating to high commodity or transit costs, is of course reassuring. But while consumers can hope to benefit from lower price increases, reduced inflation also raises the possibility that recession will be avoided.

And while the performance of the stock market seemed to disproportionately reflect the performance of seven individual companies - a source of concern for some - as 2023 closed out, a much broader stock market rally was underway.

The big picture in Q4 2023

- October was marked by significant events including a surprise attack by Hamas on Israel, leading to concerns of a broader war in the Middle East.
- The US experienced political turmoil with the ousting of Kevin McCarthy as the speaker of the House of Representatives, causing a paralysis in the legislative process.
- Economic indicators such as bond yields and oil prices fluctuated due to these geopolitical tensions and the US Treasury's decision to reduce long-term bond issuance. Given these challenges, the equity market faced headwinds, ending the month lower.
- November saw a rebound in the equity market with the best monthly returns since the previous year. This was largely due to a reduction in interest rate expectations, triggering a rally in invested assets and providing relief to real estate stocks. The technology sector also performed well, reflecting its inverse relationship with bond yields.
- Meanwhile, Chinese economic activity exceeded expectations but remained weak, with Beijing implementing selective measures to address the housing downturn.
- December saw a rise in US personal spending data, indicating a robust consumer market supported by excess savings, a resilient job market, and falling gasoline prices. This led to the S&P 500 nearing record highs. However, Chinese stocks experienced volatility due to potential strict regulations on the gaming industry.
- The Bank of Japan's decision to maintain negative interest rates kept traders on their toes, with potential implications for global markets. Despite this, the impact was more on its currency rather than global bond yields, suggesting that the removal of low interest rates in Japan may not hinder a rally in global bonds in 2024.

Market overview Q4 2023

- Asset class performance in Q4 2023 was marked by a series of significant events, but despite the challenges, markets showed resilience and ended the quarter on a positive note.

- A reduction in interest rate expectations triggered a rally in invested assets and provided relief to real estate stocks in particular, which saw a robust return of 12.6%. North American equities also did well and returned 7%. Despite volatility in Chinese stocks due to potential strict regulations on the gaming industry, the emerging market equities still managed to return 5.4%.

- Bonds also performed strongly in response to the increasing likelihood of interest rate cuts in 2024 and returned between 5% and 8%.

- Finally, gold also rallied strongly, giving a return of 6.3%, indicating its role as a safe haven during times of uncertainty.

The value of investments can fall and you may get back less than you invested.

MPS performance

MPS PERFORMANCE												
	Q4	2023	1yr	2yr	3yr	4yr	5yr	2022	2021	2020	2019	2018
Cautious Portfolio	5.9	6.8	6.8	-3.9	-0.3	6.2	17.9	-10.1	3.7	6.7	11.2	-2.6
Cautious Higher Equity Portfolio	6.0	7.4	7.4	-3.2	2.2	8.7	21.1	-9.9	5.5	6.6	-2.6	-2.7
Income Portfolio	5.8	7.7	7.7	-2.5	4.2	11.1	26.9	-9.5	6.8	6.8	14.5	-4.2
Income Higher Equity Portfolio	5.5	8.3	8.3	-1.2	7.2	14.4	31.2	-8.8	8.4	6.8	14.5	-4.2
Balanced Portfolio	5.3	8.7	8.7	-1.1	9.5	17.7	36.9	-9.0	10.8	7.6	16.4	-3.9
Growth Portfolio	4.8	9.0	9.0	-1.1	12.4	23.3	46.0	-9.2	13.8	9.9	18.4	-4.2
Global Equity Portfolio	4.3	9.7	9.7	-0.2	15.9	26.8	53.8	-8.9	16.3	9.7	22.1	5.2

All figures shown above are calculated to 31 December 2023.

Performance Calculation: All income is reinvested. Performance is shown inclusive of underlying fund charges but gross of RBC Brewin Dolphin's investment management charge. Deduction of this charge will have the result of reducing the illustrated performance. Neither simulated nor actual past performance are reliable indicators of future performance.

MPS performance highlights Q4 2023

Asset Allocation

What worked and why?

The overweight to UK Sovereign Bonds and the underweight to Absolute Return have been positive contributors. UK gilts rose over 8% over the quarter as central banks accepted the possibility of lower interest rates during 2024. Absolute return strategies that aim to deliver steady gains struggled to keep up with strong equity and bond markets.

What didn't work and why?

The underweight to property and overweight to cash was a mild contributor to under performance. Property surged in the latest market rally whilst cash couldn't compete with strong returns on bonds and equities.

Fund Selection

What worked and why?

The tech-focused Baillie Gifford American strategy outperformed on the back of developments in AI. The Man GLG Sterling Corporate strategy outperformed its benchmark. The Ninety One Global Macro Alternatives strategy had a strong run over the quarter but a period of under performance.

What didn't work and why?

Value investments have struggled over the fourth quarter. In the US, the income strategies from BNY Mellon and the JPM were a drag. The Graham Macro and the Winton funds, which are intended to deliver steady, uncorrelated returns, have been a drag at a time when all other asset classes were rising strongly.

MPS portfolio changes Q4 2023

Asset Allocation

There were no changes to the strategic asset allocations this quarter.

In October, the Asset Allocation Committee took advantage of the higher rate environment by increasing UK gilts and inflation-linked bonds by 0.5% each, funding this addition from absolute return and cash.

In December, the Committee decided to modestly increase exposure to equities by 0.5%, paying for that upgrade by reducing absolute return. The Committee also boosted the US weighting by 0.5%, at the expense of each of the other geographical regions, as the US market is most exposed to the upside of an 'AI boom', but also should be the most defensive market in a cyclical recession.

Fund Selection

In October, the Blackrock Sterling Liquidity fund and MI Select Managers Alternatives fund were reduced by 0.5% each. The MI Select Managers Bond fund has been increased.

In December, the MI Select Managers North American fund was increased, while a number of other regional equity funds were decreased. The MI Select Managers Alternatives fund was also decreased.

MI Select Manager fund weights

MISM FUND WEIGHTS			
Date	MISM Fund	Mandate	Weight (%)
31/12/2023	MI Select Managers Bond Instl Inc	Robeco Global Credits	21
		Man GLG Sterling Corporate Bond	14
		Insight UK Government Bond	21
		Colchester Global Bond	26
		Other Fixed Income Funds	4
		DWS US TIPS	14
31/12/2023	MI Select Managers NA Equity Instl Inc	JPM US Equity Income	32
		Baillie Gifford American	10
		BNY Mellon US Equity Income	27
		Brown Advisory US Sust Growth	31
31/12/2023	MI Select Managers UK Eq Inc Instl Inc	Ninety One UK Equity Income	41
		Man GLG UK Equity Income	41
		CT UK Equity Income	18
31/12/2023	MI Select Managers UK Equity Instl Inc	JPM UK Equity Core	34
		Redwheel UK Equity Income	30
		Lindsell Train UK Equity	29
		Teviot UK Smaller Companies	7
31/12/2023	MI Select Managers Alternatives	Commodities and other alternatives	38
		Muzinich Global Tactical Credit	15
		Ninety One Global Macro Alternatives	12
		Schroder Global Cities	16
		GS Global Convertible Bond	7
		Absolute Return funds	12

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Managed Portfolio Service

Annual report – 2023

MPS annual market overview 2023

- The stock market concluded 2023 on a high note, providing strong returns to investors. Despite the assumption that cash would reign supreme, stocks emerged as the best performing major asset class, surpassing the returns from the highest yielding bank accounts. North America lead the way with an impressive 18.8% return, followed by Developed Europe excluding UK at 14.4%, and Japan at 13.3%.
- Bonds, after a challenging start, ended the year strongly in anticipation of interest rate cuts in 2024, which led investors to flock to bonds to secure the relatively high yields on offer. UK Corporate Bonds had a particularly strong year, returning 9.7%, as did Global Corporate Bonds, returning 7.9%.
- The year was more favourable for investors compared to 2022, which saw most investments struggle due to a sharp increase in inflation.
- Inflation trended downwards in 2023, particularly in the UK, driven by a decrease in commodity prices, notably both oil and natural gas. Lower energy prices were beneficial for consumers and most businesses. Governments, recognising the impact of rapidly changing energy prices, implemented measures to mitigate their effects. We have seen a steady normalisation from the disruptions to supply chains that were a major source of inflation in 2022.
- The lack of demand from China, which continues to struggle economically, has helped the rest of the world on the path to inflationary salvation.
- The rapid decline in cost-driven inflation across 2023, coupled with sharp pay increases for lower income cohorts, means many consumers are now seeing their pay outpace price increases. This will enable them to spend or save more.
- The emergence of artificial intelligence (AI) was a positive catalyst for markets as investors anticipate it acting as a major growth driver for the global economy beyond 2023, with the potential to reduce inflationary pressure and enable companies to deliver their services more cheaply.
- The performance of alternatives was also positive, with gold returning 8% and Absolute Return at 4.8%. Gold continued its impressive performance throughout the year, despite generally weak commodity prices. Even property was positive despite challenges, returning 5.1%.
- Overall, 2023 was a more favourable year for investors compared to 2022, with invested assets providing positive returns.

MPS performance highlights 2023

Asset Allocation

What worked and why?

The underweight position to property and to bonds have been positive for excess performance over a year when equities performed well.

What didn't work and why?

Given the strong run in risky assets, the overweight to Cash has represented a drag to excess performance.

Fund Selection

What worked and why?

The growth exposed Baillie Gifford American strategy as part of the MI Select Managers North American fund has outperformed its benchmark. In the UK, the value-exposed strategy from Redwheel has been a contributor. Among bonds, the sterling corporate strategy from Man GLG has greatly outperformed. The SCOR fund within the MI Select Managers Alternative fund has had a strong year.

What didn't work and why?

The NinetyOne Global Macro Alternative strategy in the MI Select Managers Alternatives fund has underperformed the benchmark. The fund was positioning bearishly for much of the year which worked against it.

MPS portfolio changes 2023

Asset Allocation change highlights

Throughout the year, the Asset Allocation Committee took advantage of spikes in bond yields to add to bond exposure. In January, it increased the allocation to UK gilts and global inflation-linked bonds by 0.5% each, funded by a reduction in cash and absolute return. In March, it maintained a small underweight to equities but neutralised regional tilts due to uncertainty in markets. In May, the Committee increased the allocation to UK gilts and made small adjustments to the regional equity allocation. In July, an increase in fixed income was offset by a decrease in absolute return exposure. It added 0.5% each to global sovereigns and inflation-linked bonds, and rotated 0.5% from global credit into UK credit. In October, it increased UK gilts and Inflation-linked bonds by 0.5% each, funded by absolute return and cash. As the likelihood of a soft-landing appeared to increase, in December, the Committee increased exposure to equities by 0.5%, funded by reducing absolute return, and boosted the US weighting by 0.5%.

Fund change highlights

In Q1, the MI Select Managers Bond fund was increased, while the MI Select Managers Alternatives fund and cash were reduced. Within equities, as a result of the change in strategic asset allocation, the MI Select Managers UK Equity and the MI Select Managers UK Equity Income have been reduced in favour of an increased exposure in overseas equities.

The Winton Trend strategy was added to the MI Select Managers Alternatives fund in February following the recommendation from our analysts. It should act as a good diversifier for the broader portfolios.

In Q2, the Man GLG Sterling Corporate bond strategy was introduced in the MI Select Managers Bond fund. It replaces PIMCO UK Corporate Bond which saw the fund manager retiring over the summer. The Graham Macro fund was also added as a holding within the MI Select Managers Alternatives fund. Its team has a strong track record and should improve diversification within the Alternatives exposure.

In Q3, the allocation to the MI Select Managers Bond fund was increased while the MI Select Managers Alternatives fund was decreased. Given Japan's potential for a move towards a normalised interest rate environment for the first time in many years, the Man GLG Japan Core Alpha was increased. The allocation to Baillie Gifford Japanese has been reduced.

In Q4, the Blackrock Sterling Liquidity fund and MI Select Managers Alternatives fund were reduced by 0.5% each. The MI Select Managers Bond fund and the MI Select Managers North American fund have been increased. The Artemis US Select strategy was replaced by Brown Advisory US Sustainable Growth in December 2023.

Asset Allocation Committee investment outlook

These views are implemented across our portfolios but there may be deviations where asset classes or suitable investments are unavailable or excluded.

Cash

We remain overweight cash, which is a relatively attractive asset class at a time when global growth momentum is slowing but bonds are not rallying. Moreover, the Bank of England base rate continues to move higher.

Bonds

With central banks now looking ahead to rate cuts, we maintain an overweight to government bonds. We remain underweight corporate bonds. Credit spreads are not sufficiently large to compensate for global economic growth risks, in our view.

Global Equities

Supportive of the global equity market is the resilience the economy has exhibited. Indeed, the probability of a US soft landing appears to have risen. Meanwhile, there is the potential for AI-related themes to push equity prices higher. The main headwinds are sentiment and positioning (on balance already bullish), the current stage of the economic cycle (late), US valuation metrics (high), and the returns available on competing assets such as cash (high). Weighing everything up, holding a tactical equity exposure broadly in line with one's strategic benchmark appears sensible.

Alternatives

Gold broke out to a new all-time high in USD terms late last year thanks to a weak dollar, strong central bank buying (particularly from China), and the recent decline in real bond yields. However, on a longer-term basis, the gold price appears stretched considering how much real bond yields have risen over the last couple years. In addition, after declining so violently, real yields probably don't have a lot further to fall, at least for now. Finally, sentiment toward gold had improved in recent months and is now clearly bullish, which should make further gains more difficult. Against this backdrop, we retain a neutral position. We remain underweight property. It is often the case that one corner of the economy and/or markets "breaks" in response to central bank rate hikes, and commercial real estate seems like a prime candidate to experience pain in this cycle. Fundamentals are particularly challenging in the office space, but those are offset by stronger fundamentals in other subsectors, such as datacentres.

UK Equities

The UK market is undeniably cheap and unloved. With that in mind, it might not need a lot of good fundamental news to outperform. However, the most important determinant of UK equity relative performance is global sector and style performance. Given its high weightings in value-oriented sectors like energy and financials, and low weightings in growth sectors such as tech, the UK equity market benefits strongly during periods when global value stocks outperform. The bad news is that the outlook for value appears uninspiring. The composition of the UK market also probably makes it a good hedge against an inflation problem. Cyclically, inflation pressures have moderated. The pound would be vulnerable to a decline if markets go back into risk off mode, and the odds of that happening seem elevated. A decline in the pound would create a headwind for UK equity relative performance in common currency terms.

US Equities

There are several concerns regarding the US relative performance outlook, with the big risk relating to valuation (including the valuation of the dollar). Notwithstanding the risks, we are more optimistic on US equities than other regions, for two main reasons. The first relates to the secular outlook, which appears relatively bright for the tech stocks the US is heavily weighted in. The main upside risk for the global equity market over the next few years is if an “AI boom” scenario unfolds. With the Federal Reserve now on hold and likely to begin cutting rates next year, a weaker version of the cycle that played out during the second half of the 1990s is a possibility today. Back then, excitement linked to the growth of the internet drove gains. This cycle, AI-related investment could be the driver. The US has much greater exposure to the “pick and shovel” plays positioned to benefit from an AI spending boom than any other region. The second reason for favouring the US relates to the cyclical outlook. Even though the odds of a soft landing have gone up, economic growth risks are still significantly higher than in any given year. The US is the most defensive of our six regions, which is an attractive characteristic at a time when growth risks remain elevated.

Europe ex-UK Equities

If we can predict where the relative performance of global tech and and continental European FX are going, we stand a good chance of predicting whether Europe ex-UK Equities will outperform. We are cautiously optimistic on the secular outlook for the global tech sector, which bodes poorly for Europe ex-UK as it has low weightings in this sector. With regards to continental European FX, over the longer term, there appears to be room for appreciation, which would support regional equity relative performance in common currency terms. The euro is cheaply valued, and existential risks have declined. However, over the medium term, FX direction will likely be more influenced by risk appetite. The euro is a risk-on currency, and odds of markets moving into a risk-off phase remain elevated.

Japan

Shareholder-friendly reform momentum is building in Japan, which could help spark an expansion in relatively depressed price-to-book multiples. However, demographics amount to a major structural headwind to Japanese equity relative performance. Cyclically, Japan does not have much scope to put idle economic resources to work. Despite low price-to-book multiples, Japan does not stand out as obviously cheap vs the world ex US market, in our view.

Asia ex-Japan Equities

The Chinese authorities have continued to implement policies that negatively impact the profit outlook of its megacap companies, with new online gaming restrictions the latest high-profile measure announced. Meanwhile, incoming Chinese economic data continues to disappoint. Property remains a key area of weakness. House prices continue to contract, and residential floor space sold remains deep in negative territory on a y/y basis. Nevertheless, it is still not a bad bet that GDP in China and Asia ex Japan more widely outpaces that of the rest of the world this year. In addition, more investors have "thrown in the towel" on China. Despite this attractive combination of decent relative growth prospects and depressed investor sentiment, we are not optimistic with regards to Asia ex-Japan relative performance. China is becoming steadly less shareholder friendly. Geopolitics is likely to remain a headwind. High indebtedness and challenging demographics should act as longer-run economic headwinds in China.

Emerging markets ex-Asia

EM ex Asia is undisputedly cheap, but there does not appear to be a catalyst on the horizon to unlock that value. Brazil, Saudi Arabia, South Africa, Mexico, and the UAE are the countries with the highest market cap weightings in the EM ex Asia equity index, making it very commodity exposed. We do not expect much upside to commodity prices in an environment where global growth is slowing and China refrains from large scale stimulus.

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