

# How are we invested, and should nervous investors take the plunge?



Our investment strategies reflect our views that global growth will slow from here before improving, inflation will remain elevated, and interest rates are close to their peaks.

### Seeing value in bonds, and remaining cautious on share prices

Bond prices have undergone huge price falls, having been at the centre of 2022's market storms. We believe these price falls have created an attractive investment opportunity in UK and US government bonds in particular. With this in mind, we have gradually moved from a smaller position in bonds versus our long-term average and a preference for bonds with more limited sensitivity to interest rate changes, to the opposite stance on both fronts. If we're right about the economic environment ahead, this should help our strategies' future performance.

Our position in shares, on the other hand, is currently slightly below our long-term average. At the time of writing, we have not been rewarded for this caution in 2023, but we continue to believe that share prices are not adequately reflecting the impact that an economic slowdown is likely to have on corporate earnings. Share prices are better value than they were a year ago, but we're still not convinced that they represent good enough value to move to a larger position. We have also upped the 'quality' of our stock market positions – favouring shares in businesses which should prove more resilient in a slowing growth environment.

Among our 'alternative' assets (i.e. beyond traditional bond and stock markets), our gold positions have benefited this year, amid concerns around stubborn inflation and unrest in the banking sector. We continue to dial down (or exit) alternatives positions where the investment rationale was strong in a low interest rate world, but has since waned (our holding in music royalties is a prime example).

### Politics and interest rate expectations have distorted stock markets

This has been an unusual year for stock markets, particularly in the US. Expectations for US interest rate cuts in the second half of 2023 have buoyed the market mood. A further boost has come from the ample liquidity at work in the financial system, as the US Treasury runs down its 'Treasury General Account' to counter political fights over government spending limits (the 'debt ceiling').

However, we believe these market friends will become foes later in the year for three reasons. First, inflation is likely to remain sufficiently above the central bank's target, so we do not believe US interest rate cuts are imminent. Second, the Treasury General Account will need to be rebuilt once an agreement is reached on the debt ceiling, reducing liquidity in the financial system. And third, any debt ceiling agreement will involve austerity measures, further risking future economic growth.

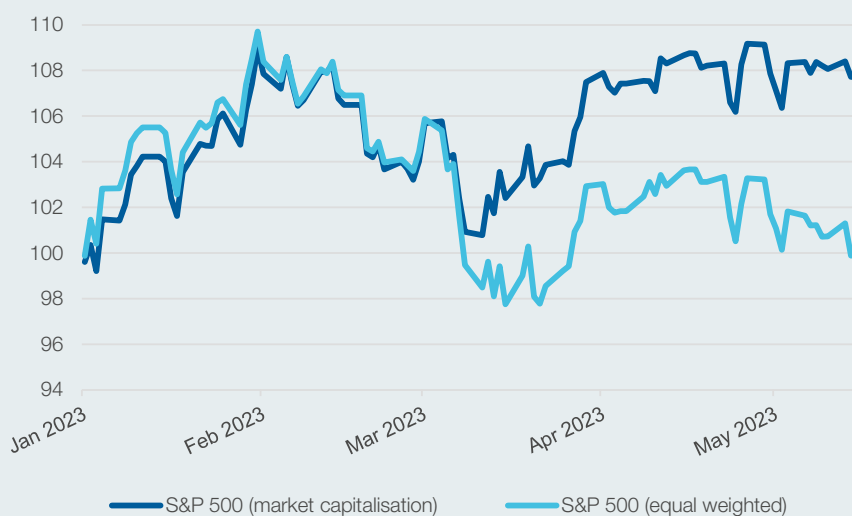
### Strong market performance by tech giants has muddied the waters

Adding to the distortion, leadership in the US stock market – as measured by the S&P 500 Index – has been very narrow. The S&P 500 is a representative index, made up of shares from the 500 largest US-listed companies. It takes a 'market capitalisation' approach, meaning that it assigns more importance (or 'weight') to the shares of large, expensive companies. Big movements in the share prices of these companies can therefore significantly impact the S&P 500's overall value.

So while the S&P 500 Index has risen by nearly 8% so far in 2023 (in US dollar terms), this is almost entirely down to the strong performance of just a handful of very large tech companies. If we look at companies in the S&P 500 on an 'equal-weighted' basis (i.e. each company is afforded the same importance, regardless of its size on the market), the S&P 500 would have fallen by almost 1% over the same time period.

#### The very largest companies have distorted US stock market returns

Two versions of the US S&P 500 Index – one weighted towards the market's largest companies, the other balancing all companies equally



Source: Bloomberg



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Graham Bishop, Chief Investment Officer

This very narrow stock market leadership has been challenging for our investment strategies. Technology is one of our favoured market themes, but building global and well-diversified strategies is one of our core aims: we would never make our strategies too reliant on a single, concentrated area of the market (where outperformance will not last forever). If anything, despite the short-term pain to our investment strategies, the current narrow focus of stock market returns gives us even higher conviction that our cautious stance remains appropriate.

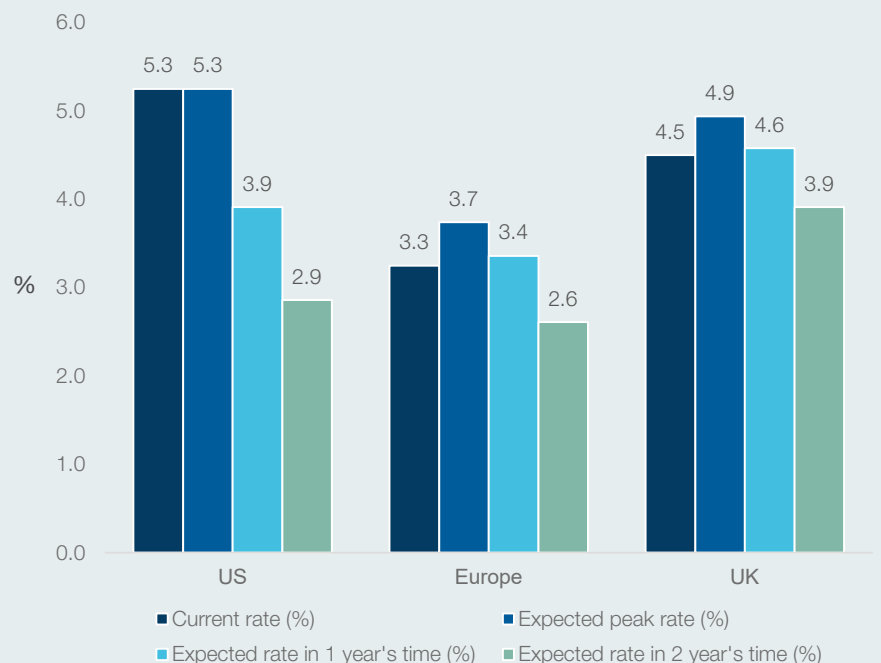
### As the attractiveness of cash fades, long-term investing could provide a better option

Since 2008, interest rates have been very low, making cash an unattractive investment. More recent interest rate rises have improved the financial returns available on cash, although savers will be well aware that wide divergence remains between central bank rates and savings rates.

What's more, we believe we are now at (or close to) the peak for interest rates. If market expectations for interest rates over the next 12-24 months are correct, returns on cash are also close to their peak and will deplete from here. As a result, while it still makes sense to hold some capital in cash for long-term investors, we continue to believe that a truly global investment proposition, diversified across a range of asset types, offers better potential for meeting our customers' aspirations in a world of lower economic growth and structurally higher inflation.

#### Returns on cash are likely to become less attractive from here

Current and expected (market predicted) interest rates at major central banks



Source: Factset

It's impossible to know the ideal time to invest, and we always caution against trying to 'time the market' to perfection. As a general rule of thumb, we tend to advise that it's better to invest when you are able to do so for a period of at least five years, and to look beyond the everyday ups and downs of the market during this time – however hard this may feel in practice.

A buy-and-hold strategy like this is certainly not easy: it requires patience and discipline. There may be prolonged periods when an investment strategy does not appear to be working, but it should ultimately emerge stronger as investments capture positive returns across long-term market fluctuations. We believe that taking a long-term approach and spending time in the market – not timing the market – is what's important.

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## Assessing the performance of our investment strategies

### Our 'target return' performance benchmarks

Most of our investment strategies aim to deliver financial returns at levels linked to the rate of UK inflation (measured by the Consumer Price Index, or CPI). Over any given five-year period, these strategies target returns which are a pre-defined level above the rate of inflation. Our CPI-linked goals are known as the strategies' target return benchmarks, and are designed to help customers evaluate the strategies' performance in a real-world context. These targeted returns range from CPI+1% for our lowest risk (Defensive) strategies up to CPI+4% for our higher risk (Growth) strategies. Our highest risk (Adventurous) strategy is the exception, as it does not use a CPI-linked goal. Instead, this strategy aims to beat the returns offered by the global stock market (represented by the MSCI All Country World Index).

If the strategies deliver total financial returns to investors (after all costs and charges have been taken) equivalent to the total return of their target return benchmarks, we consider the strategies to have achieved their targets.

### Our financial market performance benchmarks

The performance of our investment strategies can also be compared to representative indices for two of the main asset types in which most of the strategies invest. These indices are 'MSCI United Kingdom (£) – net total return' (representing the performance of UK shares) and 'BoA Merrill Lynch UK Gilts' (representing the performance of conventional UK government bonds). These indices are known as the strategies' comparator benchmarks, and are designed to help clients evaluate the strategies' performance in a financial market context.

It is important to note that financial returns are not assured: there is no guarantee that the strategies' performance objectives will be met, or that a positive return will be delivered over any time period. When you invest, your capital is at risk.

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