CHETWOOD
INVESTMENT MANAGEMENT

GROWTH PORTFOLIOS
QUARTERLY REPORT '23
Q3

## Quarter insights

- Inflation remains uncomfortably high. UK headline inflation fell sharply to 6.8% in July, but US inflation crept higher during the quarter. The oil price jumped during the third quarter, with a barrel of WTI crude moving from $70 to $90. We are closely watching this market given its impact on inflation.
- Global markets struggled in the 3rd quarter against a backdrop of tightening monetary conditions and falling corporate earnings.
- The strong labour market forced Central Banks to continue to hike their key borrowing rates, although both the US Federal Reserve and Bank of England chose to pause in September. This created a headwind for the performance of bonds during the quarter.
- Resilient consumer spending helped the global economy to hold up better than expected, raising hopes of a "Goldilocks" soft landing whereby inflation is brought under control without causing a hard recession
- US dollar strengthened despite US credit downgrade from rating agency Fitch and the threat of a US government shutdown.

## Market review

There is continued evidence that the global economy can achieve a "Goldilocks" soft landing, where inflation is gradually brought under control without causing a hard recession. Inflation is subsiding although it remains uncomfortably high in many parts of the world, particularly here in the UK.

The inflation picture has been made more complex as the price of oil jumped during the quarter as a result of supply cuts from some of the world's biggest producers. The oil price has been broadly falling since its peak in March 2022, which has been helping to bring down headline inflation. We are closely monitoring the oil price given its potential impact on monetary policy. This will have a significant impact on the outlook for equity and bond markets in the short term.

> The global economy has been helped by relatively strong consumer spending, which is the largest component of Gross Domestic Product (GDP).

However, much of this spending has been done with excess savings that were accumulated during the Covid pandemic. These excess savings are now close to being exhausted. Coupled with higher interest rates , this will ultimately slow down economic growth.

So far, the impact of rising rates on consumer spending and the real economy has been positive, as the extra income now being generated on cash holdings has more than offset the increased interest payments on borrowing. This situation will gradually reverse over the medium term, as fixed rate mortgages and corporate bonds will have to be refinanced at significantly higher rates.

The US Federal Reserve and Bank of England have continued to hike their key borrowing rates during the third quarter. Central banks did pause in September, but doubled down on the rhetoric that they are not yet finished and interest rates could go yet higher. US Fed Chair Jerome Powell hammered home this point by stating that any relief from higher borrowing costs will be neither swift nor generous.

> Chairman Powell is communicating to markets to keep interest rates high in the short term; this messaging may change very quickly. Most economists agree that we are at the peak of the rate hiking cycle.

Equity markets moved broadly sideways during the third quarter. The quarterly corporate earning season in the US passed relatively uneventfully bar a release of stellar results from chip maker Nvidia. Earnings for an index of the largest US companies fell 5% year-over-year, which marked the third consecutive quarter of declining earnings.

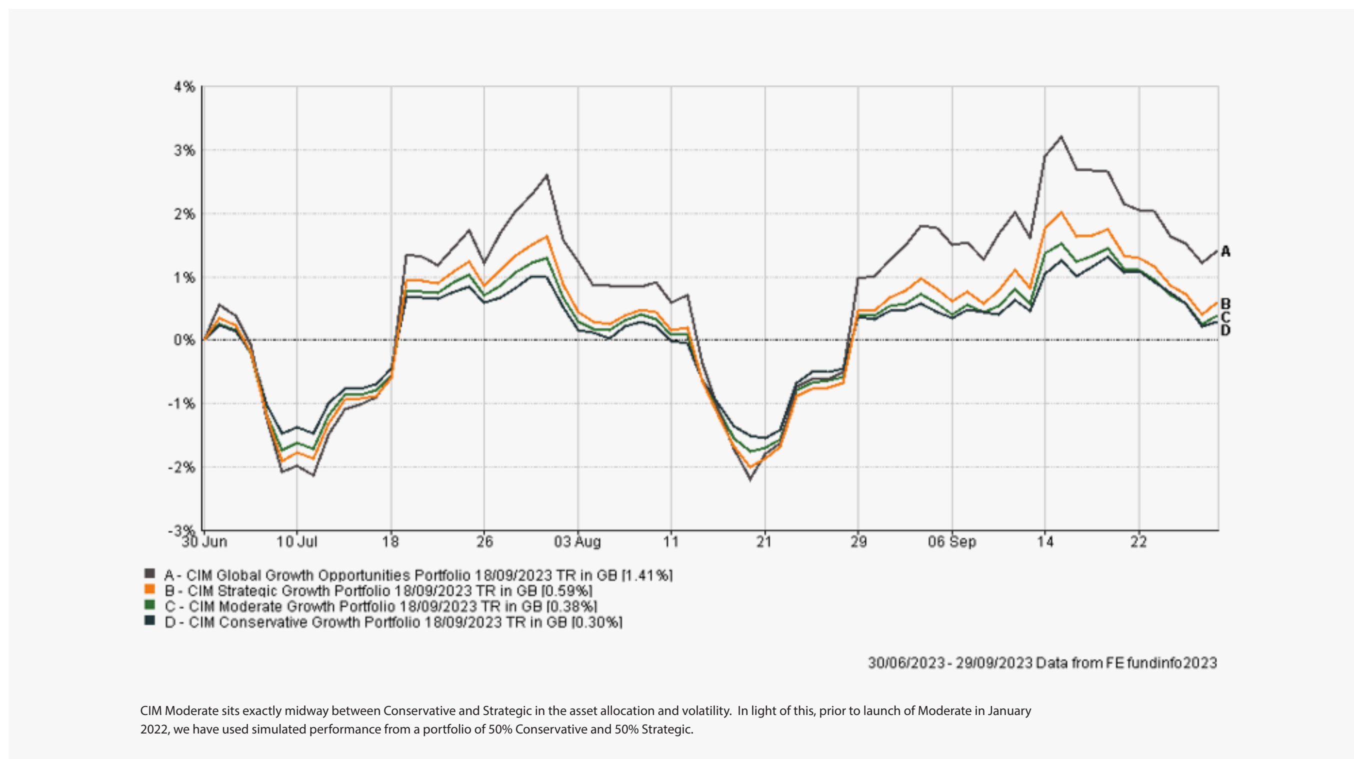
## Growth portfolios performance

| Growth Portfolios | 3 months |
|---|---|
| CIM Conservative Growth Portfolio | 0.30% |
| ARC Sterling Cautious PCI | 0.59% |
| CIM Moderate Growth Portfolio | 0.38% |
| ARC Sterling Balanced Asset PCI | 0.29% |
| CIM Strategic Growth Portfolio | 0.59% |
| ARC Sterling Steady Growth PCI | -0.02% |
| CIM Global Growth Opportunities Portfolio | 1.41% |
| ARC Sterling Equity Risk PCI | -0.13% |

| Index Returns | 3 months |
|---|---|
| UK Equities | 2.13% |
| UK Government Bonds (Gilts) | -0.63% |
| All Country World Equities | 0.65% |
| Pacific Equities (ex Japan) | -0.80% |
| Emerging Market Equities | 1.03% |
| US Equities | 0.69% |
| UK Headline Inflation | 0.00% |

Past performance is not a reliable indicator of future performance; and the value of investments, as well as the income from them can go down as well as up, and investors may get back less than the original amount invested.

## Performance graph




CIM Moderate sits exactly midway between Conservative and Strategic in the asset allocation and volatility. In light of this, prior to launch of Moderate in January 2022, we have used simulated performance from a portfolio of 50% Conservative and 50% Strategic.

## Key Funds and Trades over the Quarter

| Top 3 Model Funds | 3 months |
|---|---|
| AQR Style Premia | 10.35% ▲ |
| Amundi Prime Japan ETF | 2.74% ▲ |
| Fidelity Index UK | 2.59% ▲ |

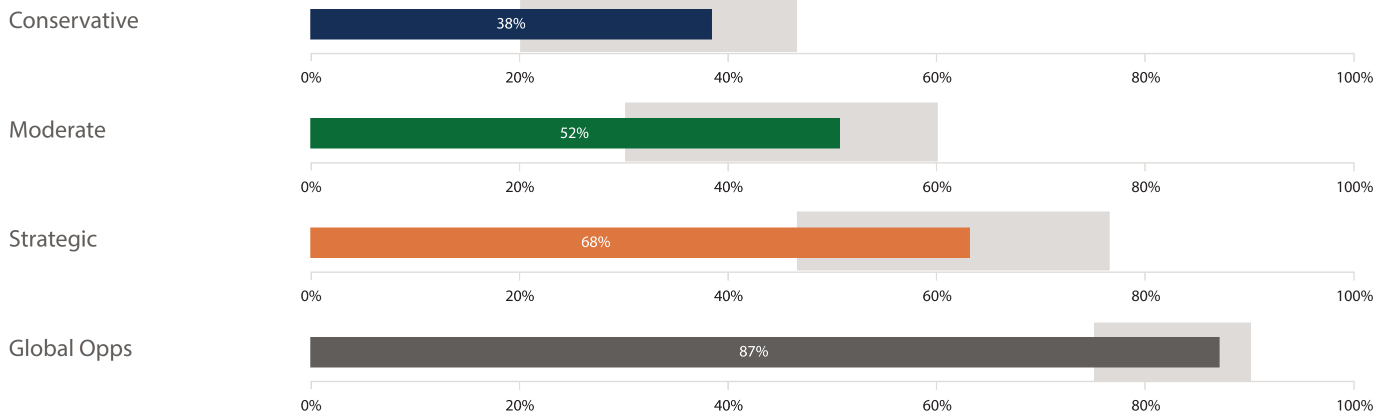
| Bottom 3 Model Funds | 3 months |
|---|---|
| HSBC European Index | -1.29% ▼ |
| Vanguard Global Bond Index Hedged | -2.34% ▼ |
| iShares $ Treasury Bond 20 + yr ETF | -13.25% ▼ |

Source FE Anaytics to 29th September 2023

| Key fund | Commentary |
|---|---|
| AQR Style Premia and Man Alternative Style Risk Premia Funds | We have recently added an exposure to these two "liquid alternative" funds. These are highly active strategies that employ leverage, shorting and sophisticated risk management and allow us to capture the significant relative value opportunities that currently exist. They will add diversification as they are not relying on the equity market to increase to perform well, but rather for certain types of equities to outperform another type. |
| iShares Edge MSCI World Minimum Volatility ETF | We have increased the allocation to this fund. The fund holds global equities that have previously displayed relatively low price volatility and typically will have a high allocation to defensive sectors such as utilities and consumer staples. We expect the fund to perform well in a risk-off environment. |
| iShares Edge MSCI World Quality Factor ETF | High-quality stocks have performed well during 2023 as investors favour the attributes of companies with solid balance sheets and stable earnings. However, the strong performance has left many quality stocks, such as chipmaker Nvidia and Meta (formally Facebook), trading on quite rich valuations. We have taken the opportunity to bank the profits generated. |
| Lyxor Core UK Government Bond ETF | We have introduced this fund, which gives exposure to UK government bonds, otherwise known as gilts. The falling prices of these bonds mean that they now offer an attractive income yield in excess of 4.5%. We also expect a capital return from the bonds if the economy weakens. |

# Asset class review

## Equity Exposure




## Conservative

| Ten largest fund holdings (%) | |
|---|---|
| Amundi Index Global Agg Hedged ETF | 14.6% |
| Vanguard Global Bond Index Hedged | 9.3% |
| Fidelity Index US | 7.8% |
| iShares Edge MSCI World Min Vol | 7.0% |
| Lyxor Core UK Government Bond ETF | 6.0% |
| Fidelity Index UK | 6.0% |
| iShares Core FTSE 100 ETF | 5.9% |
| Man Alternative Style Risk Premia | 5.5% |
| AQR Style Premia UCITS | 5.5% |
| RL Short Duration Global HY Bond | 5.1% |
| Assets in top ten holdings | 72.7% |

| Ten largest asset class exposures (%) | |
|---|---|
| Government Bonds | 22.7% |
| North American Equities | 16.8% |
| Other Alternatives | 14.9% |
| UK Equities | 11.7% |
| Corporate Bonds | 6.3% |
| Emerging Market Bonds | 5.1% |
| High Yield Bonds | 5.1% |
| Commodities | 4.9% |
| European Equities | 3.8% |
| Cash | 3.2% |

Cash includes cash held in underlying funds plus GBP held in model.

## Moderate

| Ten largest fund holdings (%) | |
|---|---|
| iShares Core S&P 500 UCITS ETF | 10.5% |
| Amundi Index Global Agg Hedged ETF | 10.2% |
| Fidelity Index UK | 9.4% |
| Fidelity Index US | 8.7% |
| Vanguard Global Bond Index Hedged | 7.5% |
| iShares Edge MSCI World Min Vol | 7.0% |
| Lyxor Core UK Government Bond ETF | 6.0% |
| iShares Core FTSE 100 ETF | 5.9% |
| Man Alternative Style Risk Premia | 5.5% |
| AQR Style Premia UCITS | 5.5% |
| Assets in top ten holdings | 76.2% |

| Ten largest asset class exposures (%) | |
|---|---|
| North American Equities | 24.2% |
| Government Bonds | 18.4% |
| UK Equities | 15.1% |
| Other Alternatives | 11.0% |
| European Equities | 5.8% |
| Emerging Market Bonds | 5.1% |
| High Yield Bonds | 5.0% |
| Corporate Bonds | 4.6% |
| Japan Equities | 3.9% |
| Cash | 3.1% |

Cash includes cash held in underlying funds plus GBP held in model.

## Asset class review

### Strategic

| Ten largest fund holdings (%) | |
|---|---|
| iShares Core S&P 500 UCITS ETF | 14.6% |
| Fidelity Index UK | 13.1% |
| Fidelity Index US | 11.5% |
| iShares Edge MSCI World Min Vol | 7.0% |
| Amundi Index Global Agg Hedged ETF | 6.8% |
| Lyxor Core UK Government Bond ETF | 6.0% |
| Vanguard Global Bond Index Hedged | 6.0% |
| iShares Core FTSE 100 ETF | 5.9% |
| Man Alternative Style Risk Premia | 5.5% |
| AQR Style Premia UCITS | 5.5% |
| Assets in top ten holdings | 81.9% |

| Ten largest asset class exposures (%) | |
|---|---|
| North American Equities | 31.1% |
| UK Equities | 18.9% |
| Government Bonds | 14.9% |
| Other Alternatives | 11.0% |
| European Equities | 7.4% |
| Japan Equities | 5.8% |
| Asia Pacific ex Japan Equities | 3.7% |
| Corporate Bonds | 3.3% |
| Cash | 2.9% |
| Emerging Market Equities | 0.5% |

Cash includes cash held in underlying funds plus GBP held in model.

### Global Opps

| Ten largest fund holdings (%) | |
|---|---|
| iShares Core S&P 500 UCITS ETF | 22.2% |
| Fidelity Index US | 16.4% |
| Fidelity Index UK | 13.3% |
| iShares Core FTSE 100 ETF | 7.7% |
| Amundi IS Prime Japan ETF | 7.1% |
| HSBC European Index | 6.0% |
| iShares Edge MSCI World Min Vol | 5.0% |
| Man Alternative Style Risk Premia | 5.0% |
| AQR Style Premia UCITS | 5.0% |
| Vanguard Global Emerging Markets | 3.7% |
| Assets in top ten holdings | 91.4% |

| Ten largest asset class exposures (%) | |
|---|---|
| North American Equities | 42.4% |
| UK Equities | 20.8% |
| European Equities | 10.1% |
| Other Alternatives | 10.0% |
| Japan Equities | 7.6% |
| Asia Pacific ex Japan Equities | 5.6% |
| Cash | 2.4% |
| Emerging Market Equities | 0.8% |
| Other | 0.2% |

Cash includes cash held in underlying funds plus GBP held in model.

| Asset Class | Portfolio Views |
|---|---|
| Fixed Interest | Bonds have continued to struggle during the third quarter as stubbornly high inflation and rising interest rates continue to weigh on prices. We have increased exposure given the attractive yields now available. We favour government bonds as we do not feel that corporate bonds offer sufficient extra return to compensate for their higher risk. |
| UK Equity | We have increased exposure to UK equities during the third quarter and hold an overweight position. We feel the UK market is attractively valued and will benefit from Sterling weakness. We also like the overweight exposure to the defensive consumer staples sector and to the energy sector, given the rising oil price. |
| US Equity | We have reduced exposure to US equities during the quarter as the market looks expensive and there are signs that the outperformance enjoyed in the first half of 2023 is starting to peter out. |
| Japan Equity | Japanese equities outperformed during the third quarter, with efforts to improve corporate governance and profitability starting to bear fruit. Japan is also benefitting from a return of inflation after decades of deflation. We also favour the defensiveness of the cheap Japanese Yen. We retain our overweight position. |
| Asia and Emerging Market Equity | Chinese equities are relatively cheap but the country continues to struggle with many challenges including trying to revive growth after a brief post-Covid bounce failed to persist. However, many EM countries such as India are performing well now. The stronger dollar will provide a short-term headwind though. We are currently waiting for an opportunity to add to our allocation to the region. |
| Alternatives | We have recently increased the allocation to market-neutral funds that employ a systematic trading approach to harvest alternative risk premia including momentum, carry, value and defensive. |

## Outlook

As we move into the fourth quarter, inflation will still be an important factor, but we think economic growth and the potential for a recession will now move markets. We will closely follow the economic leading indicators for signs of a slowdown and react accordingly. Although recession risks are elevated, consumers are coming from a very strong financial position. Unemployment is extremely low and those with jobs are getting raises. This should continue to support consumer spending in the short term.

> The list of economic positives and negatives is growing; this is a complex market environment.

All eyes will be on major global central banks. Markets are always looking ahead, so any indication that central banks are signalling a change of direction on interest rates will likely be met with a positive reaction for equities. Even if the economy deteriorates more than expected, the Quantitative Easing (QE) playbook for central banks will almost certainly be pulled out again, which should reassure markets.

We will be closely watching the earnings results of corporations. Earnings have been falling this year but analysts are projecting they will recover strongly over the next 12 months, which should be supportive for equity markets. The US equity market is undoubtedly looking quite richly valued, but many other parts of the world look more attractively valued. This is where we are focussing our attention.

> It is notoriously hard to call the direction of markets over short time frames, that is why the more successful investors are patient and long term.

We would note that the fourth quarter has historically been a good one for equity markets. With the yields on bonds and attractively valued equities now as high as they have been for quite some time, smart investors are now being paid handsomely for their patience.

### Thoughts for the quarter ahead…

- Third quarter corporate earnings results look to be key to whether equities enjoy a Santa Claus rally in the fourth quarter. We are analysing whether corporations can absorb higher costs and grow profits.
- Excess savings accumulated during the Covid pandemic are now close to being exhausted. An important tailwind to growth is starting to wane.
- We think there is a risk that the global economy will not avoid a recession as the impact from sharply higher borrowing rates continues to filter through. We currently favour defensive sectors and investments within our equity exposure.
- As bonds have fallen, we see an attractive risk reward opportunity and have started to add to our fixed income exposure. Bonds now offer a decent income return and should also produce a positive capital return if stock markets struggle. We are waiting for signs that central banks have stopped hiking rates before initiating an overweight bond position.
- Even in periods of economic slowdown, there are opportunities to create positive returns. This is what we are focused on.

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you originally invested.

[1]For the comparative index returns, we have used the total return performances of the following ETF's:

| Comparative Index | ETF Name |
|---|---|
| UK Equities | ISHARES CORE FTSE 100 |
| US Equities | ISHARES CORE S&P 500 |
| European Equities (ex UK) | ISHARES MSCI EUROPE EX-UK |
| Emerging Market Equities | ISHARES CORE EM IMI ACC |
| Japanese Equities | ISHARES CORE MSCI JAPAN |
| Pacific Equities (ex Japan) | ISHARES CORE MSCI PACIF X-JP |
| UK Government Bonds (Gilts) | SHARES CORE UK GILTS |
| Global Bonds (GBP hedged) | ISHARES CORE GLB AGG GBP-H D |
| Commodities | ISH DIVERS COMMOD SWAP ETF |