

Quarter insights

- Global equity markets rebounded to end the year on a strong note. Bond yields also fell as fixed income prices rebounded. Notably, the yield on US 10-year treasury bonds briefly rose to 5% in October but fell below 4% by quarter end.
- Inflationary pressures continued to diminish, with the US Federal Reserve's preferred inflation gauge, the core PCE price index, nearing the Fed's target of 2%. US Federal Reserve (Fed) Chair Jerome Powell cautioned that he'd like to see those rates stay there for more than just a few months before declaring victory on inflation. All the key global central banks chose not to hike interest rates during the quarter.
- Unemployment remains unusually low with major economies continuing to stave off recession. The quarter provided further evidence of a "Goldilocks" soft landing, where inflation cools to manageable levels without causing an economic downturn and significant unemployment.
- Geopolitical tensions intensified during the quarter, with the outbreak of conflict between Israel and Hamas.
- UK Chancellor Jeremy Hunt unveiled his Autumn Statement with various measures announced including cutting National Insurance by 2%.

Market review

The fourth quarter has historically proven to be a strong one for equity markets, and this was again the case in 2023. However, the quarter did not start particularly well, with both equity and bond markets falling in October as investor sentiment and confidence waned. The outbreak of war between Israel and Hamas caused the oil price to spike higher and added to investor unease.

Markets then started to turn on the release of positive third quarter economic numbers coupled with corporate earnings results that held up better than expected. The resilience in the labour market led to a healthier consumer which fuelled better than expected consumer spending and economic growth.

Inflation data also fell faster than expected and more moderate monetary policy guidance from the US Federal Reserve led to increased investor confidence. As a result, both stock prices and long-term interest rates reversed direction. Markets were particularly encouraged by Fed Chair Jerome Powell's comments during the December press conference in which he stated that he expects the Fed to lower rates by 75 basis points in 2024.

Powell drove home that point, saying the Fed did not want to restrict the economy longer than necessary.

"We're aware of the risk that we would hang on too long," Powell said, referring to waiting too long to cut rates. "We know that's a risk and we're very focused on not making that mistake."

During the quarter, Chancellor Jeremy Hunt unveiled his Autumn Statement, which focussed on growth for the future. Sticking closely to the Chancellor's "Fiscal Rule" (the aim of which is that public debt as a share of GDP should be lower in five years' time), he dished out an increase in benefits and cut National Insurance. Most of this was already being paid for by his previously enforced freeze of income tax thresholds that have remained in place despite record high inflation persisting for longer than hoped.

The favourable rise in tax receipts had left the Chancellor with £30bn of headroom below his fiscal target that he could either spend or save – he chose to spend.

For the first three quarters of 2023, positive equity returns had been concentrated on a relatively small number of large US technology stocks, which have become known as the 'Magnificent Seven' with the average global stock making relatively little headway. However, participation in the fourth quarter rally was far broader although UK equities continued to lag their international peers. Bond markets endured a rollercoaster in 2023, although following the rally during the last two months, the yields on 10-year UK and US government bonds ended the year roughly where they had started at 3.5% and 3.9% respectively.

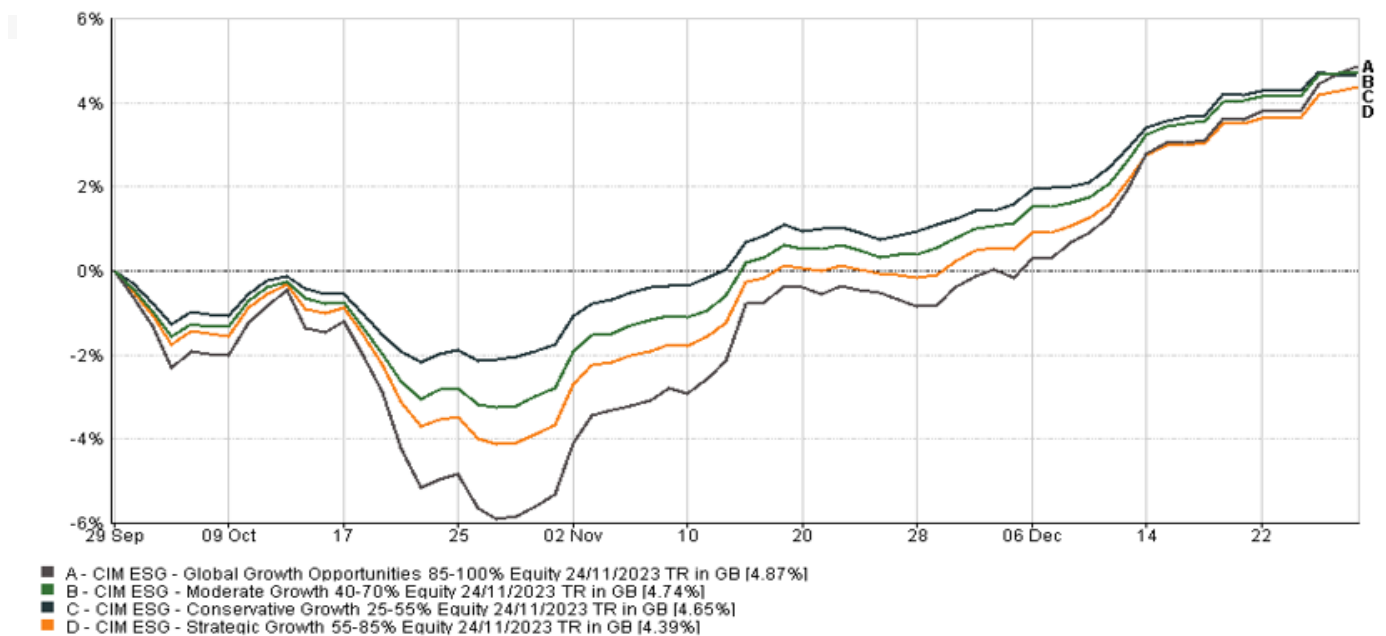
ESG portfolios performance

ESG Portfolios	3 months
CIM ESG Conservative Growth Portfolio	4.65%
ARC Sterling Cautious PCI	4.01%
CIM ESG Moderate Growth Portfolio	4.74%
ARC Sterling Balanced Asset PCI	4.89%
CIM ESG Strategic Growth Portfolio	4.39%
ARC Sterling Steady Growth PCI	5.27%
CIM ESG Global Growth Opportunities Portfolio	4.87%
ARC Sterling Equity Risk PCI	5.53%

Index Returns	3 months
UK Equities	2.27%
UK Government Bonds (Gilts)	8.09%
All Country World Equities	6.31%
Pacific Equities (ex Japan)	6.58%
Emerging Market Equities	4.26%
US Equities	6.85%
UK Headline Inflation	0.30%

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



29/09/2023 - 29/11/2023 Data from FE fundinfo 2024

Key Funds and Trades over the Quarter

Top 3 Model Funds	3 months
JOHCM Regnan Global Equity Impact Solutions	12.28% ▲
Federated Hermes Impact Opportunities Equity	11.67% ▲
Baillie Gifford Positive Change	10.5% ▲

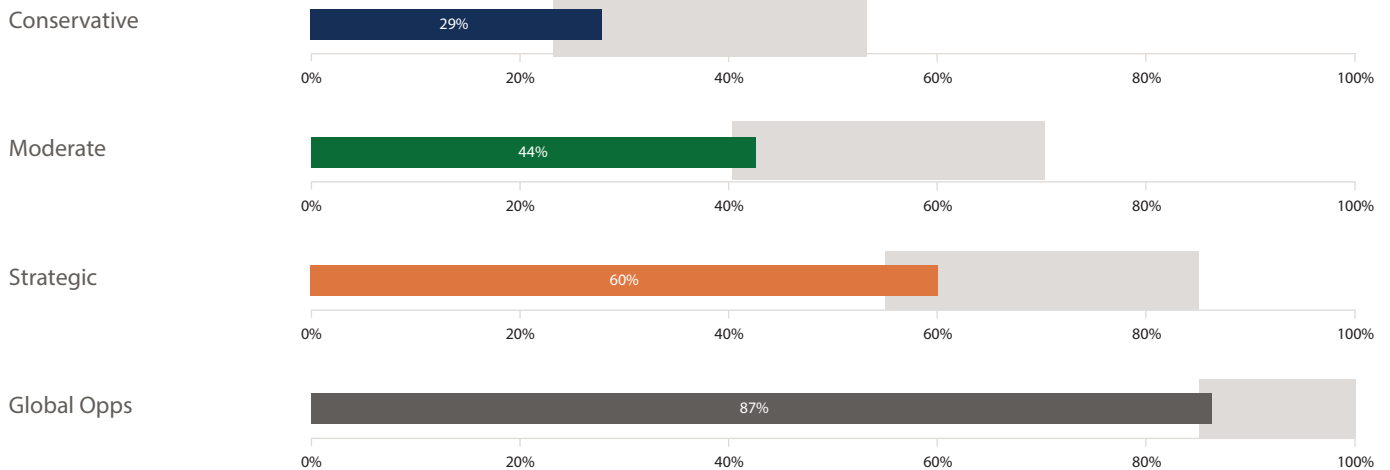
Bottom 3 Model Funds	3 months
Schroder Global Sustainable Value Equity	1.81% ▼
JPM Global Macro Sustainable	-1.03% ▼
AQR Style Premia	-6.33% ▼

Source FE Analytics to 31st December 2023

Key fund	Commentary
Vanguard Global Sustainable Equity	We have introduced this actively managed fund that allocates to stocks that pass the sustainability criteria of Wellington, who are the sub-manager. The fund has a focus on companies that are not necessarily ESG darlings of today but are improving their practices and have the potential to significantly reduce their carbon footprint. Wellington's scale enables them to access and engage with senior management to drive this transition. We funded this new investment by liquidating the R&M Global Sustainable Opportunities Fund.
iShares Green Bond, iShares Global Agg Bond ESG ETF, CT UK Social Bond	We have increased the allocation to several funds that invest in bonds to take advantage of the relatively high yields available. Also, with inflation subsiding and the jobs market cooling, this is putting less pressure on global central banks to continue hiking their borrowing rates, which should provide a favourable backdrop for bond performance.
UBS MSCI United Kingdom IMI Socially Responsible ETF	We reduced the allocation to large UK stocks during the quarter, partly on concerns about the high weighting to the cyclical basic materials and financial sectors, given we are expecting an economic slowdown. Furthermore, we were concerned about the high exposure to the US Dollar within the fund, given that a large proportion of revenues generated by large UK corporations are derived from the US.

Asset class review

Equity Exposure



Conservative

Ten largest fund holdings (%)

iShares Global Aggregate Bond ESG ETF	11.8%
Vanguard FTSE U.K. All Share Index	9.4%
iShares Green Bond Index Hedged Dis	9.1%
JPM Global Macro Sustainable	7.9%
AQR Style Premia UCITS	7.2%
Liontrust Sustainable Future Corp Bond	6.7%
EdenTree Amity Sterling Bond	6.0%
Pimco GIS Global Bond ESG Hedged	6.0%
EdenTree Amity Short Dated Bond	5.6%
Schroder Global Sustainable Value Equity	4.3%
Assets in top ten holdings	74.0%

Ten largest asset class exposures (%)

Corporate Bonds	43.8%
Other Alternatives	15.1%
North American Equities	12.3%
Government Bonds	9.5%
European Equities	8.1%
Cash	3.3%
UK Equities	2.2%
Asia Pacific ex Japan Equities	1.8%
Japan Equities	1.7%
Emerging Market Equities	1.3%

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

Moderate

Ten largest fund holdings (%)

iShares Global Aggregate Bond ESG ETF	12.8%
Vanguard FTSE U.K. All Share Index	9.2%
iShares Green Bond Index Hedged Dis	9.0%
AQR Style Premia UCITS	7.1%
JPM Global Macro Sustainable	5.8%
Liontrust Sustainable Future Corp Bond	5.7%
Pimco GIS Global Bond ESG Hedged	5.1%
Schroder Global Sustainable Value Equity	4.6%
Vanguard Global Sustainable Equity	3.9%
Royal London Sustainable Leaders Trust	3.8%
Assets in top ten holdings	67.0%

Ten largest asset class exposures (%)

Corporate Bonds	32.3%
North American Equities	16.8%
Other Alternatives	12.9%
European Equities	11.0%
Government Bonds	9.0%
UK Equities	5.8%
Asia Pacific ex Japan Equities	5.0%
Cash	2.4%
Japan Equities	2.1%
Other	1.6%

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

Asset class review

Strategic

Ten largest fund holdings (%)

iShares Global Aggregate Bond ESG ETF	11.9%
AQR Style Premia UCITS	8.1%
Vanguard FTSE U.K. All Share Index	6.9%
iShares Green Bond Index Hedged Dis	6.9%
Schroder Global Sustainable Value Equity	6.0%
JPM Global Macro Sustainable	5.6%
Vanguard Global Sustainable Equity	5.2%
Royal London Sustainable Leaders Trust	5.0%
JPM Climate Change Solutions ETF	4.8%
JOHCM Regnan Glb Eqty Impact Solutions	4.7%
Assets in top ten holdings	65.1%

Ten largest asset class exposures (%)

North American Equities	22.4%
Corporate Bonds	17.1%
European Equities	14.6%
Other Alternatives	13.7%
Government Bonds	8.3%
UK Equities	7.6%
Asia Pacific ex Japan Equities	6.7%
Cash	3.0%
Japan Equities	2.8%
Other	2.1%

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

Global Opps

Ten largest fund holdings (%)

Schroder Global Sustainable Value Equity	9.0%
Vanguard Global Sustainable Equity	7.8%
Royal London Sustainable Leaders Trust	7.4%
AQR Style Premia UCITS	7.3%
JPM Climate Change Solutions ETF	7.1%
Impax Global Equity Opportunities	6.9%
JOHCM Regnan Glb Eqty Impact Solutions	6.8%
Hermes Impact Opportunities Equity	6.7%
Baillie Gifford Positive Change	6.6%
Stewart Investors Asia Pac Sustainable	6.0%
Assets in top ten holdings	71.6%

Ten largest asset class exposures (%)

North American Equities	33.0%
European Equities	21.6%
UK Equities	11.3%
Asia Pacific ex Japan Equities	9.9%
Other Alternatives	7.3%
Japan Equities	4.2%
Government Bonds	3.2%
Other	3.1%
Cash	2.6%
Emerging Market Equities	2.5%

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

Asset Class	Portfolio Views
Fixed Interest	The performance of bonds rebounded strongly during the fourth quarter, as investors began to price in the reversal of central bank's latest tightening cycles. We continue to increase allocation, targeting medium-term government bonds, as that is where we see the best risk vs reward.
UK Equity	We view UK equities as undervalued, with a decent dividend yield. The region remains out of favour with foreign investors and has suffered a headwind from the continued sales from UK pension funds, which must be close to exhausted. However, we have tactically reduced allocation given the unfavourable sector composition as we move into an economic slowdown.
US Equity	We have reduced the broad allocation to US equities, which we deem to be overvalued, and have focussed exposure on more defensive higher yielding stocks, which are more attractively valued.
Japan Equity	We continue to overweight Japanese equities, which are growing earnings strongly yet remain attractively valued. Recent policymaker initiatives should provide support for company fundamentals and shareholder returns. We also favour the defensiveness of the cheap Japanese Yen.
Asia and Emerging Market Equity	Many Asian and Emerging markets are attractively valued and should enjoy a tailwind from many EM central banks moving from rate hikes to cuts in 2024 as well as a weaker US dollar. For the moment we retain our underweight allocation to the region until investor sentiment improves.
Alternatives	We retain an allocation to market-neutral funds, which aim to capture risk premiums, such as the 'value' investing style. Trades are typically placed in the derivatives market, meaning the cash they hold can earn an additional interest return.

Outlook

2023 started with low expectations for global growth and heightened fears of a recession. These fears ultimately proved to be unfounded as the strong consumer helped to prop up the economy. Declining inflation raised hopes that the key global central banks, such as the US Fed, would halt their interest rate hiking schedules and even start cutting. Most investment markets rallied on this expectation.

As we move into 2024 the key question is whether the central banks will cut interest rates by as much as the market is expecting.

Investors will continue to scrutinise the release of any macroeconomic data for further evidence that interest rate cuts are coming.

Geopolitical risks remain high, with two major conflicts currently ongoing and national elections soon taking place in 40 countries, including the US. The independence of the Fed will be under the microscope as they will face political pressure to cut rates at the first sign of a slowdown, given that it is hard to imagine President Biden winning re-election later this year if the US economy does slide into recession.

As bond yields rose during 2023, we gradually added to bond exposure to take advantage of the higher income available. We still see plenty of value within bonds, despite the year-end rally. We also currently see plenty of opportunities within equities. However, we will be watching closely for signs that the rosy analyst estimates for earnings growth in 2024 do not come to fruition.

The valuation of markets outside the US does not appear particularly demanding, especially in the UK, which should support equity markets. We believe that Japanese equities remain particularly attractive. Further strong foreign inflows into this previously unloved part of the investment world should provide a tailwind. Japanese corporations also boast strong balance sheets, have improving shareholder focus, and benefit from a still supportive interest rate backdrop. We have a relatively low exposure to parts of the market that we view as overvalued and at risk of a correction. We are instead favouring quality defensive stocks generating high dividends, which are available on attractive valuations. We expect these stocks to close the performance gap to the highflyers from 2023 and should also prove to be resilient if the economy does stumble.

Thoughts for the quarter ahead...



- All eyes will be on when global central banks start cutting interest rates, with the first cut from the US Fed pricing in for March. Looser monetary policy would be good news for financial markets unless the rate cuts are in response to significant deterioration in economic data.
- Inflation continues to trend lower, but this narrative could be tested if the labour market remains hot, causing wage inflation to propel broader inflation higher.
- We will be looking closely for signs of weakening consumer spending and of an economic slowdown generally as this could impact investor confidence and provide a headwind for the recent equity market rally.
- Corporate earnings held up better than expected in 2023, with analysts now expecting strong growth in 2024. The next quarterly earnings season will be critical given that earnings are the most important driver of equities in the long run.
- US equities have outperformed in 2023, led by the so-called "Magnificent Seven" mega-cap technology stocks. This has left them priced for significant earnings growth that will need to be delivered to maintain their high valuations, in our opinion. We have adjusted the model towards more attractively valued markets.

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¹For 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