

Overview

Our last portfolio rebalance in November 2023 was followed by upbeat and positive sentiment across the market.

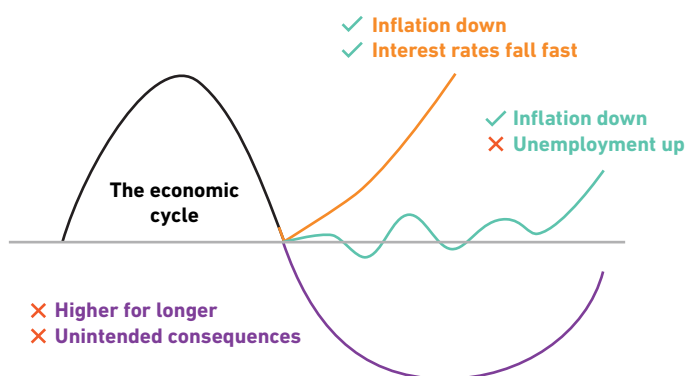
Economic data released in November brought optimism back to markets. As inflation showed signs of softening, central banks signalled the end of the hiking cycle, allowing investors to breathe a sigh of relief. This translated into a generous equity market with a month-end gain of 9% in the S&P 500, which marks one of the best November gains in a century for the index. Thanks to the large technology stocks, the Nasdaq 100 also grew almost 11% in the month, up from three consecutive months of losses. Equally, the fixed income market reacted positively to the promise of rate cuts in 2024, and global bonds underwent their fastest surge since the 2008 financial crisis.

The healthy backdrop continued into December, as fixed income and equities maintained their upwards trends. In the bond market, falling yields started providing significant capital gains; for instance, the Gilt maturing in 2061 saw a 25% appreciation in the month. In the equity market, large cap in the US climbed 5%, but with slightly less help from the Magnificent Seven; small cap also shone, proof of which was the Russell 2000 index's 14% rise. This "Santa Rally" moved all major asset classes into positive territory for the year, a stark reversal of the disappointing returns available for investors in 2022.

In January, economic data continued to convince investors that central banks have reached the end of the rate hike cycle. Data out of the US showed stronger-than-expected GDP growth, and equity markets soared once more, seeing the S&P 500 reach a new all-time high. Meanwhile in Europe the Red Sea disruptions added to an already struggling manufacturing sector and economic growth in China continued to slow, with deflation adding more pressure to the country's property crisis.

Core investment views

Despite the general optimism, it would be foolish to adopt a fully positive stance at any point in time. Even in a largely positive market, it is important to make sure no stone is left unturned to avoid any surprises on the downside. That is what we're doing at 7IM - our properly diversified portfolios enable us to grow in every kind of environment:



Deep recession – policymakers DON'T nail it Unlikely, but important to watch

Inflation continues to remain too high for comfort and central banks keep policy tighter for longer. Eventually, the lags catch up with the economy, leading to a deeper than expected recession.

Back to growth – policymakers nail it Possible, but a lot needs to go right

Inflation falls faster than expected, the demands for higher wages tail off and central banks find the space to reduce interest rates. This allows the world economy to fire on all cylinders again and profits resume growing.

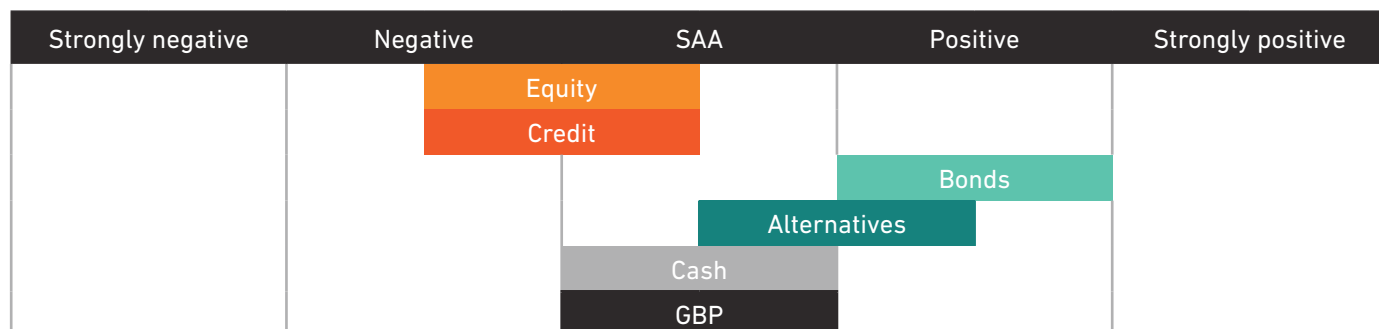
Sluggish and sideways – uncertainty and scepticism continue Most likely, until inflation is under control

A continuation of the last 12 months... will it be a recession? Won't it? High inflation and interest rates will keep that question going.

Whether growth is just above zero (not a recession) or below zero (recession) is not the point. The uncertainty will keep investors cautious – creating choppy markets, prone to sharp sell-offs and rapid rallies. This environment requires careful selection to find the right opportunities and avoid risks.

Tactical Asset Allocation

In an environment with lots of uncertainty and a lack of confidence, we want to make sure portfolios are insulated against shocks, while still generating sufficient returns to make investing worthwhile. And we think our portfolios are set up to do just that.



Portfolio positions

There's no one answer... When managing a diversified long-term portfolio, there shouldn't be a single 'big' call. For an outlook which calls for selectivity, especially in the medium and short term, we're finding lots of different opportunities – both to protect capital and to grow it.

Long term: Thematic

Healthcare companies	Stable earnings when others are seeing uncertainty
Climate transition leaders	Uncorrelated to short-term economic cycle
Metal & mining companies	Cheap and stable businesses. Short-term volatility, but profitable in the long term
Alternatives	Defensive and diversifying

Medium term: Opportunities

Finding pockets of value in the US	Investing in the most dynamic parts of the US economy
Tilt to UK Large Cap	Reduce domestic UK exposure as long as the uncertainty remains
AT1s	Attractive returns from here

Short term: Portfolio risk appetite

Underweight equity risk	Reduce equity exposure as returns will be limited for the time being
Overweight bond duration	Bonds can do well if inflation continues to fall

Asset allocation changes

We have made the following tactical changes to portfolios in this quarterly rebalance:

- **Small reduction in our Government Bond allocation**, but remain overweight compared with our SAA.
- **Reduction in our Healthcare Innovations position**. This is a position we still like for the growth potential it adds to portfolios, but after positive returns this quarter, we are rotating into other parts of the market.
- **Added some FTSE 250 exposure back into portfolios**. Having favoured focussing on the larger cap FTSE 100 part of the UK market, this quarter we moved some of this allocation back into the mid-cap space.

Manager changes

This quarter, we have added several new holdings to portfolios:

- **iShares Japan Equity ESG Index Fund** has been added to blended mandates as part of the continued effort to decarbonise strategic allocations while managing risks associated with poor governance and sustainability.
- **L&G UK Mid Cap Index Fund** was brought into portfolios. This provides exposure to the FTSE 250 section of the UK equity market.

The past performance of investments is not a guide to future performance. The value of investments can go down as well as up and you may get back less than you originally invested. Any reference to specific investments are included for information purposes only and are not intended to provide stock recommendation or investment recommendations to individual investors.

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