Your investment update

Q1 2024

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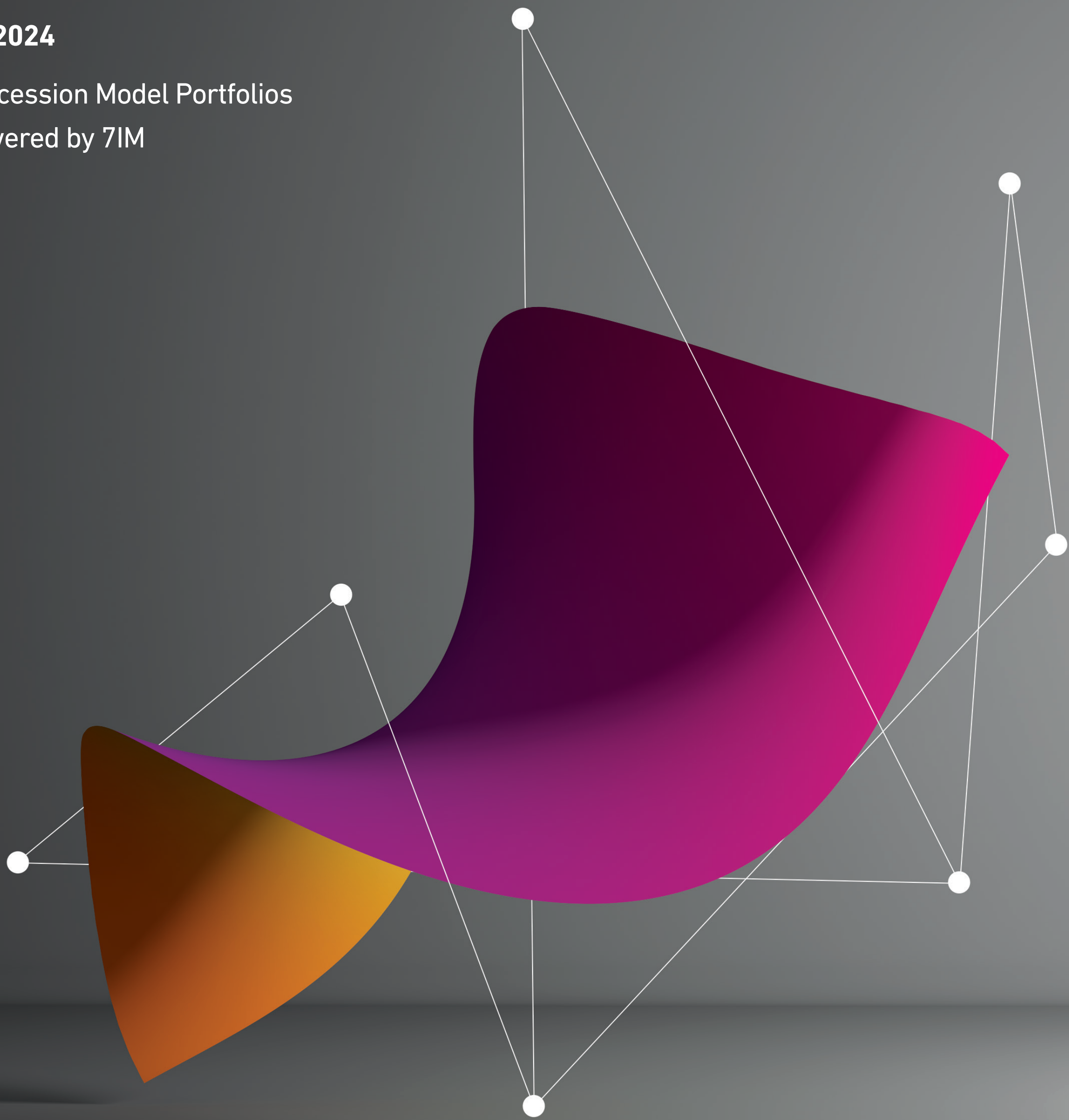

SUCCESSION
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Welcome

Tales of the unexpected

There's an old saying that we spend most of our lives worrying about things that never happen. That certainly seems to be the lesson from 2023.

Storm clouds gathered on several fronts at the start of last year. Interest rates had risen the furthest in the fastest time in history. Economies and consumers were struggling with the highest rates of inflation in a generation. The domestic political landscape seemed an unholy mess. And a look beyond our borders was downright scary as the Ukraine war rumbled on and the world's two economic superpowers, the United States and China, were locked in an ever-worsening trade war.

But here we are, looking back at a year where, to misquote Sherlock Holmes, none of those dogs have barked. The storm didn't break. There has been no recession despite the rate increases. Stock markets have delivered decent returns (spectacular in the case of US technology), bond markets have eked out positive returns and everyone's worst fears for financial markets have not been realised.

So what have we learnt? Well, once again we've learnt not to underestimate the American consumer or US corporate sector. We've seen again that a chaotic geopolitical environment seldom has a major impact on financial markets. And we've learnt that investors just don't care about valuations or fundamentals when confronted with an apparent new paradigm such as Artificial Intelligence. The stellar performance of the Magnificent 7 technology stocks in the US has truly been a rally for the ages. Just 7 companies (albeit good ones!) have been responsible for two-thirds of the stock market gain in the US – creating FOMO (Fear Of Missing Out) in anyone who invested elsewhere!

Investors have faced a conundrum in 2023 – one that they haven't faced for many years. Cash rates have risen sharply and have presented a safe option. The rise in yields too has made bonds investible again.

> But diversification isn't about prediction. It's not about investing in the perfect portfolio. It's about investing in such a way that investors can sleep soundly, regardless of what's happening."

Combining this with the worries mentioned earlier created a powerful incentive to move to the side-lines and raise cash. But a decision to retreat to the apparent safety of cash would've been the wrong one in 2023. We strongly suspect it will be the wrong one for the future too. A well balanced properly diversified strategy always has its place.

Recent years have been a struggle for diversification as a strategy. As stock market performance has been highly concentrated, investing anywhere other than US tech stocks has appeared to be a mistake – especially given the precious little return from supposedly "safe" bond investments.

But diversification isn't about prediction. It's not about investing in the perfect portfolio. It's about investing in such a way that investors can sleep soundly, regardless of what's happening. As Ahmer Tirmizi talks about, *portfolio preparation* is what matters – and we think we've got something for every environment.

And speaking of the environment, Jack Turner takes a look at the realpolitik which is emerging from the latest climate conference. For the first time ever, it seems that there are some New Year's Resolutions which politicians might actually be able to stick to.

And Ben Kumar does something I thoroughly approve of in his piece; distilling the wisdom of one of my favourite finance writers into ways to look at the world!

Enjoy reading and may I take this opportunity to wish you all the healthiest and happiest of New Years.

MARTYN SURGUY

Chief Investment Officer

Strategy

Preparations (not predictions) for 2024

Come December, predictions for the following year are as traditional as a turkey for Christmas dinner in the UK. From sports journalists to newspaper columnists to TikTok vloggers, everyone has a go. Despite markets and economies not really working in discrete calendar years, financial analysts are also compelled to get in on the action.

What will growth be?

How will central banks act?

Where will the stock market end the year?

Lots of people are going to tell you the answers to those questions.

But the thing is that while making predictions is easy, making *accurate* predictions is very, very hard. Almost no one took Covid-19 seriously when you read 2020 forecasts. Ukraine wasn't mentioned in 2022 "outlooks". And at the start of this year, Gaza didn't feature. The world changes unexpectedly, and quickly.

So, it's perhaps no surprise that as of December 2023, the S&P was already at the level that most investment banks had forecast it would hit in December 2024 [see *Why bother with Wall Street predictions?* at the end of this article].

This gets to the heart of one of the most important principles of investing. *Preparation, not prediction*. If Wall Street analysts, with all their know-how, experience and resources, can't predict what will happen or when, it might be worth spending your time doing something else.

We look to prepare portfolios for a range of outcomes. Find assets that balance each other, some doing well in one world, some doing well in another. We won't get it exactly right… but we won't get it exactly wrong either.

Here's how we're *preparing* for 2024:

1

Preparing for falling interest rates... buy bonds.

Inflation across the world has been the highest in decades. As a result, central banks globally have hiked interest rates to the highest in decades. If rates go up, the cost of borrowing goes up. Bringing demand down this way will make it harder for companies to pass on price increases.

While it would be too early to declare victory, inflation appears to be falling fast... even in the UK!

So central banks will become more and more comfortable reducing interest rates. Owning bonds in this environment is an *obvious* preparation step – which doesn't require a prediction. Even if rates don't fall, yields are high enough that you're being paid anyway!

2

Preparing for a hard landing... the safe-haven Yen.

Never underestimate the power of the status quo – even in currency markets.
If a currency gets too cheap, exports will rise, eventually pushing the currency back up. Timing is tricky, but holding on to cheap currencies pays off in the long run.

At the time of writing, the Japanese Yen is the cheapest it has ever been – ~40% below its fair value estimates – driven by Japanese interest rates staying at zero while interest rates in the rest of the world have been hiking. But that situation is changing. Falling US inflation, and thus falling rates, will be a strong driver of returns.

In a world in which the US economy starts to struggle, the Yen would benefit even further as its safe haven status becomes in-demand.

3

Preparing for a soft landing... Metals and Mining companies.

Good portfolio construction means thinking in opposites. Part of that exercise is looking for companies that should do well in an upturn. We look for attractive opportunities in cyclical sectors, which shouldn't hurt (too much) if a downturn comes instead. And Metals and Mining stocks provide that opportunity.

Valuations are as cheap as they have ever been, following a decade of serial underperformance. But the companies have reacted and restructured – net debt is close to zero, profit margins remain elevated and dividend yields of 6% shouldn't be sniffed at. Add on to that, these companies will be at the centre of the climate transition. The long-term tailwind in clear. And we're paid handsomely to wait. >>

AHMER TIRMIZI
Head of Fixed Income Strategy

Strategy
Continued

4

Prepare for any kind of landing... Healthcare companies' resilience.

The market has priced in strong double-digit earnings over the next two years – as if Covid and rate rises and inflation never happened. If profits grow, great – we all love positive surprises! But how can we guard against potential disappointment?

Looking for earnings resilience tends to mean you don't have to. The Global Healthcare sector remains one of our favourite long-term investments. Earnings stability is more certain (and less connected to the economic cycle), valuations are attractive and it's coming off one of its worst runs of performance in decades. In other words, we're being given an opportunity to own stable businesses ready to perform in a range of outcomes. That's proper preparation.

5

Prepare for the changing sentiment... equally-weight your equities.

Of course, preparation won't cover all eventualities. We went into 2023 positioned for investor sentiment to swing wildly from excessive optimism to deep pessimism. And it did, from a banking crisis in the spring to a 'back to the races' expectation as we closed the year. Historically, one of the best ways to position for this is to shift away from most recent cycle winners (this time, large tech companies) and towards those stocks that have been forgotten by the hype-machine.

We did this successfully in 2022. But, with the AI excitement, the strategy hurt portfolios in 2023. Going forward, the uncertainty over where growth and inflation are headed will continue to see those swings in sentiment.

And we continue to be guided by long-term historical patterns rather than short-term trends. Holding a basket of equally weighted stocks in the US, rather than just piling into the biggest, has been a historically profitable investment strategy over time, and especially at times like this.

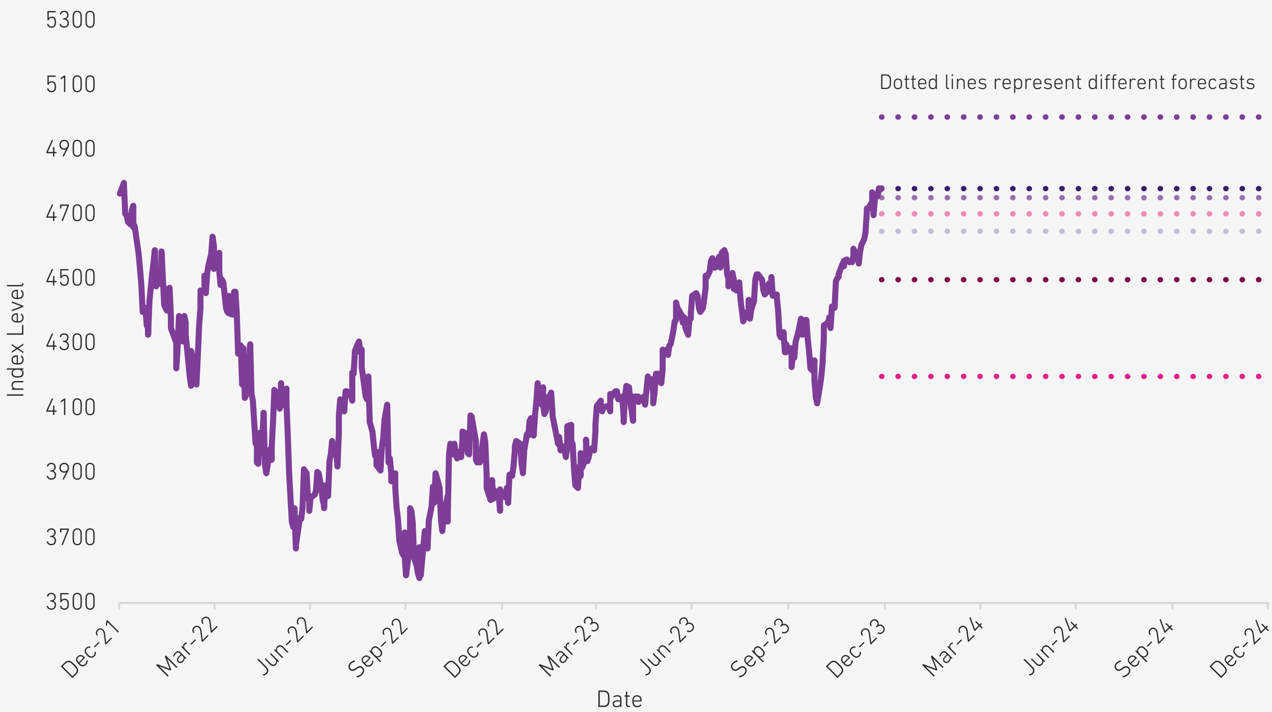
Holding bonds at inflation-beating yields should lead to strong positive returns in most worlds. Putting together a collection of equity exposures that balance each other in different scenarios, while remaining strong investment opportunities by themselves, should deliver a smooth outcome.

One prediction for 2024 is certain to come true. No one knows what will truly happen. Once we accept that, we can focus our efforts on preparing properly. And we have.

One prediction for 2024 is certain to come true. No one knows what will truly happen. Once we accept that, we can focus our efforts on preparing properly. And we have."

Why bother with Wall Street predictions?

The dotted lines below show industry forecasts for the S&P 500 by the end of 2024. Some of the brightest and most highly paid people in the industry all agreeing that… meh, could be up, could be down. If that isn't a clear recommendation to prepare for anything, I don't know what is! (In the first two months of 2023, a well-known US investment bank updated its year-ahead market predictions **seven** times…)



Source: John Authors, Points of Return

Culture & sustainability

Concrete (and steel!) climate plans

I've never been one for New Year's resolutions. I worry that if (when!) I break them, I'll feel worse than if I'd never started. But research suggests that I might be underselling myself.

A recent YouGov poll showed that 35% of people who made New Year's resolutions managed to stick to all of them, with around 50% sticking to at least some. And there's plenty of academic support for the idea that explicitly writing down a goal makes you more likely to achieve it.

And if it works with individuals, perhaps it works with countries too. The COP21 Paris Agreement in 2015 committed countries to pursue efforts to limit the increase in global temperature to 1.5°C above pre-industrial levels. Studies have shown that this commitment *did* make companies reduce their carbon emissions and spurred investments into new technologies.

At the most recent COP28, after weeks of negotiations in the UAE, there were green shoots of progress to stir the stomachs of the most pessimistic climate activist. And importantly, it resulted in a *written goal* – a signed text was included that commits countries to transition away from fossil fuels (alongside a further goal to triple the renewable energy capacity globally).

History suggests that these new commitments will have an impact on investments. According to the International Energy Agency there has been a 65% increase in the annual spend on clean energy investments since 2015. The annual spend is now $1.75tr. That is a lot of money that leads to some huge infrastructure projects.

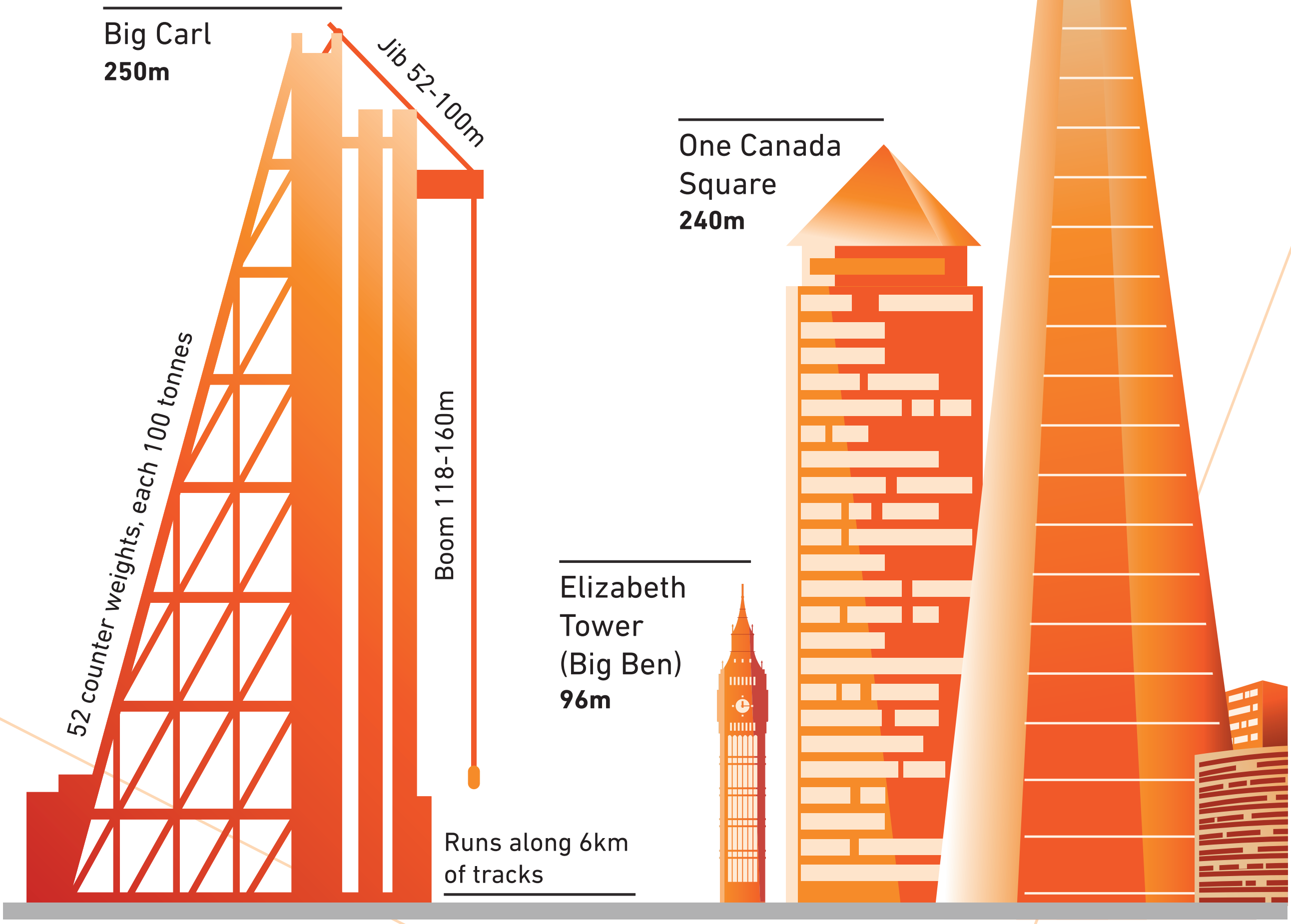
Some of these projects are close to home, take the Nuclear power station at Hinkley Point C which began construction in 2018. The world's largest crane – called "Big Carl" to its friends – was used to deploy the 245-tonne steel roof, which is wider than the dome of St Paul's Cathedral. Big Carl incidentally is two-thirds the size of the Shard.

This kind of large-scale construction is one of the underlying reasons for our investments in mining companies. Whether it's the energy plants themselves, or the machines that help build them – the world will need a LOT more metal.

Policymakers are setting goals that are beginning to have real impacts on our lives. Incorporating climate risks and opportunities into our investment process is important for the environment and also for investment returns. Maybe I should follow suit and dig out that gym membership...

Sarens SGC-250 'Big Carl' Key Stats

5,000	tonne lifting capacity, equilavent to 50 blue whales
700+	prefabricated pieces will be lifted by 'Big Carl'
250m	tall
96	individual wheels carry the crane on location
12	engines grouped in six pairs



JACK TURNER

Head of ESG Portfolio Management

Special feature

What to expect in 2024 – same as ever?

Late last year, I read a brilliant book: Morgan Housel's *Same as Ever*[1]. It hit all the sweet spots for me – looking at human behaviour and what we can learn, all told through wonderfully simple stories. It went straight into my top 10...

The book is built around one key insight: people haven't changed much over the course of recorded human history. From an evolutionary perspective, you're almost identical to the Ancient Egyptians or Mesopotamians from 4,000 years ago – and likely to be pretty similar to your great^{40}-grandchildren in 2,000 years. The same things still matter. Love, fear, security, power, family, fear, joy and so on. These tend to combine in the same old ways and produce the same old results.

This doesn't mean predictions of specific events are possible, or even needed.[2] But it does mean we can have some idea of the *type* of events that might happen, and more importantly, how people and systems will react to them.

Same as ever – 2024 investor edition

OK, so assuming people and their behaviours don't change too much, what can we usefully say about the next 12 months? Here are three things I'll be looking out for...

1

Politics will surprise us... but won't matter much for portfolios

One of the great quotes in *Same as Ever* is from Woodrow Wilson. Six years before he became the 28th US President, he wrote a book about US politics in which he described government as "*accountable to Darwin, not Newton*".

He meant that there are no fixed rules when it comes to politics – our society is constantly evolving (Darwin); the people, the structures, the systems change and adapt and interact in unpredictable ways. What shaped the outcome last time might not do so this time – making forecasting almost impossible.

And with more than half the world's population going to the polls in 2024, that's a LOT of Darwin-type events heading our way.[3]

But, over any reasonable time horizon, investing is accountable to Newton; the laws of physics and maths *don't* change. Compounding up gains into more gains will *always* be powerful – no political party can change the basic mathematics behind that.

[1] If I'm being really honest, you should stop reading my words and go and read his...
[2] As Ahmer shows, preparing for events might be better than trying to predict them.
[3] The countries having elections have a combined population of more than 4bn – though not all of them will be able to vote due to age.

2

Emotions are guaranteed to make you doubt

Reading the above section in comfort, you'll (hopefully) nod along. Most of us will calmly agree that politics shouldn't affect investments much over the long term… And the same is true of anything else we can imagine. Wars end. Pandemics pass. Companies adapt.

Every investor *knows* that the best thing is to "*buy low, and sell high*".

But when something scary is actually happening, we aren't so calm. It's all very well to agree that a nightmare isn't real – but try remembering that when you're dreaming! Whether it's the week's polling data for Labour or a bomb exploding in the Middle East, the latest Trump decree or a natural disaster a little too close to home. There's always something that makes the immediate future uncertain.

At some point in 2024, equity markets will *fall*. And there will be a *very* compelling reason for that at the time – one that speaks to people's emotions. And for people who manage their portfolios or run their lives based on their day-to-day emotions, it will make things verrrry difficult. They'll forget to "*buy low and sell high*". They'll look for bad stories to believe in instead…

BEN KUMAR
Head of Equity Strategy

3

Too much emphasis on big winners

In 2024, someone will make an *extraordinary* amount of money investing in something you didn't buy. Could be AI. Could be rocketships to Mars. Could be a new wonder-drug or crypto-currency. They'll get articles written about them. You'll think, "*could have been me*"!

But *far more* people will lose a *large* amount of money investing in *lots* of different things that you didn't. Could be AI that goes wrong. Could be rocketships to Mars that explode. Could be a new wonder-drug that fails. Some will almost certainly lose money in yet another crypto-currency that turns out to be a scam… Of course, you won't hear about them. They don't get articles written about them – in fact, they don't want to tell their stories. But if they *did* tell you, you'd think "*I'm so glad that isn't me*".

For every **BIG** winner, there are lots more people who tried and failed. They went big and they went home. There might be areas of your life where you want to do that. But investing for your future shouldn't be one of them. It's *not* a big swing and big miss situation.

There's a connection between these points. At a quiet and rational point in time, with the help of a financial planner or adviser, you'll have come up with a sensible investment plan, allowing for the entire noisy history that markets experienced up until the moment you invested. The plan will also account for most of the noise that you experience in the future. In the planning session, you'll have *absolutely understood that*.

But it is *inevitable* that, during your investment horizon, something strange and nasty will happen. It will make you think the plan won't work. Maybe as often as once a year! You'll get surprised. You'll start to doubt. And you'll pay attention to stories that divert you from the plan.

The course of action is simple. Take a deep breath. Do nothing. *Stick to the plan*! The same as ever.

Meet the teams

Investment Management Team

Martyn Surguy
Chief Investment Officer

ACA Chartered Accountant, MCSI, CISI Level 4, 37 years of industry experience.

Matthew Yeates
Deputy Chief Investment Officer

CFA, FRM, BA Economics, 13 years of industry experience.

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Senior Investment Manager

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Peter Sleep
Senior Investment Manager

32 years of industry experience.

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Jack Turner
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CFA, 16 years of industry experience.

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MSci Theoretical Physics, 1 year of industry experience.

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Investment Risk and Performance Analyst

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Loic Yegba
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