IMS Capital

Quarterly Review

Q1 2024

Market Commentary

We enter the first quarter of 2024 on the cusp of what could be a period of monetary loosening. The major western central banks are expected to start reducing interest rates which rose sharply as inflation spiked following our emergence from the pandemic. In the UK, the Bank of England (BoE) paused its programme of hikes in September after a run of 14 in a row, leaving the rate sitting at the highest point for 15 years. The US Federal Reserve (Fed) increased rates 11 times in a row finishing at a 22-year high while the European Central Bank (ECB) made ten consecutive rises taking the rate to the highest level since the launch of the euro.

Whilst there is near-unanimous support for the idea that we've seen the last of higher rates for now, it's much harder to predict what path the different central banks will take from here. Whilst all three of the authorities above paused at around the same time, the economic conditions in each region vary quite widely with different pressures at play.

The US looks to be in the finest fettle with its GDP growth rate for the final quarter of 2023 coming in at 3.3%, much higher than the 2% that had been forecast. This suggests the Fed might have a chance of achieving an elusive "soft landing" - cooling the economy without causing a major recession, something that rarely happens and that seemed impossible given the scale and rapidity of their actions over the last year.

Conversely, UK GDP growth was flat between October and November and it remains a coin toss whether we will manage to avoid a technical recession. The story was similar in the EU with Germany, usually its powerhouse, continuing to struggle and finishing the year in the red. All of this means that the BoE and ECB might need to take more strident action to give their economies a boost.

There are a range of other factors at play including persistently high employment and wage growth, but recent jumps in inflation might be giving rate setters the biggest headache. Prices rose in all three regions in December at least in part because of the withdrawal of government stimulus packages, however, it is the threat of geopolitical risks that is of greater concern. Shipping costs have risen over 300% as vessels are diverted to avoid attacks in the Red Sea which has compounded rises in oil prices which had already started to move higher in response to rising tensions in the middle east.

Despite this, US stock markets have been hitting new all-time highs this year with the S&P 500 now officially in a bull market. America's main index has risen by a third since it hit its previous low point in October 2022. A big driver of this success is the ongoing strength of the so-called Magnificent Seven, the moniker given to Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA and Tesla. The group now accounts for 30% of the main US market and although they tend to thrive when interest rates are low, higher rates haven't held them back as consumers remained resilient. If the central banks take action as expected, this could be a further boon for markets, but our priority remains to find the right balance between riding this wave while keeping an eye out for hazards.

Performance Update

The fourth quarter saw strong returns almost across the board, with China continuing to be the main area of weakness. An apparent softening in the rhetoric around the outlook for interest rates saw US markets repeatedly breach all-time record highs, led by the largest technology stocks. This is an extension of the theme that we've seen for over a year and the degree of exposure has been the primary determinant of outperformance.

This binary outcome presents a challenge for us. We have exposure to the Magnificent Seven via our US equity weighting as well as our positions in funds which have a global remit and these are responsible for a lot of the strong performance we saw across the portfolios over the quarter. However, we are conscious of the risks of relying on a single sector, especially a subset of that sector which has such a strong correlation. The risk is that all the while this theme persists, our moderately underweight position will be to the detriment of our relative returns, but following the herd would backfire if the sector sees a sudden reversal.

Away from the US, we saw good returns for our allocation to smaller and mid cap companies, while India and Japan again enjoyed a good period. As above, China struggled as result of a number of factors including a revival of fears over the highly indebted property sector. This had a knock on effect on the region with Emerging Market equities also weaker.

Portfolio	**3 month performance**	**12 month performance**	**36 month performance**	**60 month performance**	**12 month historical yield**
IMS Defensive Income	5.64%	3.75%	3.01%	13.96%	4.18%
Benchmark	*6.23%*	*2.79%*	*-2.13%*	*7.63%*	n/a
IMS High Income	6.58%	5.14%	12.82%	28.80%	4.30%
Benchmark	*7.67%*	*3.62%*	*5.92%*	*21.38%*	n/a
IMS Cautious	6.45%	3.49%	6.24%	19.70%	3.10%
Benchmark	*7.02%*	*2.98%*	*3.16%*	*15.12%*	*n/a*
IMS Balanced	7.75%	3.36%	7.27%	25.79%	2.69%
Benchmark	*8.33%*	*4.26%*	*8.74%*	*27.93%*	n/a
IMS Growth	8.79%	4.95%	9.68%	32.79%	2.25%
Benchmark	*7.98%*	*3.74%*	*8.77%*	*28.91%*	n/a
IMS Future Focused Cautious	8.48%	4.04%	n/a	n/a	2.78%
Benchmark	*7.02%*	3.50%	n/a	n/a	n/a
IMS Future Focused Balanced	9.29%	4.82%	3.54%	34.47%	2.37%
Benchmark	*8.33%*	*4.26%*	*8.74%*	*27.93%*	n/a
IMS Future Focused Growth	10.14%	3.13%	n/a	n/a	1.92%
Benchmark	*7.98%*	3.20%	n/a	n/a	n/a

All data are to 31/01/2024. Source: Financial Express Analytics

Portfolio Change Summary

At every review the Argentis Asset Allocation Committee meets to agree the sector weightings for the coming quarter. We also assess each of the funds used across all of the portfolios using a multi-metric ranking approach that combines short and long term factors to assess how each of them rank against their peers. Alongside our in-depth fund research, we work to ensure that the models retain appropriate levels of diversification which can lead us to retain funds that might appear to be underperforming in isolation. This is usually the case where the prevailing market conditions do not favour the approach of certain funds, but if we only held those which suited a particular style, the portfolios would struggle were conditions to change.

As a result of our analysis at this review we have made a number of changes at both an asset allocation and at a fund level. From an asset allocation perspective, the main theme was a further reduction in the allocation to UK equities with a focus on increasing diversification. The reduction to the UK sector is a reflection of the headwinds which it faces. There is a broad agreement that the UK economy is likely to be one of the weakest amongst leading countries over the next year, although we do acknowledge that it does offer a relatively high degree of value compared to some of the more expensive markets around the world.

One area to which we have sought to increase our exposure is Asia Pacific equities. This might seem counterintuitive given our view that the markets could be due a period of recalibration, but we are mindful of the benefits the increased exposure brings from the perspective of diversification. As mentioned earlier, the region is influenced by the performance of the Chinese economy, however, it gives us access to a wide variety of rapidly growing countries such as Vietnam, Indonesia and India.

At a fund level we saw a number of funds flagged for more detailed analysis but following a review of their usage within the wider portfolios, no changes were made as a result. However, we did elect to reduce our weighting to the infrastructure fund which is held across many of the models. This stemmed from our assessment of the fund's potential given what is expected to be period of reducing inflation. We also made a change within the Natural Income portfolios to bring in a new fund which offers a higher level yield at a lower cost.

No changes were made to the Growth and Future Focused Growth models at this review because we judged that they were both sufficiently diversified with no changes required at the fund level. A rebalance back to the original weightings is recommended to account for market movements over the period.

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