IMS Capital

Quarterly Review

Q4 2023

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Market Commentary

As predicted at the last review, we appear to have entered a world of plateauing interest rates as far as the major western central banks are concerned. Despite the fact that rate setters had been implying for some time that this would be the case, markets appear to have only recently begun to begrudgingly accept this reality.

The US Federal Reserve's suggestion that interest rates will stay above 5% for the whole of next year helped to push the yield on 10 year Treasuries (the US equivalent of UK gilts) from 4% up to almost 5% since our last review. Although the yield has moderated slightly from its peak, it still sits close to the highest rate seen since before the 2008 Global Financial Crisis and is some eight times higher than it was when interest rates were slashed in response to the pandemic.

This increase has been echoed in many developed countries and part of the reasoning is a fear that inflation might prove to be stickier than expected. Despite falls from the extreme double-digit peaks last year, the push to get back to a more typical rate of around 2% is proving tougher to achieve. In America, inflation dropped to 3.2% in July but has since jumped back to close to 4% with the US economy remaining resilient in the face of higher borrowing costs.

There are competing pressures at play as far as inflation is concerned. On the one hand consumers are helping to keep things running hot with a recent revision to savings data showing that the pot built up during Covid has not fallen as much as expected. This should allow for the continuation of a phenomenon known as "revenge spending" (an incremental increase on consumer spending versus normal levels following an unusual event). With the jobs market remaining strong, the evidence suggests that employers are also having to increase wages to attract staff which is likely to lead to price rises.

On the other hand, one factor that could change this narrative is the lagging effect of interest rate rises. It usually takes between one to two years for them to impact on the economy in a broad sense and we're approaching the 2-year anniversary of when the major central banks started on their rate rising theme. If consumers, and therefore the companies they buy products and services from, start to rein in spending and profits begin to fall (which is exactly what is meant to happen) then that could lead to a rapid cooling in the economy and prices will fall more quickly.

Of course, the terrible situation in the Middle East introduces another very unwelcome element for us to consider. As ever with events like this, we have to separate our horror about the conflict from our evaluation of what it might mean for markets. The obvious concern is for the violence to spill into other countries in the region and the consequential impact on oil prices which would lead to a spike in inflation and act to suppress growth. The changes detailed later in this update reflect our awareness of the potential headwinds we might face whilst ensuring that the portfolios are able to participate in positive market moves when they occur.

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Performance Update

Markets came under pressure during the quarter as investors reassessed the outlook for interest rates. As mentioned earlier, the yield on bonds rose sharply, in some cases back to levels not seen for 20 years despite no changes to interest rates by the Federal Reserve and only one by the Bank of England. US markets were again some of the best performing, albeit that could be classified as damning with faint praise given they finished the period lower, along with most other regions.

Away from the US, other western indices were subdued because of concerns about the medium term outlook. A very rapid tightening of monetary policy and falling consumer confidence have dented expectations, although the UK's large cap index (which we now use as a core weighting in the Capital Growth models) did fair better thanks to a preponderance of more defensive, dividend-focused companies.

Further afield, China's main index lost all of the gains it made since it reopened its economy in late 2022 as the country faces a raft of challenges including reducing global demand and a heavily indebted real estate sector. However, China's loss is a gain for other emerging markets as western countries decouple from their supply chains as political disagreements grow. India also enjoyed a very strong quarter, bucking the general trend.

In the world of fixed income, the jump in yields was obviously a strong headwind for bond prices which struggled over the quarter, although they still managed to outperform many equity sectors.

Portfolio	3 month performance	12 month performance	36 month performance	60 month performance	12 month historical yield
IMS Defensive Income	-1.08%	2.89%	1.62%	7.74%	4.13%
Benchmark	*-2.34%*	*0.83%*	*-3.78%*	*1.62%*	n/a
IMS High Income	-2.19%	4.87%	14.82%	20.21%	4.03%
Benchmark	*-3.87%*	*1.76%*	*6.90%*	*12.67%*	n/a
IMS Cautious	-2.54%	2.82%	5.76%	11.27%	2.87%
Benchmark	*-3.30%*	*1.48%*	*3.48%*	*7.62%*	*n/a*
IMS Balanced	-4.32%	1.95%	7.71%	15.71%	2.44%
Benchmark	*-4.44%*	*2.03%*	*10.40%*	*17.91%*	n/a
IMS Growth	-4.71%	2.94%	10.64%	21.34%	1.95%
Benchmark	*-4.43%*	*1.69%*	*10.52%*	*19.11%*	n/a
IMS Future Focused Cautious	-4.09%	-3.39%	n/a	n/a	2.59%
Benchmark	-3.30%	-2.93%	n/a	n/a	n/a
IMS Future Focused Balanced	-5.27%	1.63%	2.52%	23.39%	2.20%
Benchmark	*-4.44%*	*2.03%*	*10.40%*	*17.91%*	n/a
IMS Future Focused Growth	-6.37%	-5.07%	n/a	n/a	1.82%
Benchmark	*-4.43%*	-2.94%	n/a	n/a	n/a

All data are to 31/10/2023. Source: Financial Express Analytics

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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 versus their peers. Alongside our in-depth fund research, we work to ensure that the models retain appropriate levels of diversification which can require us to retain funds that might appear to be underperforming. 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 reduction in the allocation to UK and European equities with a corresponding increase to the Absolute Return sector.

The reductions resulted from our view that these regions could struggle over the coming months relative to other developed markets. Both the UK and Europe face a period of slow growth with inflation remaining relatively high. There are a number of potential headwinds which could worsen the outlook and despite a degree of residual value, we believe that other sectors offer greater potential.

Part of the assessment also related to how the existing weightings compared to the strategic asset allocation models on which the portfolios are based. At the last review these specified a reduction to the European Equity sector which we decided against implementing at that stage as we prioritised the restructure of the UK Equity holdings. However, given our expectations for the sector, we have now made this change which brings the portfolios into line.

The increase to Absolute Return is a reflection of our desire to add an extra layer of defence in the event that the final months of the year see an increase in volatility. In the Capital Growth models we have selected a new fund which complements the existing Absolute Return holding and is highly uncorrelated to the other assets. In the Future Focused models we have been able to identify a fund which meets our ethical criteria and should also provide a very uncorrelated return relative to the other funds used in the portfolios.

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