MFS Bespoke Model Portfolio Service Quarterly Report

Q4 2023 market review

Macroeconomic landscape
Q4 2023

In October, we saw the Federal Reserve (Fed), Bank of England (BoE) and European Central Bank (ECB) pause their rate hikes once again; this is two successive meetings where central banks have chosen to maintain interest rate levels.

Later in the quarter, we also saw the Fed Chair, Jerome Powell, surprise markets with "**dovish**" comments on the outlook for interest rates indicating that we are not only nearing the end of the rate hiking cycle, but cuts may be on the horizon for 2024. Inflation data in both the US and UK came in lower-than-expected, adding to the prospect of any change to interest rate levels being a cut, rather than a hike.

Markets **rallied** on their renewed confidence in the ability of central banks to control inflation, which sent bond **yields** lower. This was beneficial for not only **fixed income** and long **duration** assets, but equities too.

Earnings season kicked off in October with the **Magnificent 7** reporting mixed results. Microsoft experienced strong earnings driven from cloud subscriptions, whilst Alphabet disappointed as its cloud computing fell below revenue expectations. Meta reported strong revenues but shares later declined as the CEO warned of softer future advertising revenue. Finally, Amazon had strong results beating revenue and earnings estimates.

There is increasing optimism that central banks can achieve the **soft-landing** markets have been contesting all year: bringing inflation down whilst maintaining growth. We believe the balancing act between growth and inflation will be more prevalent in 2024, highlighting our preference for **quality** companies who can compound earnings over the cycle and withstand economic shocks.

Turning to China, additional fiscal support was announced over the quarter. President Xi issued billions in sovereign debt raising the region's fiscal deficit to 3.8%, well above the 3% target. Encouraging data also emerged; industrial output grew, and retail sales accelerated. President Xi also met with US President, Joe Biden, in December ahead of the Asia-Pacific Economic Cooperation where "constructive and productive discussions" were had. Lingering tension remains but there is cautious optimism among market participants.

Q4 2023 performance

Top Performers

Vanguard Long Duration Gilt:

In Q4 2023, the fund returned 14.28% marking a spectacular recovery of steady losses throughout 2023 and culminating in a +1.50% gain for the calendar year. This was largely driven by the significant downwards pressure on longer **maturity** government **bond** yields in December, amidst growing expectations that central banks will start cutting rates in early 2024.

T. Rowe US Smaller Companies:

The T. Rowe fund gained 13.35% over the quarter. The fund has a notable allocation to smaller companies which struggled through 2023 but rallied in the final quarter as markets began to respond to the notion that inflation may be under control in the US and that we may see reductions in interest rates as soon as Q1 2024. This particularly benefits smaller companies who are more cash constrained and reliant on cheaper borrowing costs.

Bottom Performers

Morgan Stanley Asia Opportunities:

The MS Asia fund fell 4.49% over the quarter, largely driven by a nearly 50% allocation to China. Large holdings such as Tencent, Meituan and Haidilao were hit by the stricter regulations proposed by Chinese authorities on the online gaming industry which signalled that Xi Jinping may prioritise ideological politics over economic growth. This hit investors' already fragile confidence in the region.

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BlackRock Liquidity Cash:

Though still in positive territory, the BlackRock Liquidity Cash Fund rose by only 1.35% over the quarter and proved to be one of the weakest performers in the portfolio. Though cash funds saw a strong year overall, in a quarter where broadly all asset classes saw strong returns, investors prioritised allocating to equity and bond markets instead to achieve higher returns.

Model portfolio performance as at 31 December 2023

Portfolio	3 months	6 months	1 year	3 years	Since inception
MFS Disc Cautious	4.56	4.35	5.98	5.60	20.92
MFS Disc Balanced	5.03	4.45	6.21	5.24	24.03
MFS Disc Adventurous	4.95	4.05	7.40	5.12	29.92
MFS Disc Speculative	4.87	3.32	7.02	0.66	27.32
MFS Disc Cautious Income	4.45	4.75	6.89	11.01	27.12
MFS Disc Balanced Income	4.62	5.02	7.08	12.82	28.63
MFS Disc Adventurous Income	4.92	5.23	8.92	16.52	31.69

Portfolio changes and rationale

The UK will likely need to keep interest rates higher for longer in order to bring down inflation in comparison to other developed economies such as the US. Higher rates affect both aggregate demand, as consumers face squeezes in disposable incomes, and also companies, who face an increased cost of capital. This disproportionately affects smaller firms over larger corporations, who are better able to pass on or tolerate higher costs. As a result, we have reduced exposure to smaller companies in the UK and instead added further to global quality equities.

Elsewhere, we have redistributed profits and added further to funds that focus on purchasing quality companies at reasonable valuations. This provides a cushion to investments should economic conditions deteriorate, and stocks fall and also seeks to avoid unreasonably expensive stocks.

Within bonds, we have simplified your exposures held, moving from more expensive **active** and **strategic bond funds** to more passive, cheaper alternatives. Active bond managers were included to provide excess returns in a low interest rate environment, however, in a new era of higher interest rates, the necessity for highly active management diminishes somewhat, as attractive yields become more readily available through **index** exposures.

Overall equity exposure has been broadly maintained this quarter, however, we have removed hedged equity exposure. Currency movements between sterling and the US dollar have made this a very profitable trade, hence our decision to move into an unhedged share class at this time.

Further reading material

Take a deeper dive into LGT's outlook for Q1 2024 with Phoebe Stone, Head of Intermediary Investment Services and Sustainable Investing.

Click here

Explore the wider 2024 investment themes with key members of the LGT investment team, including Henry Wilson, Senior Portfolio Manager.

Click here

Scan the QR code to watch a five-minute roundup of the last quarter with LGT's CIO, Sanjay Rijhsinghani.

Glossary of terms

Active fund	A portfolio of investments that is selected by a professional investment manager and managed on an ongoing basis with the aim of achieving an outperformance objective.
Bonds	Bonds are debt securities issued by governments and corporations to raise money. Similar to an IOU, the investor lends money with the agreement that it will be paid back by a specific date, and they will receive periodic interest payments along the way. Bonds come under the umbrella of ‘**fixed income**’ investments.
Diversification	Spreading your money across different types of investments, such as equities, bonds, and property, instead of putting all your money in just one type of investment. By doing this, you can reduce the overall risk of your investment portfolio.
Dovish	A supportive and accommodative approach to monetary policy, favoring measures like lower interest rates and stimulus to encourage economic growth.
Duration	The sensitivity of the price of a bond to changes in interest rates. A bond with a longer duration will typically be more sensitive to changes in interest rates than a bond with a shorter duration.
Earnings season	The timeframe when publicly traded companies announce their financial performance, usually on a quarterly basis, influencing market activity and stock prices.
Gilt	A type of fixed income investment issued by the UK government. They are considered to be among the safest investments available. They have a fixed interest rate and a specific maturity date, which can range from a few months to several decades.
Global index fund	Investment fund that aims to replicate the performance of a broad international market index. This fund typically invests in a diversified portfolio of securities from various countries.
Growth	Investing in companies that are expected to offer future growth prospects that are above the average in their industry or sector
Index	A fund that aims to track the performance of a market index.
Magnificent Seven	A group of high-performing and influential companies in the U.S. stock market: Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla.
Maturity	The length of time until the bond issuer must repay the original bond value to the investor.
Passive fund	A fund that aims to track the performance of a market index.
Quality	Considered to be financially stable, profitable, and well-managed.
Rally	A sustained and widespread increase in the prices of financial assets, driven by optimistic investor sentiment, positive economic indicators, or favorable corporate earnings.

Selling off	A sell-off is when holders of an asset collectively sell their holdings at the same time, in quick succession. This can trigger a large reduction in price.
Sentiment	Market sentiment is the overarching attitude or outlook of investors towards a particular security, sector of the market or economy as a whole.
Soft landing	A gradual and controlled economic slowdown, avoiding sharp contractions or recessions for a smoother transition to sustainable growth levels.
Strategic bond fund	Actively adjusts its portfolio of fixed-income securities, including government corporate bonds, to optimize returns in response to changing market conditions.
Ultra-large cap	Market capitalisation – cap – is the market value of a company based on its current share price and total number of shares. Ultra-large cap companies have the largest market capitalisation. The largest companies by market cap are currently Apple, Microsoft, Alphabet (Google), Amazon, Nvidia and Meta (Facebook).
Volatility	A measure of how much returns may vary over a year.
Yield	The income you receive on an investment, such as dividends from shares or interest from bonds.

Cover image Bauer brothers, Hortus Botanicus, detail from "Lilium," 1776/1804