

MODEL PORTFOLIO SERVICE

MONTHLY COMMENTARY

SUCCESSION
MODEL PORTFOLIOS

POWERED BY

7IM

JANUARY 2023

Portfolio Performance

At 7IM, we believe that taking a long-term view is essential when investing. We can't always avoid the short-term bumps and shocks that the financial world has in store, but a well-diversified portfolio goes a long way towards smoothing out some of the journey. The long-term nature of our strategic and tactical process is a good complement to the Succession Matrix Expected Parameters.

	Q4/2017	Q4/2018	Q4/2019	Q4/2020	Q4/2021	3 Year Ann. Return	5 Year Ann. Return	Succession Matrix Expected Parameters – Ann. Return
	-	-	-	-	-			
	Q4/2018	Q4/2019	Q4/2020	Q4/2021	Q4/2022			
Defensive	-3.87%	7.09%	5.99%	1.74%	-8.39%	0.04%	0.91%	3.0 – 4.5%
Cautious	-5.27%	8.78%	6.48%	4.40%	-7.22%	1.76%	1.83%	4.5 – 6.0%
Balanced	-6.71%	11.28%	6.03%	8.47%	-6.08%	3.42%	2.81%	5.2 – 7.5%
Moderately Adventurous	-8.37%	13.47%	5.98%	11.27%	-4.41%	5.14%	3.64%	6.0 – 8.0%
Adventurous	-9.68%	15.65%	5.28%	14.36%	-4.91%	5.91%	4.05%	7.0 – 10.0%
Income	-4.60%	11.22%	2.23%	7.11%	-5.83%	2.05%	2.59%	

Source: 7IM/FE. Annualised return is defined as 'Ann. Return' in the performance table above and is as at end January 2023. Market returns have been poor in absolute terms since the beginning of 2020 with the Covid pandemic and then the inflationary shock of 2022. While portfolios have held up well relative to peers, the 3 and 5 year absolute returns are lower than average, even though the since inception longer term numbers are in line with expected parameters..

Summary

At the end of last year, the vast majority of economic and market forecasts were *really* negative, and, to a large extent, they still are. So, why is everything rallying and does that mean it's going to be plain sailing for markets for the rest of 2023?

First, here's what happened in equity markets in January:

Index	Jan 2023 Price Return
S&P 500	6.2%
Nasdaq	10.7%
FTSE 100	4.3%
TOPIX	4.4%
MSCI EM	7.9%
EuroStoxx 50	9.8%

As you probably know, we are *underweight* equities at the moment. So, it should come as no surprise that we don't think equities will continue this stellar rally. Here are a few of the possible reasons why the tick up in equities has happened, and more importantly, why each one *isn't* the sign we are looking for to bring our equity allocation back up to neutral:

- **Premature pivot narrative.** There has been a lot of optimism around US inflation data getting *slightly* better. The US inflation figure you tend to hear in the news (US year on year CPI) has fallen from 9.1% in the middle of last year to 6.5% at the start of this year. This is a good sign and it's what is getting markets excited, but inflation is still a long way above its 2% (Personal Consumption Expenditures) target. Prices are STILL increasing at 6.5% per year!

The Fed will want to have inflation dead and buried before they pivot. Jay Powell will want to be remembered as a Fed Chair who slayed the inflation beast in one go, and not one who pivoted prematurely and got bitten again. We still have some way to go until the Fed *actually* change their tune – but the market refuses to believe it.

- **China...** Licking your elbow is really hard, but predicting what will happen in Chinese policy is even harder. After three years of President Xi's zero Covid policy, China is reopening both internally, and to the rest of the world. This has caused a lot of excitement around Chinese equities and hard commodities.

A continued reopening would have a big positive impact on global demand, but there is a huge amount of uncertainty. Would a demand boom from China cause inflation? Will Xi lockdown again when hospitals become overwhelmed? Could Xi attack another sector as he did with real estate or education? All of these are tough to predict, and excitement around China could be misplaced.

- **Europe is getting some good news.** A big concern for Europe since February 2022 has been natural gas prices. Over the past couple of months, these have returned to pre-Russia/Ukraine invasion levels, giving Europe's inflation and the European consumer some respite. Other factors such as the Purchasing Managers' Index stabilization, slightly better earnings revision trends, and hopes of a demand boost from a China reopening have also contributed to positive sentiment.

These are definitely good signs, but they are not the foundations for a *global* recovery. Europe does not drive the global economy, and bad weather could derail a lot of the good signs Europe is seeing anyway.

- Bear market rallies do just happen. Back in November, I wrote about a few examples of bear market rallies [here](#). The majority of bear markets experience some sort of bear market rally. They can be fast, slow, deep, shallow, completely unexpected, and painfully recurring. One example of a bear market that experienced pretty much all of this was the 2000-2001 dot.com crash. Over this period, the Nasdaq entered eight bear market rallies greater than 18%, none of which materialized into a bull market.

In short, expect some bear market rallies. They don't necessarily mark the end of tougher times.

Portfolio Positioning and Changes

During January, no changes were made to our model portfolios. they will be rebalanced in February in line with our quarterly rebalancing schedule.

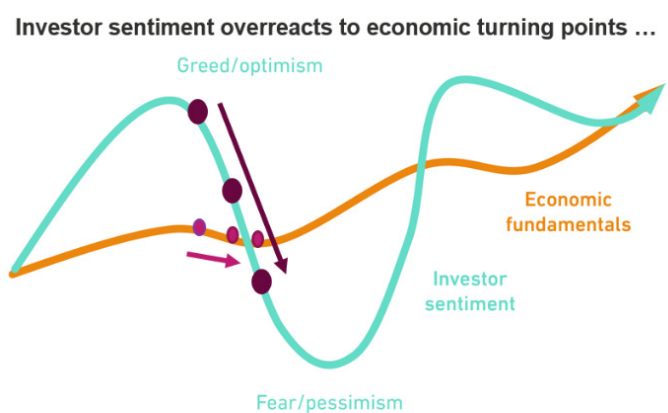
Core views

At 7IM, we have a number of long-term core views that help to guide our investment decisions and allocations within portfolios.

Over the next 12 months, we think markets will generally move **sideways with volatility**. In this environment, it is important to rely on a stable identity. Economic uncertainty creates fear and investor sentiment tends to overreact to economic turning points. Going forward, we believe that:

- Inflation **will** come down. Goods inflation is slowly normalising, and supply chain pressures are easing.
- Central banks are **getting close to the end of their hiking cycles**, but there is still a bit more work to do.

- **A US recession is highly likely.** Most leading indicators point towards a recession, but the recession shouldn't be too long or deep.



... with *slightly* weaker data leading to panic right now

Source: 7IM

And so, investors are starting to worry about what's next for financial markets. Economic data isn't likely to stabilise until next year, so 'Sideways with volatility' is the most likely scenario for the next few months.

We **know** our investment identity helps us to deliver in **just** these kinds of environments. We have positions that can generate returns despite this volatile backdrop.

ASSET ALLOCATION

Detailed asset allocation

	Defensive	Cautious	Balanced	Moderately Adventurous	Adventurous	Income
UK Equities	3.25%	6.50%	15.25%	18.50%	21.00%	8.00%
US Equities	3.00%	4.25%	8.50%	9.00%	10.00%	4.50%
European Equities	1.50%	2.25%	3.50%	7.00%	7.75%	2.75%
Japan Equities	1.50%	2.50%	3.50%	7.25%	8.25%	1.75%
Emerging Markets Equities	4.00%	6.50%	6.75%	10.00%	13.25%	6.50%
Global Themes	4.00%	6.25%	9.75%	13.75%	17.75%	3.00%
Global Government Bonds	18.50%	6.75%	3.50%	0.00%	0.00%	9.50%
Gilts*	9.00%	1.50%	1.00%	0.00%	0.00%	4.00%
Global Inflation Linked Bonds	6.00%	3.00%	0.00%	0.00%	0.00%	0.00%
Global Corporate Bonds	13.25%	18.50%	7.00%	0.00%	0.00%	21.50%
UK Corporate Bonds	0.00%	3.50%	0.00%	0.00%	0.00%	10.00%
Global High Yield Bonds	10.00%	10.00%	10.00%	5.50%	0.00%	12.50%
Emerging Markets Bonds	3.00%	6.00%	6.00%	5.00%	0.00%	11.00%
Real Assets***	0.00%	2.50%	3.25%	2.50%	3.25%	3.50%
Alternatives/Hedge Funds	21.00%	18.00%	17.50%	16.50%	13.50%	0.00%
Cash	2.00%	2.00%	4.50%	5.00%	5.25%	1.50%

Source: 7IM. *Includes Short Term Sterling Bonds **Includes Convertible Bonds ***Includes Infrastructure

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.

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