7IM

7IM COMMENTARY

Quarterly Rebalance Commentary

NOVEMBER 2024

Overview

You'd be forgiven for thinking that anything other than the US election took place over the last three months. Blue states, red counties, polling, betting, Elon Musk – it's felt more pervasive than any prior election. Imagine if the US devoted a similar amount of attention to UK General Elections as we do to theirs; *"y'all hear the new constituency of Gorton and Denton voted Labour? Sure looks tough for that Richie Sunak guy – but great for Keith Starmer I guess".*

Let's not jump straight into the US election then.

Over the last three months, interest rates have fallen everywhere. Yet, over that period, government bond yields have risen. Here in the UK, at the end of September the 10-year gilt had a yield of 3.75%; yet now it's around 4.5%, despite a 0.25% cut in rates over that time. The same is true in the US and Europe. What's happening?

Lots of investors had become overexcited about how quickly rates were falling and had expected the pace to continue. As rates fall, government bonds perform strongly, so lots of money has been sucked in. So, when central bankers started using words like '*cautious*' and '*slowing*' and '*higher rates for some time*' that money flooded back out again.

We'd always said that rates would stay higher than most were hoping (it's the only way to crush inflation), but we've never really thought of government bonds as a way to make a quick buck. We'll ride out the daily or weekly ups and downs, knowing that bonds are there for when times get really tough.

The arguments over whether Donald Trump's win was predictable ahead of time will rumble on for a long time; probably about four years – until the next cycle. And there's a similar level of uncertainty about the impact of the outcome on financial markets.

Back to bonds; lots of commentators have been talking about the potential increase in US debt on the back of Trump's victory, possibly impacting the US bond market as a safe haven. We're not too worried about it. No one is suggesting the US won't be able to pay back a higher debt load, and – perhaps more importantly – where else are you going to go? Developed governments all around the world are all in the same boat. When trouble comes, bonds will still deliver.

In the equity space, it's still far too soon to have an opinion on what will and won't do well under Trump 2.0. The policies are all still nebulous, and simply shouting *"business confidence"* doesn't *actually* give businesses confidence. Tax cuts and tariffs? Crypto and climate? Migration and military involvement? Too soon to tell; and with a healthy diversified chunk of US companies in portfolios, we'll have exposure to the winners.

Core Investment Views

After more than a decade of lurching from one financial crisis to another, the markets are gradually remembering how economic cycles work.

In those cycles, the economic world spends most of the time *between* extremes. There will be a mixture of good and bad data, and policy responses; but only rarely will these result in large market shifts.

Over the next twelve months, we expect:

Economic growth to be positive but slowing as the lagged impact of rate rises comes through. We wouldn't be surprised to see US GDP growth at 2%, rather than 2.3%, for example.

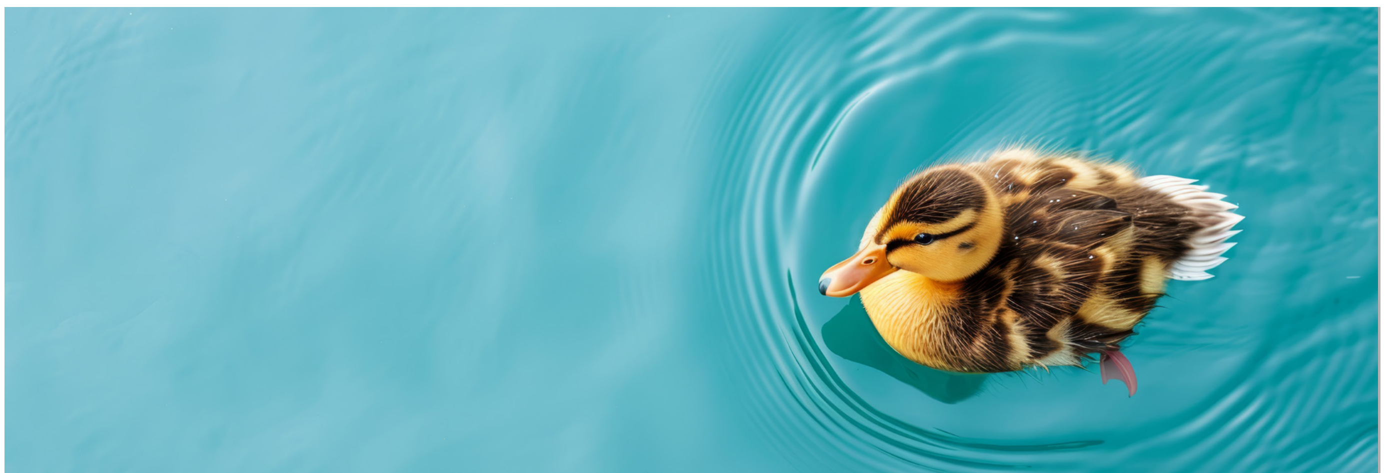
Inflation to keep falling, but only because interest rates don't. We've consistently said that central banks are going to make sure that inflation is crushed, before they start to *really* cut interest rates. And the end destination for rates isn't zero. Looks like the market is getting the message.

So how should we invest for a world which isn't at extremes?

Well. Basically. Like a duck.

It might sound a little silly, but hear us out. Think of a duck simply bobbing along on the current, riding over the little waves which come along, swimming out of the way of any obstacles. If necessary, it can take off and fly – or disappear under the water altogether. But most of the time, it doesn't need to do anything extreme to get where it needs to go and do what it needs to do.

We think that's the same with our portfolios. We want to allow market forces to work, to get our investments where they need to go. So, for most of the economic cycle, we let the smaller waves pass by. We don't need to start flapping our wings or diving down (although it doesn't mean we're not alert!).



7IM

7IM COMMENTARY

Tactical Asset Allocation

Macro	Model-driven allocations, reflecting 6-12 month macro outlook
Equity	**Neutral:** Most fundamental economic signals are around neutral; concerns around high valuations are balanced with a robust outlook for economic growth. Our model signals suggest that there aren't any obvious risks or opportunities to position for.
Government Bonds	**Small overweight:** Government bonds are, for the first time in over a decade, offering a real yield that's compelling. And, in addition, there's the protection that they offer during market downturns. However, given some of the unwinding in central bank books, there are some liquidity indicators which caution against a stronger overweight.
Credit	**Underweight:** While corporate bond spreads (the extra money that companies pay to borrow vs governments) are at the lower end of their historical range, there are few signs of any impending crisis – instead we simply reallocate to government bonds.
Healthcare	**Overweight:** Healthcare is a typically defensive sector, which we like as a diversifier against the growing concentration in US markets. At the same time, the valuations are attractive vs. history and the long-term theme has strong support.
Diversification	**Evidence-based diversifiers, which outperform through multiple market cycles**
US Equal-weight	Another diversifying strategy with a higher expected return than market-cap weighting over the long term, with recent underperformance accelerating the likelihood of that outperformance being frontloaded.
Put-Selling	A diversifying strategy focused on generating income through selling put options on the S&P 500 Index as a means of earning premiums, aiming for stable returns with reduced exposure to equity volatility.
Alternatives	Diversified basket of strategies which aren't correlated to bonds or equities. Continuing to deliver cash-plus returns while markets are stable but will tend to perform best during dislocations.
Tactical Opportunities	**Mispriced areas of the market with the potential to deliver meaningful excess returns**
Global Miners	Mining companies are the gatekeepers of the material world. There are only a few businesses with the ability to provide the vast quantities of raw materials that are going to be needed over the next century. They have the mines, the machinery, the engineers. And they are debt-free, unloved, and ready to rally.

Asset allocation changes

At the November model rebalance, 7IM has taken a number of actions:

- Added to equity allocations, taking our exposure to neutral vs long-term SAA, while also trimming government bonds back towards neutral. The 7IM quantitative macro dashboard suggests that neutral is a reasonable place to be, given the blend of positive and negative economic and market signals.
- We have increased our US equal weight position after a minor trim to healthcare and closing out the climate change position. This reduces idiosyncratic equity risk in an uncertain policy environment, and instead opted for the more reliable equal-weight diversification approach.
- We have closed out our AT1s (European Bank Debt) position completely after an extended period of price recovery, and introduced a small position in global high yield, remaining underweight in this part of the market.

Manager changes

This quarter we have added the following holdings to portfolios:

- Amundi Index MSCI Emerging Markets Index Fund to provide a more cost-efficient exposure to emerging market equities within Passive and Blended portfolios.
- JPM Europe Dynamic (ex-UK) Fund to provide a third and differentiated management approach to Active portfolios.
- Candriam Bonds Global High Yield Fund to provide an actively managed, higher quality credit exposure to Active portfolios.
- BNYM Efficient Global High Yield Beta Fund, to provide a cost-effective solution to access high yield bonds for Blended portfolios.

Please note: All of the comments in this document refer to the models we run on the 7IM platform, but the models are also available on a range of other platforms. As much as possible, we try to replicate the models we run of the 7IM platform across all platforms, but due to differing security availability, not all of the points outlined in this document may be relevant across these platforms. If you are unsure whether certain changes apply to models on a specific platform, please reach out to a member of the team.

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. Any reference to specific investments are included for information purposes only and are not intended to provide stock recommendation or investment recommendations to individual investors.

www.7im.co.uk

Seven Investment Management LLP is authorised and regulated by the Financial Conduct Authority.
Member of the London Stock Exchange. Registered office: 1 Angel Court, London EC2R 7HJ. Registered in England and Wales number OC378740.