Quarter in review:

The summer months did not provide investors with the quiet period many had hoped for after a very busy start to the year.

The movement of markets continues to be sentiment driven with investors looking to price in their longer-term forecasts from the ever-changing macro-economic conditions. For many, the main issues that are being focussed on are global inflation, the impacts that higher interest rates will have across all assets prices, and whether a policy mistake will occur from central banks.

The major news event for the quarter was that central banks continued to raise interest rates, especially in the developed world. Inflation does seem to have peaked, but it is staying higher than expected especially in areas like workers' wages.

Unemployment has not risen as quickly as many had expected, meaning that markets are now pricing in higher interest rates for a longer period. However, now it seems that any recession that occurs (if it occurs), may be less impactful to economies and so asset prices must reflect this.

What Are the key trends we are focussing on going forward?

Bonds for income, capital appreciation and diversification.

Historically our portfolios have been underweight fixed income as we have felt there have been better opportunities elsewhere. We have been positioned in mainly shorter duration credit which has provided greater protection in a rising yield environment. We have also been focused in the area of global corporate credit including high yield bonds and emerging market debt as the starting yield was higher, which provided greater coupons over time.

Our view was that yields in general were too low and credit spreads (the difference between corporate and government bond yields) were very tight, meaning that the return investors were receiving for the bonds was small and so this wasn't compensating them for the risk that both yields and spreads could widen.

What we've seen over the last couple of years is higher inflation, which in turn, has led to central banks moving from fiscal easing to fiscal tightening and raising interest rates to levels not seen for over a decade. This has resulted in bond yields increasing.

Bond markets got a little over-optimistic earlier in the year about the prospect of imminent rate cuts but have now reset back to more compelling valuations. We feel now we can rely on bonds for providing portfolio income and diversification from disinflationary shocks as the starting yields on bonds is far more positive. This should allow for more positive returns to be made within fixed income moving forward which is why we are currently reviewing our exposure to the asset class.

Alternatives for risk diversification.

As we have highlighted above, global markets continue to provide investors with heightened volatility due to the global reset post the COVID-19 pandemic. Add into this, political risks, wars and higher debt burdens it is no surprise that markets continue to navigate a higher risk environment.

Because of this, alternatives as an asset class continue to be a hot topic as many of these investments provide a different source of positive returns with lower correlations to equities and bonds.

As correlations between equities and bonds have been higher than average, the use of alternatives has been a pivotal cog within our portfolios to drive returns and provide lower beta for investors.

Within this space we continue to focus on gold which provides investors a hedge against inflation. Gold has performed relatively well in a rising rate environment even though it does not provide an income. Gold can provide protection against market events like we have seen in the past few years.

In addition to Gold, defined returns continue to be a stalwart of our alternatives exposure. Defined Returns provide set return outcomes if specific conditions are met within select equity markets. We like these types of alternative investments as you can currently receive 8-10% per annum over 5 years plus with protection on the downside, which means markets must be lower than these protection barriers for these returns to not be made. We think this is an excellent investment opportunity for investors, especially as the correlation of these investments to markets is low compared to other assets.

Continued emphasis on equities with a focus on dividends and quality.

We continue to be overweight equities as, over the longer term, the risk to reward characteristics for equities is still positive. However, due to the macro backdrop, we believe you need to be selective as not all equities are priced to provide the same risk to reward characteristics. Unlike what occurred in the decade of the 2010's when markets generally moved up with little resistance, equity markets now have far more headwinds and hurdles to manoeuvre. Within our portfolios, we will continue to invest in growth, value, and income strategies.

One area we are concentrating on is equity income, dividend payers and dividend growth companies. Equity Income plays an important role in our portfolios. Some investors may solely focus on capital growth, however we believe that focusing on income as well as capital growth can provide investors with a stable return profile over time that works in most market conditions.

Dividends can provide a regular return for investors whilst helping to identify high quality companies. As these businesses continue to grow cash flows, excess reserves can be paid out as dividends.

Another reason for focusing on income as part of our overall strategy is that if higher inflation and interest rates leads to an economic slowdown in the future, dividend paying stocks can help reduce volatility and protect portfolios.

With the ever-improving global dividend picture and the diversification, quality uplift and cash generation that equity income investing provides, we will continue to incorporate equity income within our equity allocation.

Conclusion

As we move into the 4th quarter of 2023, we are expecting the jobs market to cool off slightly, which will give the central bankers a slightly easier job. There are predictions of no more rate hikes, or if there are hikes, they are likely to be minimal.

Diversification is key and we are extremely happy with the positioning of our portfolios currently. We will be increasing the duration of our bond allocations, but we don't feel now is the time to do this and we are monitoring it very closely for when the opportunity arises.

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