Wealth Management

Quarterly report

Q3 2023 market review

Overview

- Higher for longer
- The big risk with cashing out
- Looking beyond China for investment in Asia

A political path to net zero

Written by Ben Palmer, Senior Portfolio Manager

Prime Minister, Rishi Sunak, has recently announced a watering down of some of the UK's climate policies that were originally engineered to help transition the country to net zero by 2050.

A summary of the changes:

- Delaying the ban on new petrol and diesel car sales from 2030 to 2035
- Delaying requirements to phase out sales of gas boilers by 2025 with homeowners now only having to install heat pumps when they are replacing their boilers. However, boiler upgrade grants will be doubled to £7,500
- Energy efficiency targets for landlords scrapped
- Previously announced in July, a commitment to issue more North Sea oil and gas licences.

These announcements may undermine the UK's position on the global stage and create further uncertainty for companies that may be looking to invest into climate friendly operations and net zero technologies. If the Government can't provide sufficient confidence and conviction around their commitment to reach net zero emissions by 2050, then companies may be more likely to delay investment or invest elsewhere. This is of course particularly relevant for those industries that need to undergo highly disruptive changes, for example the automotive industry. Interestingly, and perhaps surprisingly, there has been heavy push back on the Government's actions from some leading voices in these sectors.

US carmaker, Ford, was quick to respond saying "the UK 2030 target is a vital catalyst to accelerate Ford into a cleaner future" and "our business needs three things from the UK government: ambition, commitment and consistency. A relaxation of 2030 would undermine all three".[2] Part of the Government's argument is that Electric Vehicles are still too expensive, but this fails to address the highly probable innovation and cost efficiencies that will occur from now up until 2030, and such a policy move could allow companies to delay investment and push these cost efficiencies down the road.

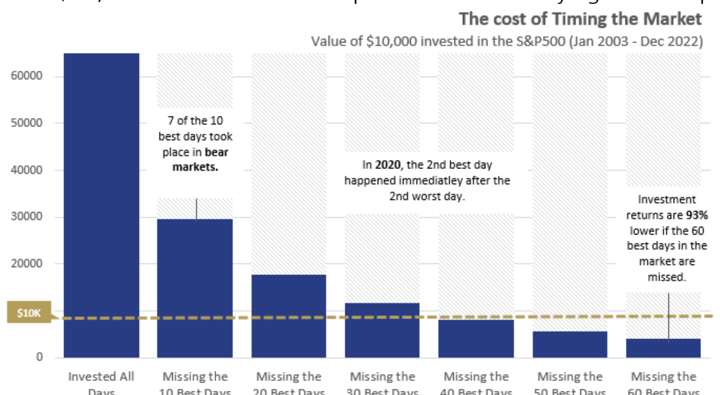
The UK's recent changes to key green policies marks a disappointing setback, however, we continue to watch global developments. For example, it has now been a year since the US Government set out its Inflation Reduction Act, which provided $369bn in support for home grown climate investments. Since its announcement, we have seen more than 270 new clean energy projects announced with investments totalling $132bn, supporting the creation of over 130,000 new jobs. The International Energy Agency has also estimated that more than $1.7trn will be invested in renewables this year, which compares to just over $1trn in fossil fuels. Our global approach means we are able to access compelling investment opportunities that can take advantage of both regional and global dynamics and are not dependent on the UK Government's stance and potential missteps.

So, whilst we pay close attention to these bumps in the road and assess whether they indicate any structural shift in the longer-term attractiveness of our sustainability mega trends, we place them into a broader context. To us, it remains clear that the shift from a fossil fuel powered energy system to one reliant on renewables is both environmentally and economically attractive, which will sustain support and progress over time.

The big risk with cashing out

Written by Phoebe Stone, Partner and Head of Intermediary Investment Services

Interest rates, and therefore rates on cash, are the highest they have been in the UK for 15 years. For investors that have endured a tough investment landscape for the last few years, it may seem tempting to liquidate, or to invest new money into a fixed return from a cash deposit. However, making this choice is risky for a number of reasons. It is very well-documented that poor, or unlucky timing of such a move can significantly impact long-term returns. The majority of clients have their wealth invested to meet medium or long-term financial objectives. By missing the 10 best days of the market over the last 20 years, would have reduced your $10,000 invested in the S&P 500 from the potential of $64,844 to $29,708[1]. The behavioural phenomenon of buying at the top



[1] JP Morgan, S&P total returns from 1 January 2003 to 30 December 2022 (including graph)
[2] Power Technology, 20 September 2023

of the market and selling at the bottom is characteristic of the human psyche and negates the fact that it is often better to leave wealth invested and compounding through the market cycle.

Whilst rates on cash may seem attractive today, we could be close to 'peak' interest rates, as inflation looks to be brought under control and the continuous increasing of interest rates may no longer be required. The Bank of England is cognisant of causing the economy too much pain, and if the Bank starts to see evidence of a coming recession, interest rate cuts could be needed. As and when interest rates do start to fall, the rates on cash investments will also fall, meaning that investors may not just be missing out on equity market moves which would be likely to rise on the back of falling borrowing costs. Investors will also miss out on the yields on bonds that may fall in line with interest rates falling, leading to the price of bonds to appreciate as yields fall. Investing in bonds, and benefiting from the attractiveness of current yields, which unlike cash can today produce a positive return after inflation is an opportunity to consider carefully.

> **The behavioural phenomenon of buying at the top of the market and selling at the bottom is characteristic of the human psyche and negates the fact that it is often better to leave wealth invested and compounding through the market cycle.**
>
> Phoebe Stone, Head of Intermediary Investment Services, LGT Wealth Management

Looking beyond China for investment in Asia

Written by Rhys Cann, Trainee Portfolio Manager

In the ever-evolving landscape of the global economy, Asia has long been a focal point for investors. The region is a vast and diverse continent with a multitude of opportunities beyond the most dominant economy, China, and there are compelling reasons to remain positive about the prospects of Asia as a whole.

Long-term prospects of China

China, often at the centre of discussions about Asia's economic outlook, has indeed faced several hurdles over the past few years. Gross Domestic Product (GDP) growth targets have proven elusive and the slowdown in consumer spending has raised concerns. The construction sector's struggles have sent ripples throughout the economy, leading to cautious investment strategies. That being said, China has attractive long-term trends including a growing middle class, a high rate of technological adoption, a growing sustainability sector, soaring healthcare demand along with wealth growth. As China contends with their current challenges, other countries within the Asian region provide attractive investment opportunities.

Alternative manufacturing hubs

One of the key reasons for shorter-term optimism is the potential for other Asian countries to benefit from the challenges faced by China. As global supply chains undergo a transformation, countries such as Vietnam, India, and Indonesia are emerging as alternative manufacturing hubs, attracting investment and diversifying the regional economic landscape.

A cheap and resilient region

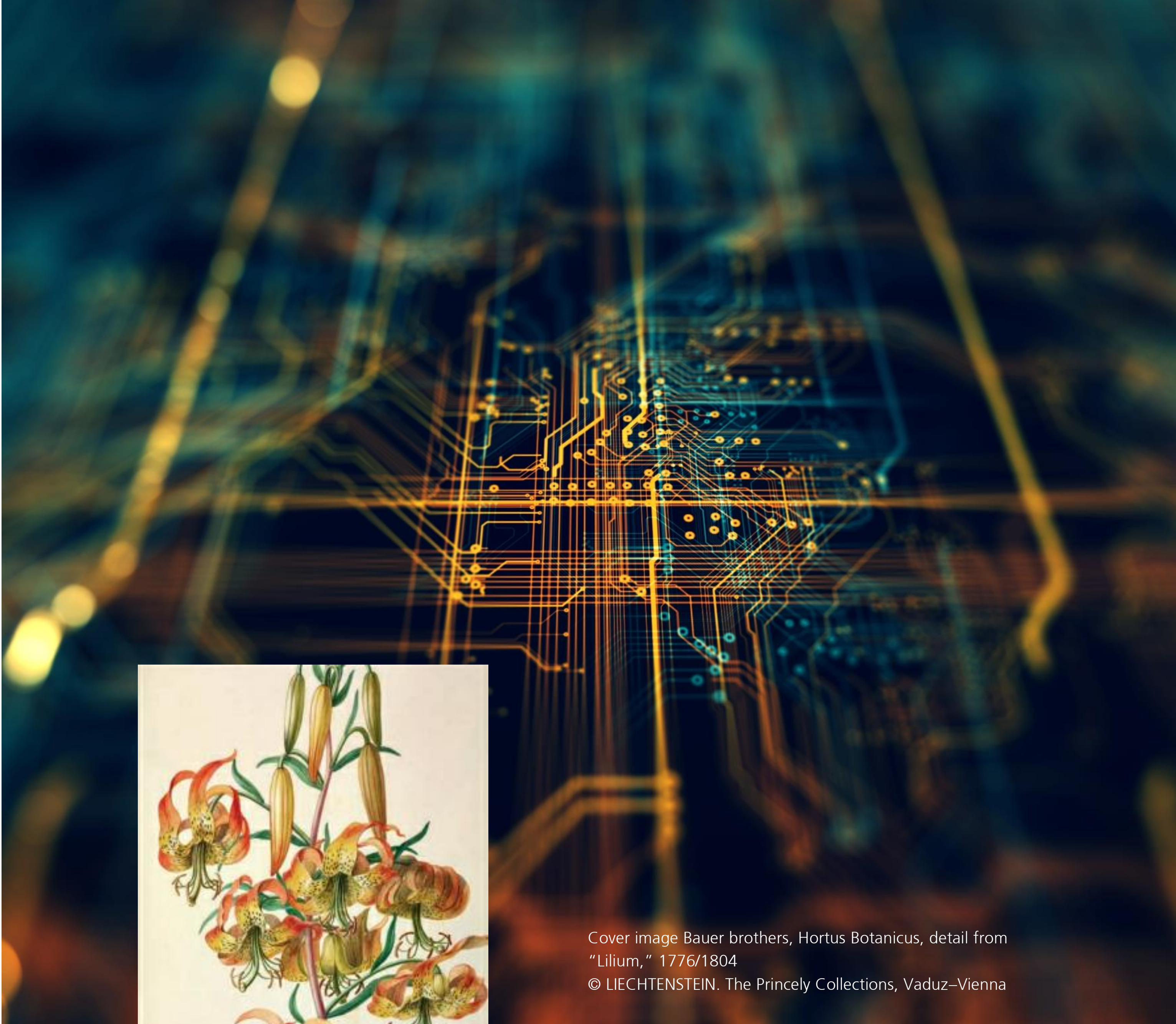
Valuations play a pivotal role in the attractiveness of Asian markets. When compared to the often-elevated valuations (expensive stocks) in the United States, many Asian markets appear more reasonably priced. This relative valuation advantage can be a compelling factor for investors seeking opportunities beyond their home markets.

Some Asian companies have continued to demonstrate resilience and adaptability when it comes to earnings expectations. As economies recover and global demand rebounds, these companies are poised to benefit.

A diversified supply chain strategy

The "China + 1" growth story is gaining traction, emphasising the importance of diversifying supply chains beyond China. This approach presents an opportunity for other Asian nations to step into the void, bolstering their economies and positioning themselves as attractive destinations for foreign investment.

Asia offers diverse opportunities and challenges for investors. While China grapples with its own economic woes, the broader Asian region offers good investment prospects. As investors, it is prudent to adopt a diversified approach, exploring not only different countries but also various sectors and investment styles across the region to harness the resilience and opportunity that this dynamic continent has to offer.



Cover image Bauer brothers, Hortus Botanicus, detail from "Lilium," 1776/1804
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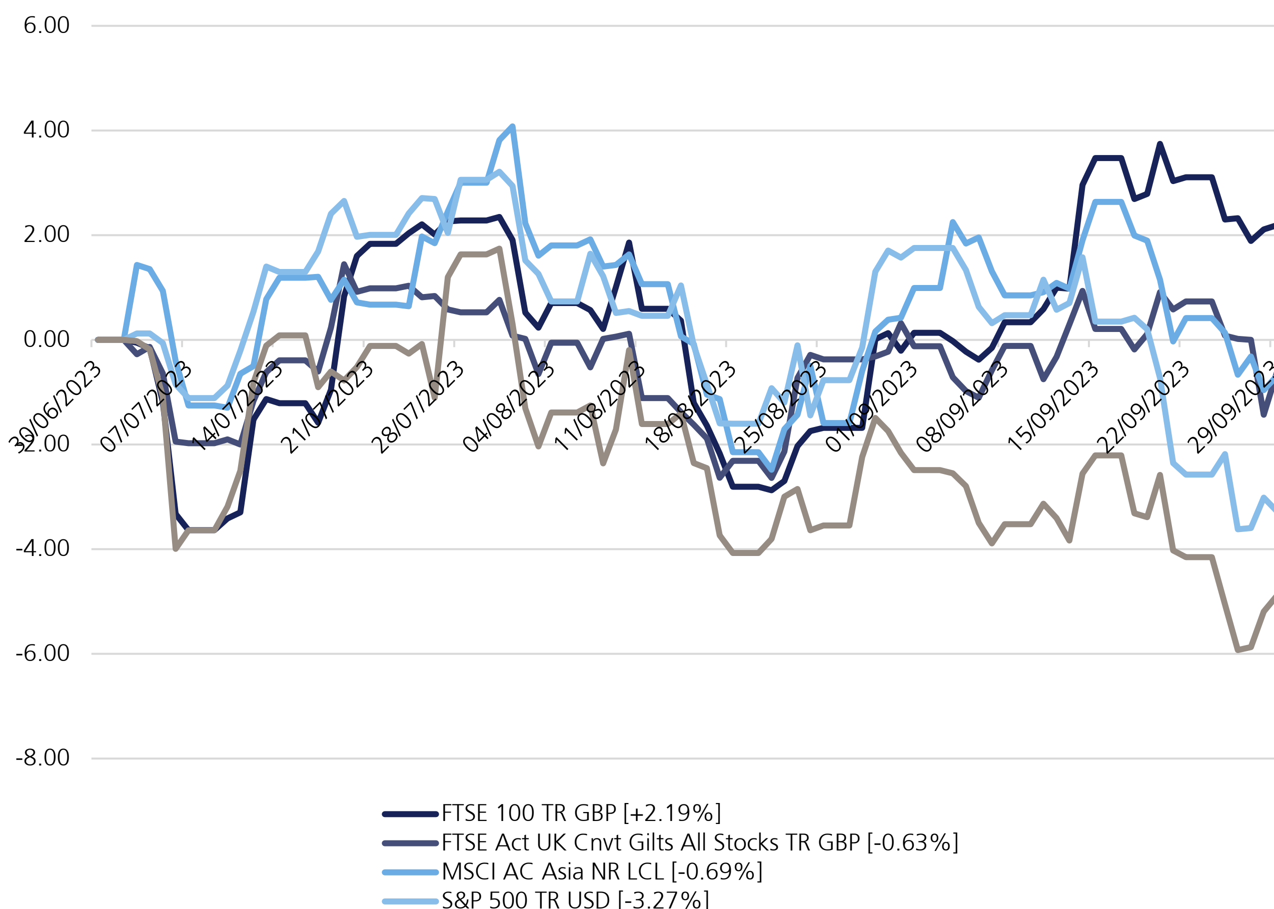
Q3 2023 index performance (%)



Model portfolio performance as at 30 September 2023

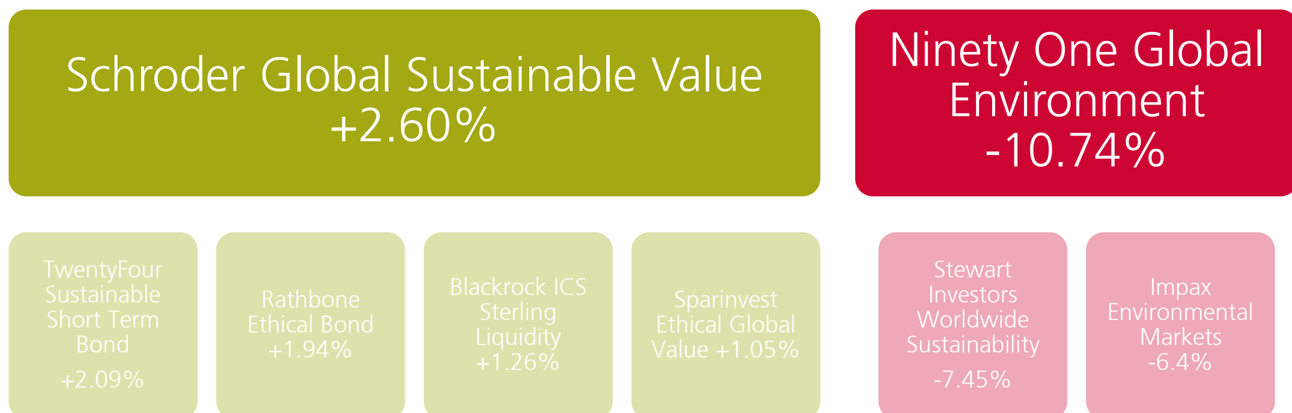
	3 months	6 months	1 Year	3 Years
Sustainable Adventurous GBP	-2.76	-1.56	5.76	8.57
Sustainable Growth GBP	-2.17	-1.39		
Sustainable Balanced GBP	-1.37	-0.76	4.83	6.13
Sustainable Cautious GBP	-0.86	-0.47		
Sustainable Defensive GBP	-0.34	-0.25	3.45	-0.09

	3 months	6 months	1 Year	3 Years
Sustainable Adventurous EUR	-3.62	-0.66	6.24	10.75
Sustainable Growth EUR	-2.89	-0.40		
Sustainable Balanced EUR	-1.90	0.10	5.77	6.95
Sustainable Cautious EUR	-1.29	0.06		
Sustainable Defensive EUR	-0.66	0.14	4.34	-1.92

	3 months	6 months	1 Year
Sustainable Adventurous USD	-5.66	-2.42	12.87
Sustainable Growth USD	-4.83	-2.07	
Sustainable Balanced USD	-3.17	-0.97	10.93
Sustainable Cautious USD	-2.22	-0.38	
Sustainable Defensive USD	-1.24	-0.20	7.38

Past performance is not a reliable indicator of future performance; and the value of investments, as well as the income from them can go down as well as up, and investors may get back less than the original amount invested.

Performance of LGT WM funds in Q3 2023 (GBP portfolio)



Source: Morningstar

The central theme this year has been the Federal Reserve and other central banks steadily raising interest rates, the noticeable change in Q3 was the shift in expectations to a "higher-for-longer" mentality in the west. This was driven by stronger than expected economic data sets being released in the US. The impact of investors believing rates will remain at these elevated levels for a longer period was a general deterioration in sentiment with longer duration assets such as long dated bonds and infrastructure experiencing the largest declines. The majority of this occurred in September with global stock markets falling by around 7%.

The second area of focus for markets this quarter has been China's disappointing performance, we have seen a deterioration in economic data within the region and problems within the property sector continue to weigh on sentiment. While recent policy responses from Chinese authorities have been slow, they have shown signs that they are willing to use more of their considerable fire power to help support and stimulate the economy. Whilst challenges and the associated risks remain, taking a long-term view, valuations are looking attractive and as outlined earlier in this report we are also finding a growing opportunity set in the wider Asia region.

Given the weakening sentiment to both bonds and equities, all the portfolios experienced losses over the quarter but are still in positive territory over 12 months. The key detractors this quarter have all suffered from their style and regional biases. Ninety One Global Environment was the worst performing fund, it takes a high conviction approach investing in companies that are global leaders in enabling the move towards a renewables based energy system. With this objective it has meaningful exposures to forward thinking utility companies, these were impacted by the change in interest rate expectations as they are viewed as 'longer duration' assets. The fund was also negatively impacted by its overweight to Chinese renewables companies. Despite the short-term headwinds to this strategy, we still believe in the long-term opportunity set and strength of management team and process.

Other detractors included Stewart Worldwide Sustainability, which felt the impact of underperformance in the small and mid-cap growth space which they have larger exposures to.

Positives within our equity exposures came from our value managers (such as Schroder Global Sustainable Value), who performed well in tough market conditions. In general, this investment style was more insulated from the change in interest rate expectations and strong stock selection resulted in positive performance. Our defensive shorter duration bond allocations

also added protection whilst providing an attractive yield above cash.

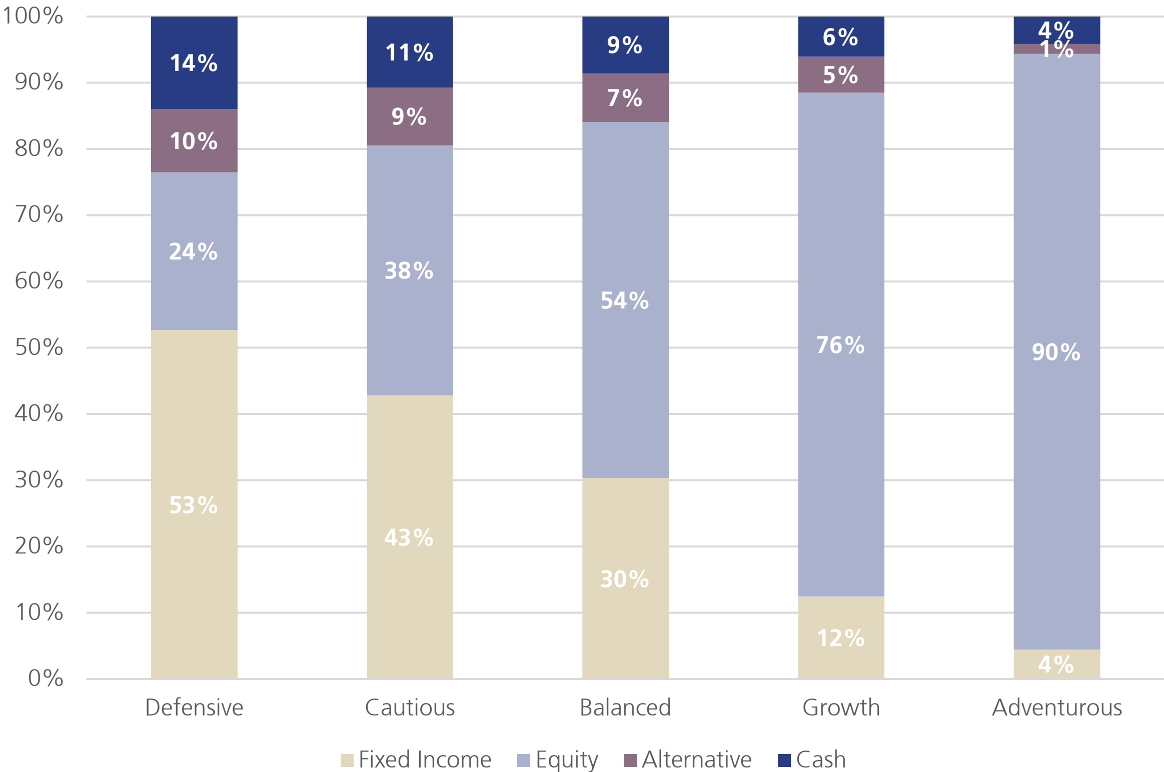
Overall, this quarter has highlighted the benefit of diversification within portfolios, be that from a regional, style, or asset perspective. Looking ahead, the remainder of the year promises to be eventful, with central bank meetings, volatile energy prices, the very sad events unfolding in the middle east, and another earnings season on the horizon. The reassuring aspect for the fourth quarter is that we may be approaching the peak of global interest rates, potentially bringing some stability.

Portfolio changes and rationale

Fixed income changes while remaining comfortable with equity positioning

- We introduced the **Mirova Short Term Sustainable Bond** fund in the lower risk portfolios
- This was funded by the sale of the **Allianz Green Bond** fund and a reduction in **Threadneedle European Bond** fund where held
- We decided to introduce more broad-based exposure to government bonds across shorter, medium and longer term durations, favouring the safe haven characteristics that government bonds provide, along with the added benefit of attractive yields
- This was funded by moderating credit exposure, primarily via a reduction in the **Rathbone Ethical Bond** fund
- We remain comfortable with the balance and blend of exposures provided by our underlying equity managers and made no changes within the equity allocation over the quarter

Portfolio positioning



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