LOWES
INVESTMENT MANAGEMENT

MI Diversified Strategy Fund

Quarterly Report to 31 December 2023

Objective & Strategy

The investment objective of the MI Diversified Strategy Fund is to achieve long term capital growth. The Fund intends to meet its objectives through exposure to a combination of equities, fixed interest and structured products. The majority of the Fund's exposure will be to equities. It may also have exposure to property. With the exception of structured products, this exposure will be through investment in OEICs, Unit Trusts, Investment Trusts, Exchange Traded Funds and other collective investment schemes across several management groups. It may also invest in equities from the world's major markets, bonds and other transferable securities. The Fund has no specific limits on exposures to any asset class, geographic area, industry or economic sectors.

Market Commentary

After a difficult month of October most asset classes ended the quarter in positive territory. Stubborn inflation data, coupled with the potential that interest rates could remain higher for longer, initially caused concern that the global economy could potentially see a harder landing than some commentators were expecting. This had a negative impact on both equity and fixed income markets, with both asset classes remaining positively correlated.

During November, however, we started to see some sign of hope that inflationary pressures maybe starting to ease, particularly in the US, which gave asset markets reason for cheer. This was confirmed somewhat in December, when we saw a change in rhetoric from the US Federal Reserve regarding the outlook for interest rates in 2024. The latest dot plot, which plots the interest rate expectations for policy setting committee members, showed that the median expectation for 2024 was for three interest rate cuts. This caused not only fixed income prices but also equity prices to rally. Whilst the Bank of England and European Central Bank were more stubborn in their policy stance, insisting that they needed further evidence that higher inflation had been beaten, the market gave their view little credence, and priced in rate cuts anyway.

UK fixed income markets therefore posted a strong return for the quarter. Returns were particularly strong within investment grade and UK government bonds (gilts), given their higher interest rate sensitivity. The longer the duration, the stronger the return. Despite their lack of interest rate sensitivity, high yield/non-investment grade bonds also performed positively. Their return is more sensitive to changes in the credit outlook and, for now, this appears to be relatively stable, with little change in current or forecast default expectations.

In local currency terms it was US equities which led the way. The Nasdaq posted a strong return for the quarter, with the 'magnificent 7' companies of Apple, Amazon, Alphabet, NVIDIA, Meta, Microsoft and Tesla, continuing to deliver. Their dominance, however, was not as strong, with smaller companies head of the pack, the Russell 2000 index outperforming the Nasdaq and S&P 500. The latter performed strongly on the back of the interest rate cut expectations, which increased hope that the US economy may be able to avoid a hard landing. It was a similar picture in the UK, where the mid-sized outperformed large sized companies.

There were also positive returns for European and Japanese equities. Woes continued to be seen further east, however, with the Hang Seng posting a negative return. The market failed to be buoyed by the rally seen in western markets. This was despite economic growth for the third quarter being above expectations, and year on year almost in line with the official annual target of 5%, coupled with a benign inflation outlook. Concerns remained that the property sector issues were still to take full effect.

Fund Performance

There was a wide array of performances from the underlying fund holdings during the quarter, with some returning high single to double digit returns, whilst some struggled to breakeven. We would stress however that only two holdings generated a negative return. The top performer during the period was FSSA Japan Focus. Its focus on quality growth had been under pressure given higher bond yields, which had put pressure on stock valuations. The change in rhetoric from the US Federal Reserve, however, drove this investment style back into fashion, the fund posting a double digit return for the period.

Given the fall in the bond yields which was seen, as referred to earlier, it is perhaps unsurprising that the next four strongest performing funds were all fixed income funds. The top performing fund within this pack was the Man GLG Dynamic Income fund.

Fund Performance continued

This fund was less of a duration call however, with performance driven in the main by security selection. The manager and his team are focussed on identifying mispriced credit opportunities. The duration of the fund remains relatively low, standing at just over 3% at the end of November. The fund currently benefits from a double digit yield. The remaining bond funds returned c.7% for the period, with the exception of Artemis Target Return Bond do to its lower duration positioning.

Weaker performances came from positions such as Man GLG Japan Core Alpha and WisdomTree Silver. The former saw underlying stocks succumb to profit taking following a period of strong performance. The silver position meanwhile saw weakness. This came despite falling bond yields during the period.

The Fund underperformed the sector average over the quarter, although still posted a positive return of 4.41%, against a sector average return of 5.27%. Whilst the overweight positioning in fixed income was beneficial, the underweight position in US equities was detrimental, with this being one of the strongest performing equity markets during this period.

Fund Activity and Positioning

There were a number of changes made to the underlying holdings during the quarter. We saw the successful maturity of a FTSE 100 Autocall issued by Societe Generale. This occurred in year 5 with the index being above the initial strike level. This note was paying an annual coupon of 12%, meaning a total return of 60%. This compares to a 27.1% total return for the underlying index. Proceeds were reinvested into a new autocall this time issued by Goldman Sachs. This was again an at-the-money contract, maximum 8 year term, with the ability to mature from year 2 onwards, with annual observations. This is paying a coupon of 10.3%.

Invested in this note were also the proceeds from the sale of Jupiter Gold & Silver. Despite the gold price action, miners continue to prove unpopular. Positive real yields now available from fixed income could also weaken the appetite for precious metals. For the same reasons, the position in the Amati Strategic Metals fund was also closed.

Finally, following a review of the fixed income exposure there were some changes made to fund allocations. This saw the allocation to Artemis Target Return Bond reduced in favour of Nomura Global Dynamic Bond. Given the potential for interest rate cuts in 2024 and onwards, we believe that a fund with greater flexibility around duration within their mandate is warranted. Artemis has undoubtedly performed well but a reallocation seemed sensible given the wider mandate afforded to the Nomura fund.

At the end of December the fund remained overweight fixed income. Despite the pullback in yields seen through November and December, they still remain attractive relative to what we have become more accustomed to over the years. The higher yield on offer also means that there is a greater cushion on offer to protect against any rise in yields, from a total return perspective. This means that the asymmetry of potential return from this asset class is positively skewed. Whilst this is the case, preference remains for strategic bond bonds who have flexibility within their mandates in terms of both duration and asset allocation. Exposure is also taken to specialist fixed income managers focussing on specific areas of the market, such as GAM Star Credit Opportunities.

The Fund maintained a marginal overweight to alternatives during the period, predominantly through the holding of long/short equity funds. Earnings forecasts for 2024 are double digit for some equity markets, which could yet prove too optimistic. Disinflation has the potential to see earnings come down, with companies unable to force home price increases. At the same time, there remains the threat that we will see a harder economic landing than some market commentators and investors expect. This could also add to earnings and margin pressure.

A moderate overweight to equities was held at the end of the year. The potential for earnings surprises to the downside, as mentioned above, means that we are reticent to take on more equity risk at this point in the economic cycle. This is particularly the case given the yields which have been available from fixed income more recently. In terms of regional selection particular attention is being paid to valuation. There is a wide dispersion across markets, especially after the moves seen during the quarter. This is on a relative basis to the regions own valuation history and also to other markets. This meant overweight positions in markets such as Japan and the UK at the year end.