EQUILIBRIUM

Quarterly investment report

April 2024

Introduction

Welcome to the third edition of our new style investment report. This replaces what was previously provided in our Equinox magazine every six months but is now produced quarterly.

It has been a positive start to 2024 for all the portfolios.

As you will no doubt recall, 2022 was a difficult year with most asset classes falling sharply. 2023 saw much volatility throughout the year, but the final quarter saw a strong rebound from many of the major asset classes, which has for the most part continued into 2024.

As a reminder, the volatility of the past few years was mainly due to very high levels of inflation, and the steep increases in interest rates which followed. This hit not just equities but saw other assets like bonds and property fall at the same time, meaning that the diversification in portfolios was less helpful than in previous equity falls.

Page three illustrates just how steeply inflation and interest rates moved over the past few years. However, things have been improving for some time and inflation has now returned almost (but not quite) back to central bank target levels. As a result, the banks have indicated the next move in rates is likely to be down rather than up. Hearteningly, this slowdown in inflation appears to have been achieved without the major economic downturn that many had predicted. This combination of better-than-expected growth, with slowing prices and expectations for rate cuts, has allowed most of the asset classes to at least partially recover.

Table one:

Portfolio	10-year total return %	10-year % p.a.
Cautious	47.71	3.98
Balanced	58.20	4.69
Adventurous	76.27	5.83
Competitor mixed investment fund (balanced)*	46.66	3.90
Competitor discretionary portfolio (balanced) **	44.47	3.75
UK Inflation (CPI)	32.70	2.87
Cash (Bank of England base rate)	11.04	1.05

*UT Mixed Investment 20-60% Shares. ** ARC Sterling Balanced Index.

Source: FE Analytics 31/03/2014 to 31/03/2024. Green numbers denote outperformance of sector. All portfolios based on IFSL Equilibrium fund and discretionary model performance prior to fund launch. Defensive and Global Equity long-term returns based on backtested portfolio.

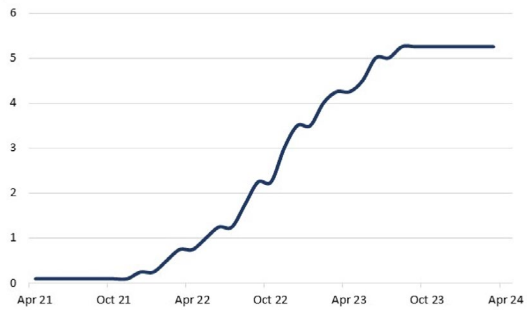
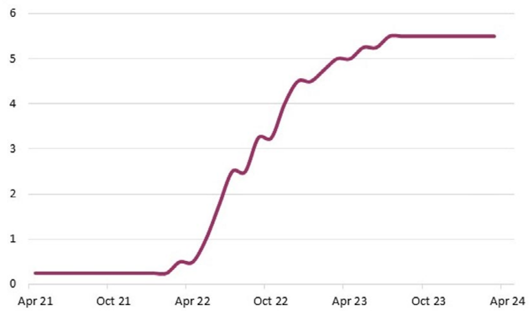
Page four shows the returns of a selection of the major asset classes we invested in over the past year and the 12 months prior to that. This shows that equities have recovered relatively strongly (for the most part), although some other assets have found it more difficult. Notably, government bonds have been roughly flat over the past 12 months, not yet recovering from the previous year's losses even though they have bounced substantially from the lows.

This essentially means our more aggressive funds which have more in equities have performed the best recently, with the more cautious funds which have more in bonds recovering more slowly.

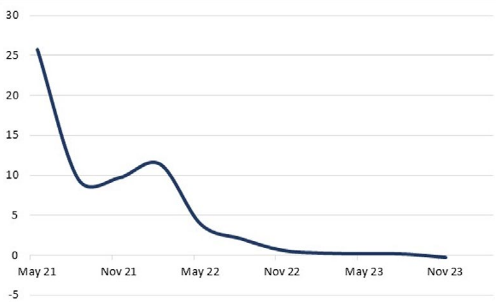
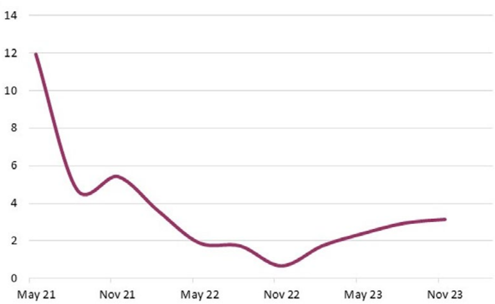
Despite recent volatility, all our core portfolios have a strong long-term track record. **Table one** shows the returns of our three core strategies over 10 years – all have outperformed both the typical balanced fund* and the typical balanced portfolio from other wealth managers**. Importantly, long-term returns remain well ahead of inflation despite the recent spike in consumer prices. The same cannot be said for cash, which would have lost money in real terms over this period despite higher rates recently.

The economy

On this page we look at some key economic indicators, focusing on the UK and the US which have the biggest effect on portfolios.

<table>
<tr><th></th><th>UK</th><th>US</th><th>Equilibrium view</th></tr>
<tr><td>Interest rates %</td><td>
</td><td>
</td><td>Interest rates in the UK have risen from 0.25% in 2021 to 5.25% today. Rates in the US have taken a similar trajectory as central banks try to tackle inflation.

Both central banks have indicated they expect no further rate hikes. Currently markets expect the next moves to be rate cuts, perhaps in the early summer, with around 1% of cuts expected over the next 12 months or so.</td></tr>
<tr><td>Inflation % p.a.
(Consumer prices index)</td><td>
</td><td>
</td><td>UK inflation went from near zero in 2021 (0.4% in February 2021) to 10.4% in February 2023. This was driven by energy prices as well as accelerated growth after the COVID-19 pandemic. US inflation took a similar path but with a lower and earlier peak.

Inflation has now fallen back to 3.4% in the UK and 3.1% in the US and is expected to moderate further throughout 2024.</td></tr>
<tr><td>Economic growth % p.a.</td><td>
</td><td>
</td><td>Growth has generally been better than expected, despite high inflation and steep rate hikes. The UK just about entered a technical recession with marginal falls in the size of the economy at the end of 2023, but signs are that growth is now accelerating. The US economy slowed in 2022 but then rebounded, and forward economic indicators currently point towards growth in both economies this year.</td></tr>
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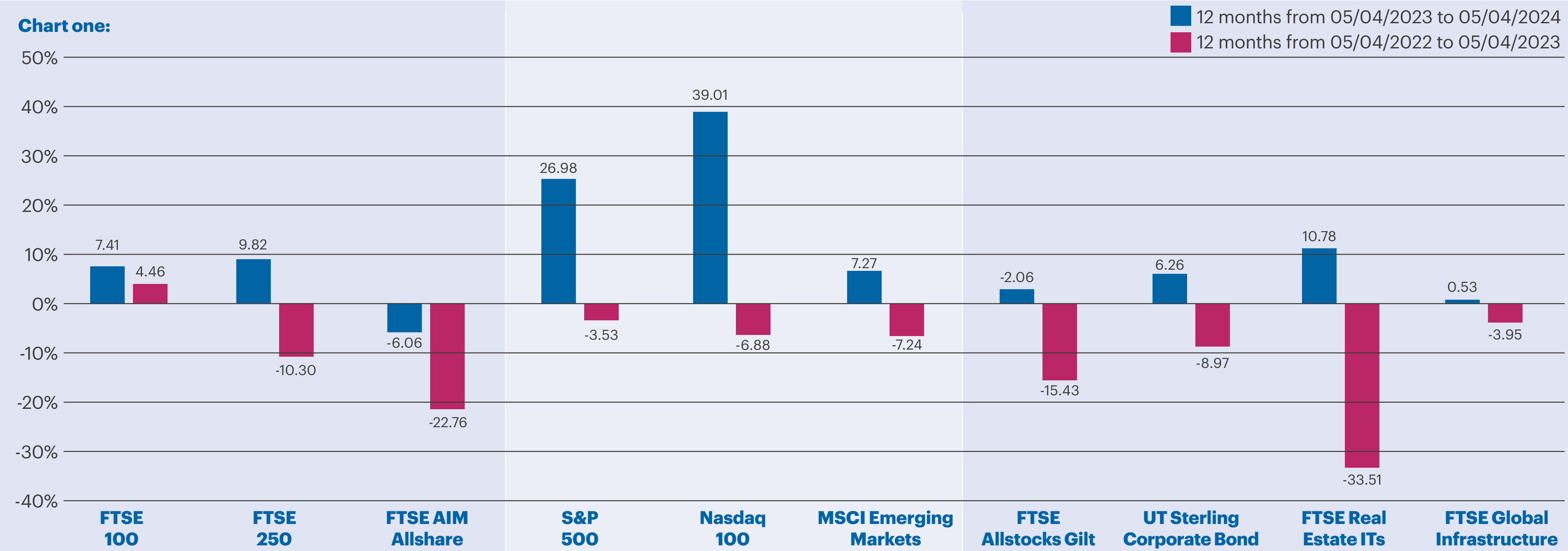
Source: LSEG Eikon, ONS, Bank of England, Equilibrium Investment Management.

Markets

Chart one shows the returns of some of the major asset classes we can invest in from 2022 to 2024.



UK equities	Overseas equities	Other assets
The FTSE 100 is one of the few markets which made a gain in both 12-month periods, with the oil & gas stocks holding up well in 2022 due to higher energy prices. Medium (FTSE 250) and small companies (FTSE AIM) suffered more than most in 2022. Recently, medium-sized UK companies have performed strongly and outperformed the top 100. AIM has continued to lag but more recently has begun to see something of a recovery.	US stocks fell sharply in 2022, but this blow was partly cushioned for UK investors by the stronger dollar. In 2023 and so far in 2024, the big tech stocks have performed remarkably well – as illustrated by the performance of the Nasdaq index - driven by enthusiasm for artificial intelligence. Emerging markets continue to lag but again have more recently seen signs of recovery. India has done well but China has performed poorly after disappointing economic growth last year.	In 2022, government bonds like gilts performed just as badly as equities. Corporate bonds weren't much better. Over the most recent 12 months, gilts remain roughly flat, but corporate bonds have done well. Real estate and infrastructure have both been hard hit by rising interest rates and increased borrowing costs. However, as the prospect of rate cuts has risen, property has partially recovered of late. Infrastructure has continued to struggle, partly due to a green backlash with renewable energy performing poorly recently.

Source: Financial Express, total return in sterling to 05/04/2024. This is a non-exhaustive list of some of the major asset classes we can invest in. Blue bars are the most recent 12 months, red bars the 12 months prior.

Portfolios

The tables below show our portfolios over various time periods, compared to other funds with similar objectives and risk tolerance.

Calendar year returns over 10 years relative to other funds (%)

Portfolio	2024 so far	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Cautious	1.68	4.91	-9.62	6.51	3.60	12.37	-3.60	8.58	7.76	4.36	6.27
Balanced	2.24	6.50	-10.93	7.73	4.31	13.79	-4.12	9.75	8.93	5.53	6.43
Adventurous	3.41	8.69	-14.54	9.58	6.98	16.61	-5.60	12.79	12.44	6.21	6.35
UT Mixed Investment 20-60% Shares	**2.25**	**6.68**	**-9.47**	**7.20**	**3.51**	**11.84**	**-5.10**	**7.16**	**10.32**	**1.21**	**4.85**
Global Equity	5.02	10.63	-18.37	11.10	13.36	20.99	-8.40	19.08	18.06	7.23	4.60
UT Flexible Investment	**3.98**	**7.45**	**-8.98**	**11.30**	**6.70**	**15.66**	**-6.72**	**11.21**	**13.82**	**1.99**	**4.89**
Defensive	0.73	2.93	-9.21	1.93	7.39	6.29	0.01	4.95	4.64	0.90	4.21
UT Global Bond	**-0.10**	**4.74**	**-10.26**	**-1.05**	**6.03**	**5.57**	**-0.69**	**2.25**	**12.58**	**-1.32**	**3.81**

Various time periods to 5 April 2024 (%)

Portfolio	6 months	1 year	3 years	5 years	10 years
Cautious	7.76	5.21	1.50	12.50	46.47
Balanced	8.58	6.83	2.94	16.00	56.57
Adventurous	10.70	9.91	3.07	21.17	74.68
UT Mixed Investment 20-60% Shares	**9.18**	**6.93**	**5.41**	**16.48**	**45.08**
Global Equity	13.72	13.10	2.62	29.63	106.86
UT Flexible Investment	**10.40**	**9.59**	**10.59**	**28.93**	**71.12**
Defensive	6.11	3.09	-3.50	7.02	24.46
UT Global Bond	**5.79**	**2.63**	**-4.56**	**2.30**	**20.07**

Source: Financial Express, total return in sterling to 5 April 2024. Green numbers denote the outperformance of the sector. All portfolios are based on IFSL Equilibrium fund and discretionary model performance prior to launch. Defensive and Global Equity long-term returns based on back-tested portfolio.

Portfolios

The tables below show our portfolios over various time periods, compared to wealth manager portfolios that have similar objectives and risk tolerance, as calculated by Asset Risk Consultants (ARC).

Calendar year returns over 10 years relative to wealth manager portfolios (%)

Portfolio	2024 YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Cautious	1.98	4.91	-9.62	6.51	3.60	12.37	-3.60	8.58	7.76	4.36	6.27
ARC Sterling Cautious PCI	**1.90**	**4.43**	**-7.60**	**4.23**	**4.2**	**8.05**	**-3.63**	**4.48**	**5.52**	**1.25**	**3.98**
Balanced	2.67	6.50	-10.93	7.73	4.31	13.79	-4.12	9.75	8.93	5.53	6.43
Adventurous	3.66	8.69	-14.54	9.58	6.98	16.61	-5.60	12.79	12.44	6.21	6.35
ARC Sterling Balanced PCI	**3.01**	**5.98**	**-9.14**	**7.64**	**4.31**	**11.73**	**-5.10**	**6.69**	**8.64**	**1.87**	**4.51**
Global Equity	5.27	10.63	-18.37	11.10	13.36	20.99	-8.40	19.08	18.06	7.23	4.60
ARC Sterling Equity Risk PCI	**4.96**	**8.10**	**-11.40**	**12.31**	**5.82**	**18.04**	**-6.50**	**11.39**	**13.73**	**2.06**	**4.07**

Various time periods to 29 March 2024 (%)

Portfolio	6 months	1 year	3 years	5 years	10 years
Cautious	6.94	6.06	1.85	13.79	47.71
ARC Sterling Cautious PCI	**5.22**	**4.66**	**1.84**	**10.78**	**27.03**
Balanced	7.86	7.86	3.38	17.75	58.20
Adventurous	9.50	10.77	3.32	23.27	76.27
ARC Sterling Balanced PCI	**7.86**	**7.31**	**6.00**	**18.14**	**44.47**
Global Equity	12.14	13.89	2.95	32.74	109.51
ARC Sterling Equity Risk PCI	**10.96**	**11.06**	**11.07**	**30.81**	**77.27**

Our portfolios have consistently delivered strong long-term performance. Against other wealth manager portfolios, all the portfolios outperformed in 2023, and have demonstrated consistent performance over the long term. For example, Balanced and Adventurous underperformed just one calendar year in the last 10 full years as shown in the above table.

Our core funds also show strong long-term performance and consistency relative to other mixed investment funds. Generally, higher equity allocations have resulted in better performance, both in the last year and over the long term, with Adventurous and Global Equity producing the strongest returns recently.

The Defensive fund is shown against the global bond sector as it is majority allocated to bonds. It experienced a milder decline than bonds during one of the worst bear markets for fixed interest in history in 2022 and has shown a strong recovery, particularly in the last quarter of 2023 and so far in 2024.

Source: Financial Express, total return in sterling to 29 March 2024. Green numbers denote the outperformance of the relevant ARC index. All portfolios are based on IFSL Equilibrium fund and discretionary model performance prior to launch. Global Equity long-term returns based on back-tested portfolio. Note, that there is no relevant ARC index for Defensive.

Drivers of performance

Table two shows how each of our core asset class portfolios have performed over the past 12 months, along with the current asset allocation of the Balanced portfolio and what this was a year ago. We have made similar changes in other portfolios to a greater or lesser extent.

Calendar year returns

Asset class	1-year return %*	Current allocation %	Allocation 1 year ago %	Change in allocation %	Commentary
Cash and money market	n/a	0.3	1.7	-1,4	We have increased fixed interest (bonds) exposure significantly over the past couple of years, as the yields available have gone up significantly. For example, the average "investment grade" corporate bond now yields 5.4% p.a. compared to just 1.9% p.a. at the end of 2021**, with riskier bonds yielding even more. If interest rates are cut as expected and if economies continue to grow, we think there are some very positive potential returns.
Fixed interest	6.01	43.0	35.0	+8.0	
Real assets	-6.58	7.5	13.0	-5.5	Real assets like property and infrastructure have struggled in the past couple of years, with the rising borrowing costs having an impact. We have reduced exposure in favour of fixed interest, but still retain exposure to both assets as they often tend to grow income with inflation.
Defined returns	12.73	11.0	8.5	+3.5	We have had several defined returns kick out (mature) in the past 12 months as markets have recovered. We have replaced some of these with new products, but more recently have found that the rates available are less attractive. We may well increase exposure should markets take a dip and if volatility increases, which normally means the available rates improve.
Alternatives	4.20	4.5	8.5	-4.0	Having had significant exposure to alternatives in preference to bonds a couple of years ago, we have now switched a substantial amount of this into fixed interest. The funds did their job and held up relatively well in 2022, and so gave us the ability to switch into bonds at a lower price and at a higher yield.
Equity	15.45	33.7	33.3	+0.4	We have kept equity exposure relatively steady over the past 12 months, with strong returns pushing our exposure up slightly. We have typically been trimming this back to bank gains as markets hit new highs.

*Source: Financial Express, 12-month total return of relevant Equilibrium asset class portfolio from 5 April 2023 to 5 April 2024, gross of fees. Equity is based on the Balanced Equity mix. Real Assets assumes 2/3rds infrastructure and 1/3rd real estate. Allocations may not add up to 100% due to rounding etc. ** Source: LSEG Datastream

Commentary

Stock markets have had a very good start to 2024 which has helped the portfolios achieve some very positive returns of late.

Once again, it has been the US stock market which has done particularly well. In particular, as we noted in the last quarterly update, much of the gains continue to be driven by the big tech stocks.

As investor enthusiasm for AI continues, the likes of Nvidia in particular maintain strong growth. In fact, in just the first 10 weeks of 2024, Nvidia's total market capitalisation grew by over $1 trillion! So far this year, the gain was bigger than the TOTAL size of many of the other top 10 S&P 500 stocks like Berkshire Hathaway or JP Morgan. Nvidia's market value is now not far off that of the total size of the FTSE 100 (£1.9 trillion or $2.39 trillion USD according to FTSE).

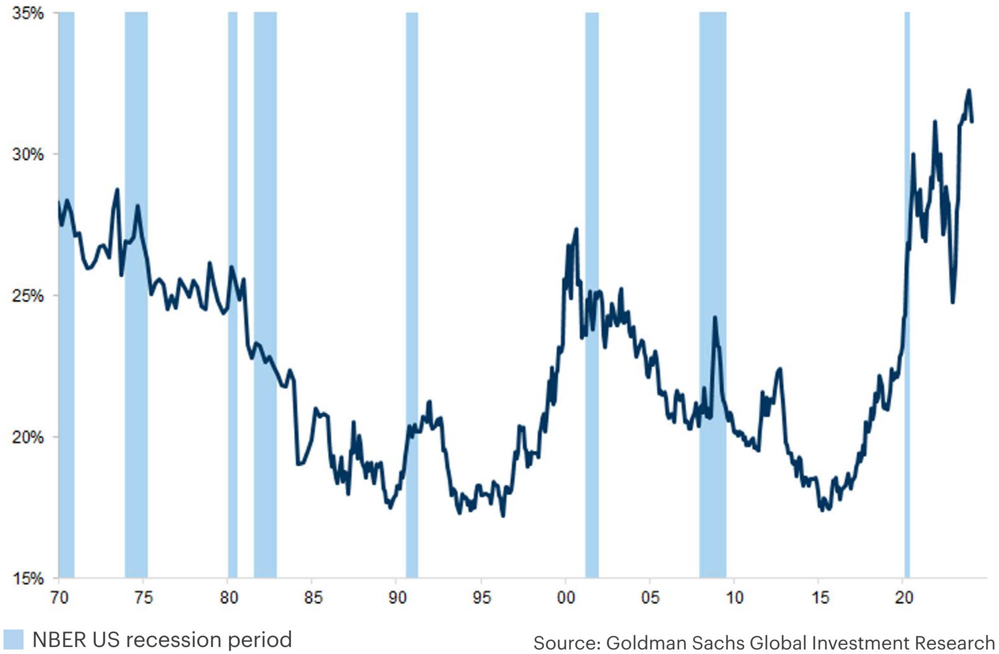
As these big tech giants get bigger, they represent more and more of the US market. **Chart two** shows the total weight of the top 10 stocks in the S&P 500 over time. The blue-shaded areas are US recessions. There has never been a time in history when the market was so dependent on the returns of such a small number of companies.

We do wonder if this concentration has been partly driven by the rise of index-tracking funds. According to Morningstar, the proportion of the US market held by passive funds has now reached over 50% for the first time. Whilst we like index trackers and use them extensively (but selectively) for low-cost access to various asset classes, when everyone is using them, this could impact market dynamics longer term. Perhaps it might increase momentum in the market as index funds allocate the most to the largest companies. This might mean stronger gains when markets are going up but could potentially mean the opposite when markets fall.

This level of concentration is fine when everything for those companies is rosy. However, as most of these companies are in similar industries, should there be a downturn in technology-related sectors, then having so much in such a small number of companies could be risky.

In addition, the US market as a whole now looks pretty expensive in our view. We compile our own valuation score which combines well-known metrics such as price/earnings ratios and price-to-book ratios.

Chart two: Top 10 stocks (in weighting) in the S&P 500.



Source: Goldman Sachs Global Investment Research

Chart three shows how this valuation metric has changed over time (blue line) and how this has correlated with the returns on the market over the subsequent 10 years.

The more expensive the market, the lower the line is on the chart and the lower the implied future return. The green line shows the rolling 10-year return of the US stockmarket – this should be read across on the right-hand axis.

The green line ends in early 2014 as that is when the last 10-year period we can analyse began. As you can see, the two lines follow each other very closely. Taking a long-term perspective, the valuation of the market tends to tell you what return is likely.

Our valuation metric has only been lower (more expensive) twice before – firstly during the tech bubble of 1999/2000, and secondly during 2021. In both instances, the market then fell sharply the following year.

Chart three: US composite scores and subsequent 10-year returns.

Source: Equilibrium Investment Management / LSEG Datastream

Whether or not that happens this time around we cannot say. Valuations tend not to be a great indicator of short-term moves, but after such a strong run in the markets, the next 10 years look likely to see lower returns in the US market.

To get some idea of what might happen in the short term, you could do worse than look back at what the market has done recently!

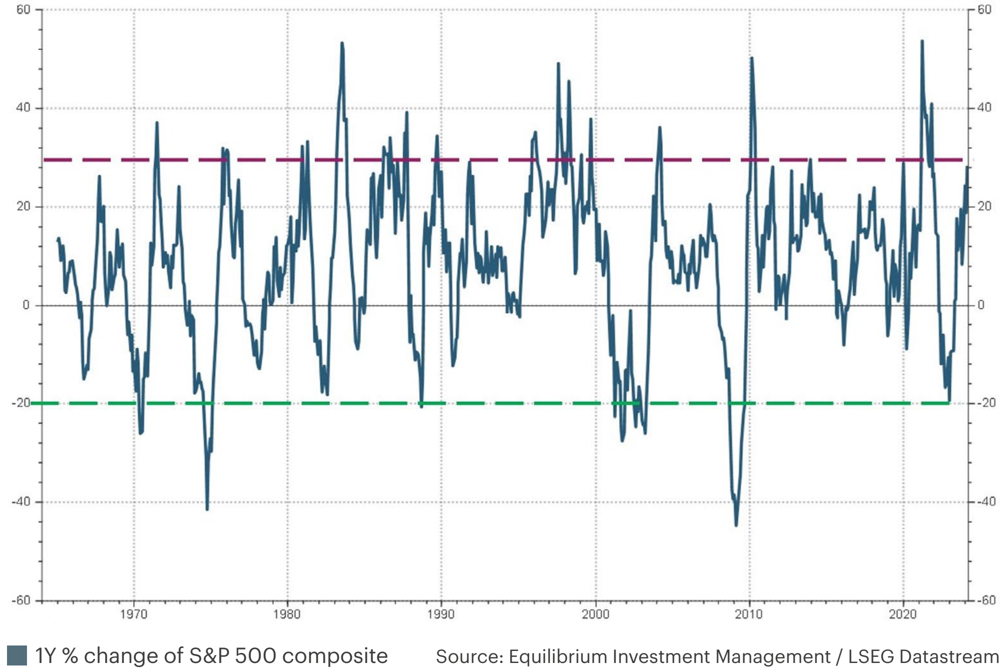
Chart four shows the rolling 12-month return of the S&P 500 Index return going back to the 1960s. The red line shows times when the market has returned 30% or more over the previous 12 months. The green line shows where the market has fallen 20% or more over the past year.

When returns have been more than 30%, they tend to turn negative shortly afterwards. When returns have been minus 20% or worse, the next 12 months tend to be very strongly positive.

In the US, many of our risk indicators are flashing, if not red, then at the very least an amber. This may sound like we're being negative, but as mentioned above, the market valuation and returns have been skewed by a small number of stocks. We are retaining a relatively high weighting to US stocks but just allocated differently.

Firstly, we hold an "equal weight" tracker fund which puts the same amount in each of the 500 companies rather than allocating by size of company. Whilst the S&P 500 trades on almost 22 times the expected future earnings of the companies, the equal weight version trades on just 17.3 times (Source: LSEG Datastream & Deutsche Bank). We also hold smaller US companies, actively managed funds, and defined returns products linked to the US market. All these offer the growth potential of the US but without as much risk, in our view.

Chart four: Rolling return of the S&P 500.



Source: Equilibrium Investment Management / LSEG Datastream

Opportunities and risks

We believe there are many other asset classes that look much better value than US equities. This includes other regions of the stock market, such as the UK and Japan, which still look relatively cheap. From an economic point of view, most of the recent news has been very positive. Both regions, along with the US and China, have seen growth indicators pick up recently.

The UK has technically been in recession as it had two consecutive negative quarters at the end of last year. However, both these quarters were only mildly negative, and forward-looking indicators give grounds for optimism. For example, **Chart five** shows the UK leading economic indicator index as calculated by the OECD in blue. The orange line is UK economic growth, whilst the grey bars show recessions.

Generally, the orange line follows the blue line with a lag, showing the leading indicator does indeed tend to point the direction of travel. Last year it was showing the UK was likely to see growth slow, but more recently it has turned sharply upwards. This gives us greater confidence that the UK should see reasonable growth this year. We are seeing a similar upturn in China after they again saw disappointing growth last year.

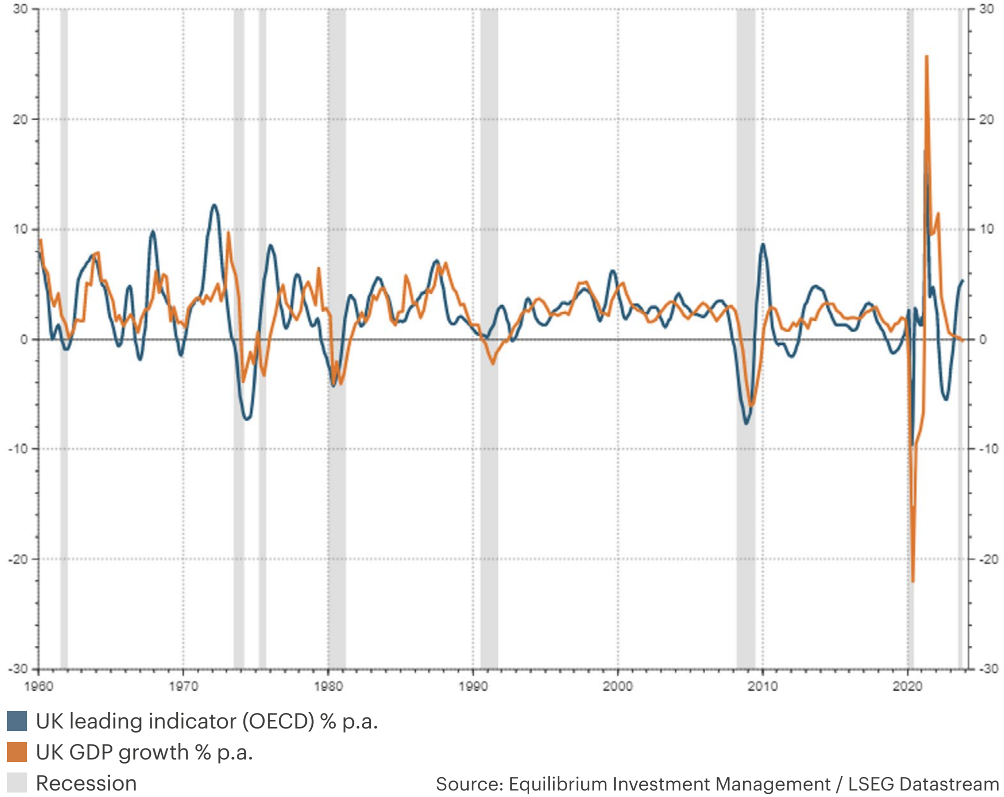
Whereas previously many people were worried about a recession because of high inflation and rising interest rates, now it appears inflation has been brought under control without crashing the economy.

As well as selected equities, in this environment we think corporate bonds – where we lend money to companies – could produce some very good returns.

Currently, if you lend money to a very secure "investment grade" company in the UK, you will receive around 5.4% p.a. yield. If you lend money to a slightly less credit-worthy company, you might receive around 8% p.a. yield (Source: LSEG Datastream. High-yield data based on the US$ index). Some of the funds we hold in portfolios yield even more.

In bonds as well as equities, valuations tend to give you a good guide to long-term returns. The bond yield tends to account for most of the variance in returns and we think these look very attractive. In some cases, we think the potential return of corporate bonds is similar or even higher than might be the case in the stock market. If the economy continues to hold up well, then default rates on corporate bonds should remain low.

Chart five: UK leading economic index and UK economic growth (1960 – 2024).



Source: Equilibrium Investment Management / LSEG Datastream

Rate cuts?

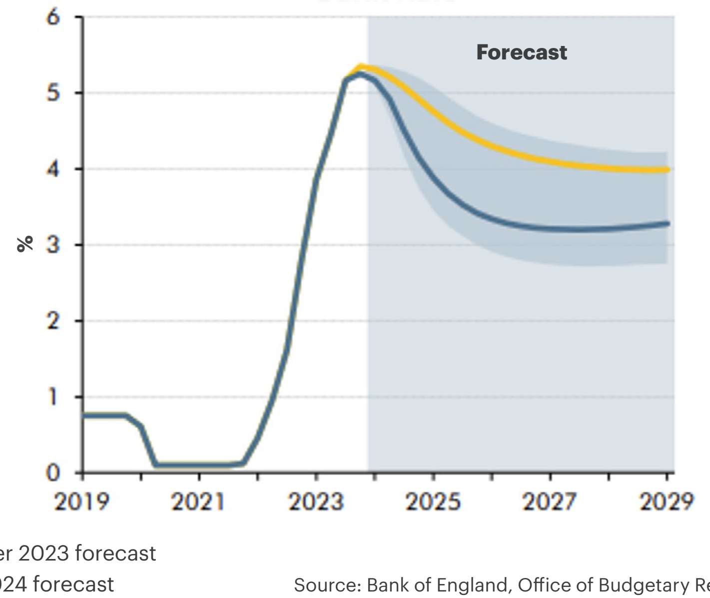
Corporate bond returns would also be helped if central banks go ahead with the rate cuts currently forecast to begin this summer.

Chart six shows the current projected path of the Bank of England base rate, as calculated by the Office of Budgetary Responsibility (OBR). The blue line shows the current forecast, and the yellow line is the forecast from last November.

As you can see from the blue line, rates are projected to be cut from the current 5.25% gradually down to around 3.5% over the next couple of years. This was not the case in November when rates were only expected to fall more gradually over a longer period (yellow line).

This change in rate expectations has helped bonds to recover. If the bank rate is indeed cut to 3.5% or less, then the yields on the corporate bonds look more attractive in relative terms.

Chart six: Bank of England base rate forecast (2023 and 2024).



Source: Bank of England, Office of Budgetary Responsibility (OBR)

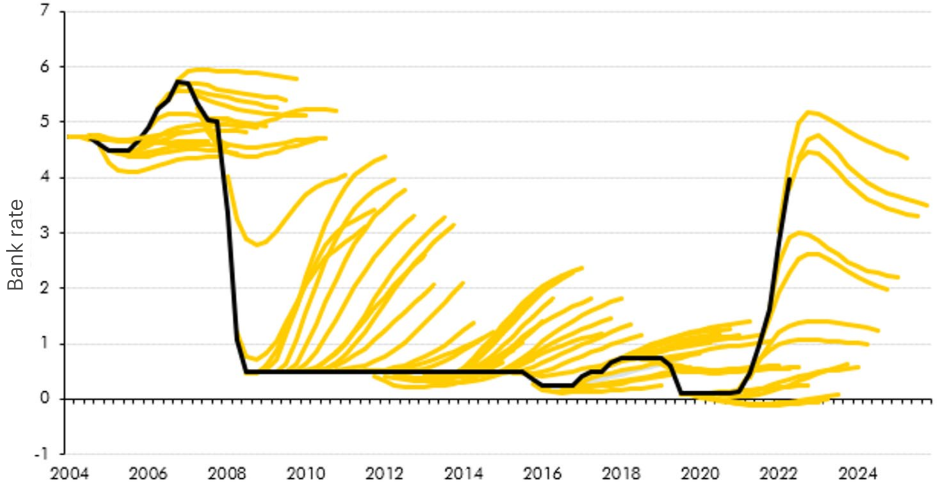
However, we should sound a note of caution because financial markets have historically been terrible at forecasting where rates will go!

Chart seven – again from the OBR - shows how the base rate has changed since 2004 (the black line). The yellow lines show all the previous market forecasts for where they might go. From 2008 to 2020, markets were continually forecasting a rise in rates that never happened. Since 2022, most of the forecasts have undershot the number of rate hikes which occurred.

We do believe that rates will probably be cut this summer as inflation is likely to dip below the Bank of England's 2% target in the next few months. However, what happens from there will largely depend on what happens with the economy and with inflation.

There are some signs that inflation has stopped falling as much as it had been and as growth appears to be relatively robust, the need to cut rates so soon or so quickly has reduced.

Chart seven: Financial market-implied and actual Bank rate path.



Outturn
Previous forecasts
Source: Bank of England, OBR

Of course, should the economy slow, or inflation fall further, then the rate of cuts might increase, but our suspicion is cuts are more likely to be slower than expected rather than faster or steeper. Should the rate cuts currently expected by the market not occur, this could pose a risk to some of the asset classes, notably government bonds and high-growth equities.

In summary, we are positive about the outlook for the economy and for selected asset classes, but somewhat wary of a potential pullback in others and have positioned the portfolios accordingly.

Risk warnings and notes

Past performance is never a guide to future performance. Investments will fall as well as rise.

Any performance targets shown are what we believe are realistic long-term returns. They are never guaranteed.

None of the information in this document constitutes a recommendation. Please contact your adviser before taking any action.

Unless stated otherwise:

- All performance statistics are from Financial Express Analytics on a bid-bid basis with income reinvested.
- All performance data is to 5 April 2024.
- Model portfolio performance is stated after a 0.5% investment management fee with no adjustment for financial planning or platform charges.
- Your own performance may vary from that shown due to dividend pay dates, transaction dates, contributions and withdrawals.
- Actual performance may also differ slightly due to constraints over how we can reflect fees and discounts from fund managers. These are assumed not to change over the whole investment period. In reality, discount levels change as we change the funds in which we invest.
- Individual sector portfolios are shown with no charges taken off or fund manager discounts applied.

For details of your own portfolio performance, please refer to your half-yearly statement from the wrap platform in which you are invested. We will also provide personalised performance information at your regular reviews.

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