EQUILIBRIUM

Quarterly investment report

July 2024

Introduction

It has been a positive start to 2024 for all the portfolios. Generally, economic growth has been better than expected, with the UK rebounding from its mild recession of late last year. Meanwhile, the US continues to see robust growth, whilst we also saw something of an acceleration in Chinese activity earlier this year.

Inflation has continued to fall, with the UK Consumer Price Index (CPI) dropping to 2% as of May this year. This means prices are still going up but at a more normal pace - in line with the Bank of England's target – which is very welcome given the double-digit levels of price increases we saw two years ago!

However, progress on inflation has been slightly slower than hoped, and it looks likely that the headline UK inflation rate will go back up a bit later this year. The headline always looks for the change in prices from one year to the next and as we move through the year some of the previous price decreases will drop out, meaning the headline rate may increase.

Meanwhile, in the US, inflation seems to have got stuck at about a 3% rate for the past 6 months or so. We are not too worried about this as we don't see anything indicating large future price increases in the underlying data, however, it does mean that central banks have not yet cut rates, as they had indicated they would do a few months ago.

Interest rates have now been on hold for the past 12 months or so. Right now, markets still expect one or two 0.25% rate cuts this year, with perhaps a further 1% of cuts next year. However, much will depend on what happens to prices from here.

Table one:

Portfolio	10-year total return %	10-year % p.a.
Cautious	48.02	4.00
Balanced	58.83	4.74
Adventurous	77.65	5.92
Competitor mixed investment fund (balanced)*	44.89	3.78
Competitor discretionary portfolio (balanced) **	44.47	3.75
UK Inflation (CPI)	33.63	2.94
Cash (Bank of England base rate)	12.34	1.17

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

Source: FE Analytics 27/06/2014 to 28/06/2024. 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.

Given this outlook, equities have generally done much better than government bonds this year. Bond markets had hoped for several rate cuts by now, which would make the yield we receive from the bonds more attractive. Because those rate cuts haven't yet happened, the price of gilts (for example) has fallen slightly so far in 2024.

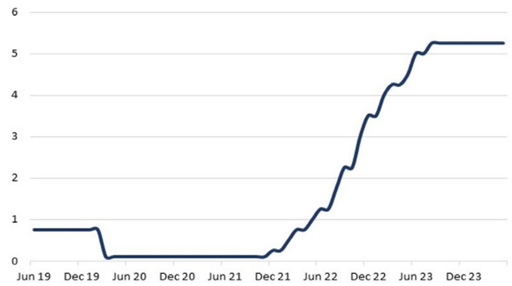
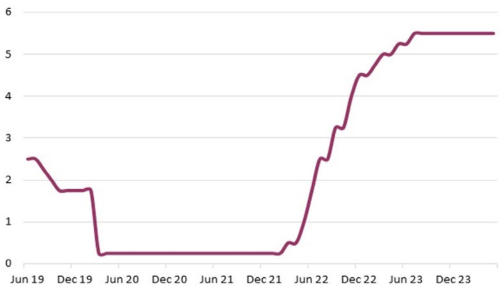
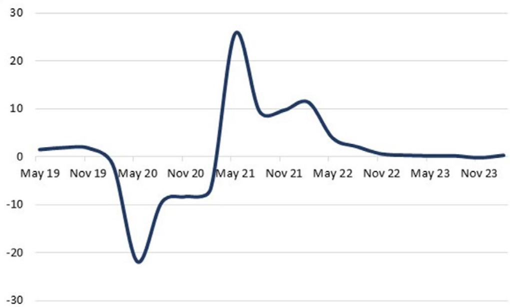
However, the positive economic outlook has helped stock markets to grow. With the US economy continuing to outperform, and with continued excitement around artificial intelligence (AI), US technology stocks have again been the place to be. Nvidia briefly became the biggest company in the world with massive demand for their high-powered chips required to run AI programs.

We have also continued to see strong and steady returns from some parts of the corporate bond market, which remains one of our favoured asset classes. Whilst the portfolios with more equity content have done the best in the past year or so, the more cautious ones have begun to catch up in recent months.

Over the next few pages, we'll look at how various assets have performed, how this has impacted portfolios, and discuss the outlook from here. **Table one** shows the long-term returns of the core portfolios over 10 years. Despite recent volatility and high inflation, the returns are still greater than inflation over this time frame. They have also returned more than the typical balanced fund or wealth manager portfolios, as well as being significantly ahead of cash, which saw negative real returns over this period.

The economy

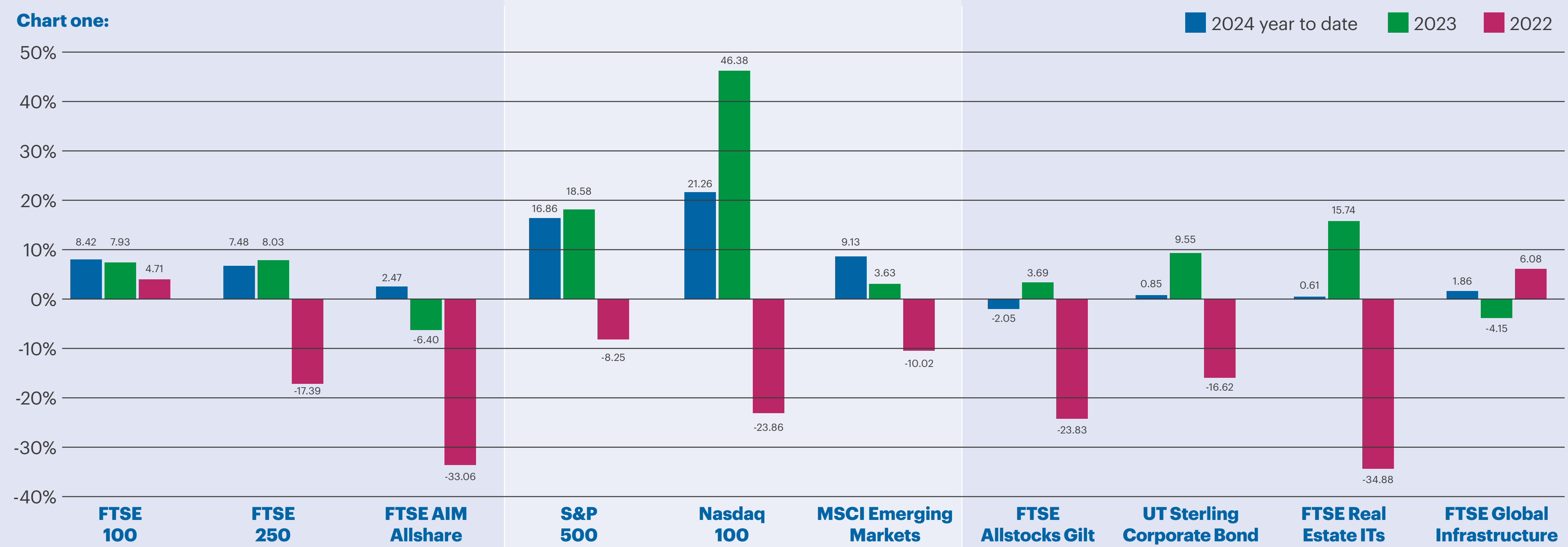
On this page, we look at some key economic indicators, focusing on the UK and the US which have the biggest effect on portfolios.

	UK	US	Equilibrium view
Interest rates %			Rates went from close to zero to more than 5% on both sides of the Atlantic in less than two years as central banks attempted to tame inflation. However, rates have now been on hold for around a year, and the next move looks likely to be downwards. Markets expect one or two 0.25% rate cuts by the end of the year and a further 1% or so of cuts in 2025.
Inflation % p.a. (Consumer prices index)			Inflation went from less than 1% during 2020 to over 10% in the UK and 9% in the US by mid-2022. The rate of price increases has slowed since then, dropping to 2% in the UK as of May. However, it may well increase again later this year, whilst in the US, inflation seems stuck at around 3%. This is why central banks have been slower to cut rates than anticipated.
Economic growth % p.a.			The five-year charts show wild swings in the economy during 2020 and 2021, as growth collapsed and then rebounded strongly around the pandemic. Arguably, we are still feeling the effects of this now. Recent growth has been better than expected, with the UK rebounding from a mild recession late last year, whilst the US has so far avoided much of a slowdown.

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 over the past two calendar years and so far in 2024.



UK equities	Overseas equities	Other assets
Large UK companies, as represented by the FTSE 100, are the only asset class shown here to have achieved a positive return over all three periods. By contrast, smaller UK companies as represented by AIM, have struggled consistently over this time frame, partly due to the lacklustre UK economy. That said, we have recently seen a number of bids for UK companies that are starting to have a positive effect on this part of the market.	After falling sharply in 2022, US tech stocks produced phenomenal returns in 2023 and 2024 so far. This can be seen in the Nasdaq returns, but these same companies are also driving the main US market, the S&P 500. Emerging market equities had a sluggish recovery in 2023 but have started to pick up lately, driven in part by a rally in Chinese stocks.	Government bonds, such as gilts, lost just as much money as equities during 2022. However, there was only a weak recovery in 2023, and the asset class has fallen again this year. Corporate bonds fell less far in 2022 and had a decent recovery in 2023. They are flat so far this year (although high-yield and short-dated corporate bonds are doing very well). Real assets like property and infrastructure have continued to struggle, as expectations for rate cuts receded.

Source: Financial Express, total return in sterling to 05/07/2024. This is a non-exhaustive list of some of the major asset classes we can invest in.
Blue bars are the returns so far in 2024, green bars represent the returns in 2023 and red bars represent the returns in 2022.

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 5 April 2024 (%)

Portfolio	2024 so far	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Cautious	3.62	4.91	-9.62	6.51	3.60	12.37	-3.60	8.58	7.76	4.36	6.27
Balanced	4.30	6.50	-10.93	7.73	4.31	13.79	-4.12	9.75	8.93	5.53	6.43
Adventurous	6.00	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	**3.99**	**6.81**	**-9.47**	**7.20**	**3.51**	**11.84**	**-5.10**	**7.16**	**10.32**	**1.21**	**4.85**
Global Equity	7.74	10.63	-18.37	11.10	13.36	20.99	-8.40	19.08	18.06	7.23	4.60
UT Flexible Investment	**6.57**	**7.08**	**-8.98**	**11.30**	**6.70**	**15.66**	**-6.72**	**11.21**	**13.82**	**1.99**	**4.89**
Defensive	2.58	2.93	-9.21	1.93	7.39	6.29	0.01	4.95	4.64	0.90	4.21
UT Global Bond	**2.32**	**5.97**	**-10.87**	**2.84**	**3.90**	**8.70**	**-3.35**	**4.84**	**8.47**	**0.38**	**4.84**

Various time periods to 5 April 2024 (%)

Portfolio	3 months	6 months	1 year	3 years	5 years	10 years
Cautious	1.91	4.36	8.20	-0.42	11.28	47.42
Balanced	2.02	5.11	9.08	0.33	14.65	58.21
Adventurous	2.50	6.97	11.18	-0.39	19.53	76.93
UT Mixed Investment 20-60% Shares	**1.88**	**5.21**	**9.50**	**2.73**	**13.86**	**44.73**
Global Equity	2.59	9.51	13.23	-2.53	26.72	111.82
UT Flexible Investment	**2.59**	**8.03**	**11.86**	**6.94**	**26.48**	**76.79**
Defensive	1.77	3.16	6.89	-3.50	6.28	25.17
UT Global Bond	**1.22**	**3.50**	**7.66**	**-2.59**	**4.58**	**26.84**

Source: Financial Express, total return in sterling to 5 July 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	3.44	4.91	-9.62	6.51	3.60	12.37	-3.60	8.58	7.76	4.36	6.27
ARC Sterling Cautious PCI	**2.36**	**4.43**	**-7.60**	**4.23**	**4.20**	**8.05**	**-3.63**	**4.48**	**5.52**	**1.25**	**3.98**
Balanced	4.04	6.50	-10.93	7.73	4.31	13.79	-4.12	9.75	8.93	5.53	6.43
Adventurous	5.66	8.69	-14.54	9.58	6.98	16.61	-5.60	12.79	12.44	6.21	6.35
ARC Sterling Balanced PCI	**4.22**	**5.98**	**-9.14**	**7.64**	**4.31**	**11.73**	**-5.10**	**6.69**	**8.64**	**1.87**	**4.51**
Global Equity	7.31	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	**6.86**	**8.10**	**-11.40**	**12.31**	**5.82**	**18.04**	**-6.50**	**11.39**	**13.73**	**2.06**	**4.07**

Various time periods to 28 June 2024 (%)

Portfolio	3 months	6 months	1 year	3 years	5 years	10 years
Cautious	1.47	3.44	8.12	-0.17	12.58	48.02
ARC Sterling Cautious PCI	**0.79**	**2.36**	**6.02**	**-0.14**	**8.87**	**26.35**
Balanced	1.34	4.04	9.01	0.50	16.01	58.83
Adventurous	1.93	5.66	11.32	-0.47	21.20	77.65
ARC Sterling Balanced PCI	**1.29**	**4.22**	**9.15**	**3.29**	**16.09**	**44.47**
Global Equity	1.94	7.31	13.49	-2.69	28.93	113.55
ARC Sterling Equity Risk PCI	**1.88**	**6.86**	**12.39**	**7.03**	**27.59**	**78.35**

We have seen relatively consistent outperformance of all portfolios compared to wealth manager and other mixed investment funds over various time frames.

In particular, shorter-term performance has been strong, with all portfolios seeing returns so far this year, whilst we also generally see outperformance over the longer term. Three-year returns are now largely flat, with gains in 2023 and 2024 offsetting most of the losses from 2022, when most asset classes fell.

We are also seeing the portfolios behaving as expected, with the more cautious portfolios losing less in 2022 and the more adventurous portfolios gaining more in the recovery. This is particularly pleasing as in recent times, many other supposedly cautious portfolios failed to mitigate losses, with usually lower-risk bonds falling just as much as equities in 2022.

Source: Financial Express, total return in sterling to 28 June 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.

Table two: Calendar year returns

Asset class	1-year return %*	Current allocation %	Allocation 1 year ago %	Change in allocation %	Commentary
Cash and money market	n/a	1.7	1.2	+0.4	Interest rates have remained on hold over 12 months, meaning we can still get a reasonable return on cash. Yields on bonds also remain attractive in our view, especially corporate bonds – both "investment grade" (strong companies) and "high yield" (companies with lower credit ratings). As a result, we have continued to increase exposure over this period.
Fixed interest	8.80	45.0	39.8	+5.2	
Real assets	6.52	7.9	10.2	-2.3	Real assets like infrastructure and property have continued to struggle with interest rates remaining high. The asset class continues to see income grow with inflation, which can be attractive but has been relatively volatile. We have somewhat reduced exposure by opting for fixed interest where we see less uncertainty of returns.
Defined returns	12.99	7.8	8.7	-0.9	We struck some new defined returns in the Autumn but as markets have risen in 2024, we've had a few products "kick out". We have not reinvested all of this back into defined returns but instead used this to top up fixed interest. We will look to increase this asset class again should markets dip and volatility increase, which tends to mean an increase in the rate of return available.
Alternatives	5.65	4.9	6.5	-1.6	We have slightly reduced exposure to alternatives. The funds we hold in this asset class are designed to profit from rising volatility, which could potentially hedge some of our equity exposure.
Equity	15.53	32.9	33.6	-0.7	We have marginally reduced equity exposure over the period, taking some profits as markets rise. We have not made any big shifts to equity allocation, retaining exposure to the fast-growing US stock market but adding hedges, and also keeping a reasonable exposure to the UK. Over the year we also added to Japanese equities, with changes to corporate governance helping to make Japanese companies more attractive.

*Source: Financial Express, 12-month total return of relevant Equilibrium asset class portfolio from 5 July 2023 to 5 July 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

On 18 June 2024, Nvidia became the world's biggest company.

After a surge in its share price, the company hit $3.35 trillion in market capitalisation, which made it briefly bigger than Microsoft before the share price dropped back somewhat.

As of the end of June, the stock was up 182% over 12 months and 483% over three years. It now makes up close to 7% of the S&P 500 – the main US stock market index - with fellow $3 trillion companies Apple and Microsoft representing a similar proportion of the index

For context, the TOTAL market capitalisation of the top 100 stocks here in the UK - the FTSE 100 - is roughly $2.6 trillion (Sources: Reuters, LSEG Eikon, Blackrock, FTSE).

Nvidia has been one of the biggest winners of the Artificial Intelligence boom. It makes the high-powered chips that are required to run AI programs.

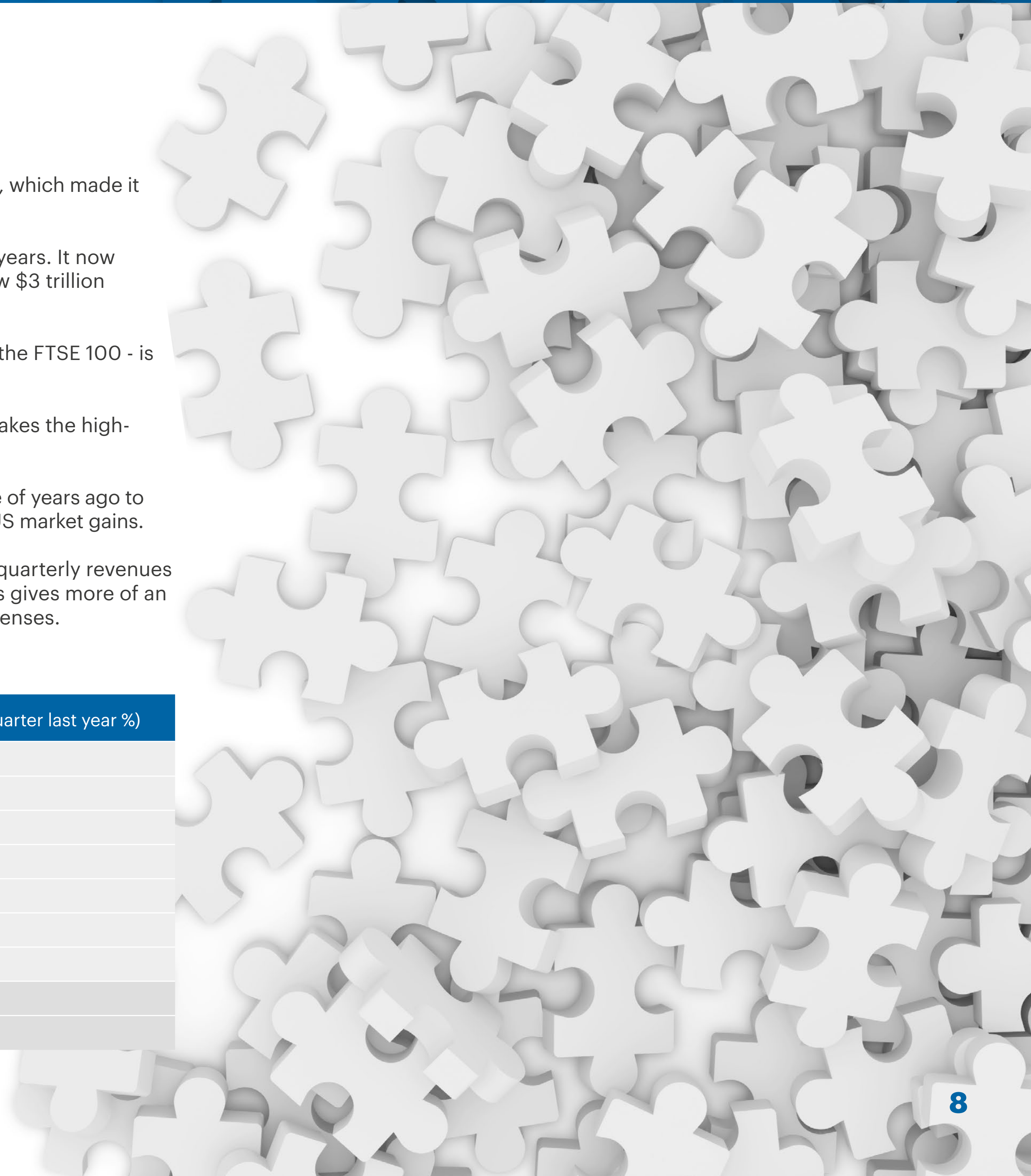
Table three shows the so-called magnificent seven stocks – a name coined a couple of years ago to describe the large technology-related stocks which have been driving much of the US market gains.

It shows the growth each company has experienced comparing their most recent quarterly revenues with the same quarter last year. We're looking at revenues rather than profits as this gives more of an indictation about how sales have increased, rather than profit which considers expenses.

Table three: Revenue growth of the so-called magnificent seven stocks

Company	**Revenue growth** (latest quarter vs equivalent quarter last year %)
Nvidia	262.12
Apple	-4.31
Meta	27.26
Microsoft	17.03
Tesla	-8.69
Alphabet	15.41
Amazon	12.53
Average	**45.91**
Average ex Nvidia	**9.87**

Source: LSEG Eikon / Equilibrium Investment Management



At 262% growth, Nvidia stands out a mile! The average revenue growth of the seven stocks is a very healthy 45%, but Nvidia has done most of the work on this average. If you exclude Nvidia from the calculation, the others have grown their revenues by less than 10% on average. Apple and Tesla's revenues actually fell on this metric.

There's a saying that, in a gold rush, you want to be the one selling the shovels. Very few gold prospectors strike it lucky, but they all need something to dig with!

Nvidia is selling the 21st century equivalent of the shovels to those digging for AI gold.

In fact, according to Bloomberg, around 40% of Nvidia's revenues come from sales directly related to Microsoft, Meta, Amazon and Alphabet!

In essence, those four companies' investments in AI are driving much of Nvidia's gain. However, their own revenues have yet to see such substantial increases. In fact, their profits would be higher in the short term were they not making such large investments in hardware.

AI has many exciting potential applications. For example, at Equilibrium, we've started trialling an AI program to take meeting notes and have been amazed at the initial results. However, from an investment point of view, we have been concerned that people are getting ahead of themselves.

Nvidia has seen phenomenal results, but so far, they (and a few other chip makers) are the only ones who've really benefited from the bottom line. In addition, for Nvidia's stunning growth to continue, the other big tech stocks have also got to achieve some decent results soon as well.

There is the danger that, having brought forward their hardware investment, these four companies could decide they need to slow down their spending. The interconnected nature of these big tech companies could be a concern should AI revenues disappoint.

As we mentioned last quarter, the main US market (and the main global equity indices) is highly concentrated in these big tech stocks – nearly 21% of the S&P 500 is in Nvidia, Microsoft and Apple alone. The magnificent seven are also relatively expensive, with the simple average price/earnings ratio of the seven stocks being around 45 times their underlying profits. The market as a whole remains on a hefty 27 times, with the index ratio dragged higher by the seven (Source: LSEG Datastream).

If growth in these companies is even slightly below expectations, then we think market reaction could be quite severe.

Portfolio insurance

Whilst we are concerned that these stocks could pull back, we also don't want to avoid them completely.

As the main driver of growth in stock markets over the past couple of years, we want to retain exposure. If our concerns remain unrealised and these stocks continue growing at a similar pace, we don't want to miss out on those gains.

So, whilst we have marginally reduced equity exposure and allocated more to different parts of the stock market (including parts of the US market), we instead need to find other ways to mitigate risk.

Largely, this comes through diversification. We hold other assets in portfolios that we think could do well in different scenarios.

For example, should economies take a downturn (which could hit stock markets), then we think our holding of government bonds will benefit. In this scenario, investors often head for "safe havens" like bonds. Interest rates might be cut, making their coupons look more attractive.

We also hold some "alternative" strategies designed to benefit should volatility in stock markets increase. Usually, when markets fall, volatility increases.

We have also taken out some portfolio insurance by buying what is known as a "put option" on the S&P 500 Index. We discussed this in The Pulse in June, but essentially you should think of this as an insurance policy. We have paid a small premium for this insurance, and if the market continues to rise, we will lose that premium.

However, if the market drops more than 10% from its highest point over the next 12 months, the insurance policy will start to pay out and mitigate the losses.

By using this approach, we can maintain a higher allocation in US stocks. This allows us to capitalise on any further gains in the US market, while also mitigating some of the potential losses if there is a market downturn.

High yield bonds – theory and reality

Over the past year, we've talked a lot about why we like high-yield bonds in portfolios. These are corporate bonds where we lend money to companies. High-yield bonds are those where the lending is to companies with lower credit ratings, which means they are a riskier form of debt. However, in return, we get paid a much higher yield than for "investment grade" corporate bonds (where we lend to more secure companies).

On some of the high-yield funds we hold, the underlying yield to maturity on the bonds is above 10% p.a. (Source: Equilibrium Investment Management and the various fund managers). This is an attractive potential return in line with what we might expect from equities over the long term. We've recently been making the point that, whilst they are riskier than other types of bonds, in many ways high yield is less risky than equities since to receive the return, we simply need the companies not to go bust. We don't need them to grow like we do for equities.

Our theory has been that we should expect similar returns from high yield but with less risk. But how has it been working in practice?

Chart two: Returns of Equilibrium high-yield funds compared with the FTSE100

Source: Data from FE fundinfo 2024. 03/07/2023 to 03/07/2024

Chart two shows the returns of our high-yield holdings in blue (a simple average of the four funds we currently hold). Over 12 months, the high yields funds are up by more than 14%.

Also included on the chart is the FTSE 100 in red. Our high-yield funds, which invest in a mix of global and UK bonds, have outperformed and been a lot less volatile than UK equities in red. The returns have been very much slow and steady, unlike stock markets which have bounced up and down.

This is one reason we have less in equities and more in bonds than we have had at times in the past – because in many ways the high-yield funds are doing the job of equities in providing very attractive returns. The bonus is that we have more confidence about the potential returns than we do with stocks, given the structure of the investments.

In the present economic environment, with slow but not spectacular economic growth, these funds could continue to do well. Rate cuts would further enhance the appeal of these already attractive yields.

Should the economy take a turn for the worse, then we would look to cut exposure since there would be more risk that companies might default on our loans. We continue to watch this carefully, but again a sensible mix of assets and remaining vigilant about such risks should mitigate this to some extent.

Political risk

We have just seen an election here in the UK, with Labour winning by a landslide (in seat numbers at least).

There has been a mildly positive reaction from UK stocks, in particular smaller companies that make more revenue from the UK rather than overseas. However, given the result was expected, the impact has been limited.

At the time of writing, we have just received the French election result where no party has an overall majority. The far-right has not done as well as expected but still won a lot of seats. All this uncertainty has caused some volatility in French stocks and bonds.

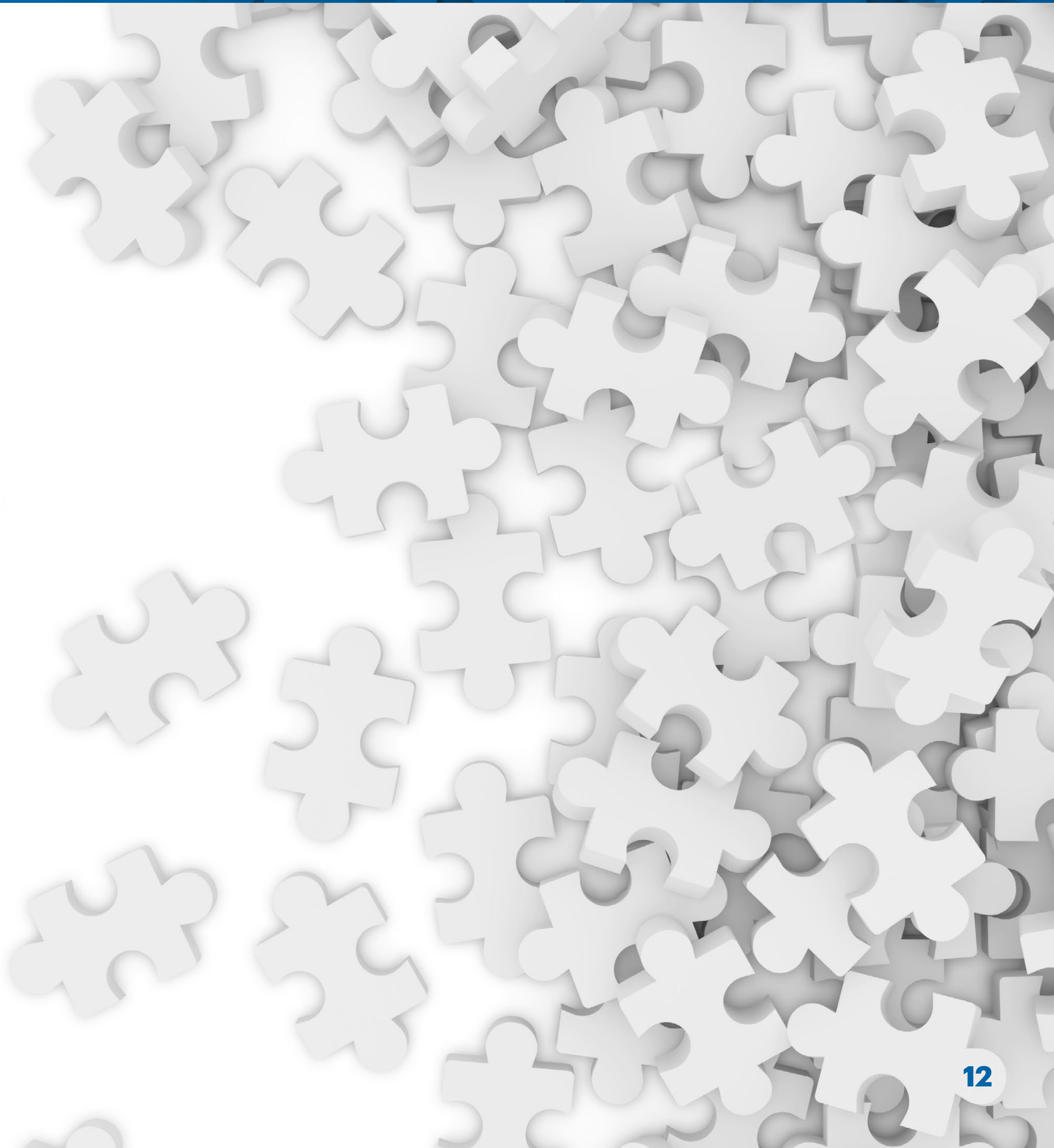
Of course, later this year we also have the US presidential elections which again brings much uncertainty. As a result, certain strategists are now favouring the UK given its newfound political stability, a novelty after the turmoil of the past few years.

Donald Trump is now a strong favourite to win the presidential race. At present, we have very little detail on what he plans to do. Our suspicion is that he will extend the previous tax cuts which had been due to expire. He could also cut other taxes and/or increase government spending and is likely to be “protectionist” by perhaps increasing trade tariffs and trying to reduce immigration.

If so, this could potentially keep inflation higher for longer, but may also increase US economic growth in the short term. This would likely mean interest rates stay higher for longer, which might not be good for government bonds.

However, in our view smaller company equities which make more money domestically might benefit. We also think high-yield bonds ought to be fine in that environment. Companies that sell overseas might find things harder.

In other words, we don’t think we need to change our positioning as described above should Trump get in, but as ever we will be watching carefully and ready to react if required.



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 July 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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