Q3 2023 Overview – Countrywide Assured plc Balanced Managed Pension / Life Investing Fund

This report is provided by our Fund Manager Schroders and covers the portfolio activity on our main investing funds the Countrywide Balanced Managed Pension/Life Investing Funds, together with their short-term economic outlook. The report describes the current economic background and Schroders' perspective of this and how it impacts their management of the Countrywide Balanced Managed Pension/Life Investing Fund. It also covers all individual asset class sectors (UK & Global Equities; fixed interest; Property and cash).

Your policy will be invested in a specific customer fund of your choice which has its own fund objectives (see fund list and specific fund objectives) www.countrywideassured.co.uk/fund-centre/understanding-my-funds/fund-objectives/. All customer managed funds are invested in the Countrywide Balanced Managed Pension/Life Investing Funds, to a greater or lesser extent depending on the nature of the fund objective. If you're invested in an individual asset class sector fund, although no specific commentary is provided for these funds, the report does cover individual markets and other asset classes, which is consistent with the fund managers reasoning.

Portfolio Activity

At a high level little changed, and we maintained a cautious stance, refraining from any strong directional views while we wait for clarity on the next phase of the economic cycle. However, under the surface we took advantage of selective opportunities.

In the US, an overweight small caps versus large caps position was added to the fund in July. The resilient economic data coming out of the US was likely to help the economy avoid a recession and we deemed US small cap stocks more likely to benefit in that scenario. In August, an overweight position in US financials versus US large caps was added to the fund so as to diversify our pro-cyclical positions (cyclical sectors tend to outperform when financial markets rise). These positions were closed in September. The performance of the US large cap stocks is still very much dominated by the fortunes of the so-called Magnificent Seven stocks which is too idiosyncratic (Magnificent Seven stocks: Apple, Microsoft, Amazon, Alphabet, Nvidia, Tesla and Meta Platforms).

From a regional perspective, we have a positive view on Japan relative to Germany and so this position was added to the fund in September. Japanese companies appear to have stronger fundamentals (e.g. more financial stability, profitability and growth potential) whilst German economic data has deteriorated.

Having added an overweight US energy equities position to the fund last quarter, the position was closed in September following the downgrade in our view to neutral. Energy prices rose sharply after Russia and Saudi Arabia cut production levels. However, we believe that the impact of these production cuts have been factored into market prices and so the position was closed at a profit.

In fixed income, we continued to see encouraging developments on US inflation over the summer. With no sign of an imminent recession, this supported our expectations of a soft landing and increased the probability that interest rates in the US had reached a plateau. Additionally, with the rise in yields, bonds appeared more attractive and so we upgraded our outlook on government bonds to positive in August. From a regional perspective, an overweight US and German versus UK government bonds position was added to the fund. UK inflation remains stubbornly high whilst we expect lower inflation surprises from the US and Germany. The position was closed in September following the surprise drop in UK inflation which was likely to dominate the narrative in the short-term.

In currencies, having added an overweight US dollar versus euro position last quarter, the position was closed in September in order to book profits. An overweight Canadian dollar versus euro position was added towards the end of the period. The position aims to capture the divergence between Europe and Canada. On the one hand, the Canadian dollar has benefited from the positive spill over effects from the US, as well as more resilient economic growth. In contrast, the outlook for Europe is more stagflationary as the purchasing managers' index (PMIs) has continued to fall whilst energy inflation remains sticky (in the PMI surveys, a reading below 50 implies contraction, while a reading above 50 implies expansion).

Outlook

As we move into the final quarter, we acknowledge our cyclical view shifted significantly mid-way through the year. Our baseline narrative of preparing for a slowdown and ultimately a recession, has been replaced by a soft-landing. In sharp contrast to 2022, global growth expectations are moving upwards, while inflation stabilises, after rising sharply last year. However, given the consensus move we believe there are several challenges to the continuation of the soft-landing narrative. Firstly, improvements are not universal across regions. Secondly, further falls in inflation will be harder to achieve as they require an easing of sticky service sector inflation. Thirdly, there are issues around how effective monetary policy is in the post pandemic world.

Starting with our forecasts, our baseline view has moved more reflationary, raising both growth and inflation projections. We have revised up US growth for this year to 2.3% (previously 1.5%) but slashed Chinese growth to 4.8% (from 6.5%). These moves largely cancel each other out leaving global growth at 2.5%. We expect global growth to decelerate further in 2024 to 2.1%, as policy continues to dampen activity. Global inflation is expected to moderate from 7.2% last year to 4.4% this year and 3.1% next. Within this, advanced economies and EM are divergent, with inflation cooling in the former and rising in the latter, as China lifts itself out of deflation. Finally, policy rates are close to their peak and will fall next year, although we have pushed out the easing cycle to reflect the challenge of beating inflation.

Having turned neutral on equities in June, we have been discussing whether we should alter this position. With recent market moves triggering a cheapening of equity valuations, we believe there is an opportunity for equities to move higher into year-end, supported by a stabilisation in rate volatility. Given the decent equity earnings, favourable seasonality and stretched sentiment, we have upgraded equities to positive. However, there is a divergence across regions; with Japan continuing to run a little bit hot and China still dealing with the consequences of over-investment in the real estate sector. Japan is a bright spot which continues to beat its own drum, with better fundamentals and a less restrictive monetary policy. In contrast, we maintain our negative stance on Europe following weak German economic data, coupled with a broader decline in the services and manufacturing sectors.

On government bonds we are neutral, preferring the shorter end of the yield curve. The longer end remains unattractive given the ongoing level of inversion, and medium-term concerns over government debt levels and inflation.

In conclusion, our outlook for the world economy has improved, however next year is still forecast to be the weakest for more than a decade, excluding the pandemic year of 2020. That said, we think it is too early to position for a soft landing and we believe there is a window of opportunity for equities to move higher into year end. Finally, with cash rates a source of competition relative to other asset classes, we believe we need to focus on identifying situations where we can generate positive carry versus cash.

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