# Q4 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

Over the period, inflation continued to trend down, confirming our view that US interest rates had reached a plateau. A rise in the participation rate (the number of persons in the workforce as a percentage of the working-age population) helped to reduce pressure on the labour market. As such, a soft-landing scenario remained our baseline forecast (a soft-landing refers to a scenario where economic growth slows but a recession is avoided).

At a tactical level, going into the quarter, the overweight to Japanese equities relative to German equities position had been maintained given the divergence in central bank policy between Japan and Europe. However, in November, we adjusted our regional equity exposure by closing the underweight to German equities whilst maintaining the overweight position in Japan. These changes reflected our view that the pessimism surrounding European equities had largely been priced in, whilst Japanese monetary policy was likely to remain relatively loose. This position was closed in December following the downgrade in our equities view to neutral.

In line with our positive outlook on commodities, an overweight US energy equities position was added to the portfolio mid-quarter. Investor concerns over weaker demand and higher supply had led to a decline in oil prices. However, demand indicators looked strong and we expected OPEC+ (Organization of the Petroleum Exporting Countries) to extend production cuts into 2024. This position was closed in December as we downgraded our view to neutral. Whilst OPEC members agreed on further cuts, many of its constituents were failing to comply with the pre-existing quotas, which would have undermined any further cuts to supply.

Turning to fixed income, an overweight Australian 10year versus Canadian 10year government bond position was added to the portfolio in October as we expected a divergence in monetary policy between the two economies. Australia has a larger percentage of variable-rate mortgages, so higher interest rates are more likely to impact consumers. As a result, we expected the Reserve Bank of Australia to maintain its pause in raising interest rates. In contrast, Canada has a stronger labour market compared to the US, primarily due to immigration policies, leading to faster wage growth. We therefore believed that there was a higher chance of

the Bank of Canada raising interest rates. This position was closed towards the end of the month as economic data and comments from the central banks went against our expectations.

In currencies, slowing economic growth in Europe had led us to be underweight the euro against the Canadian and US dollar. These positions were closed as markets had started to price in US exceptionalism whilst pessimism over Europe had declined. Weaker labour market data also sparked recessionary concerns in Canada. Towards the end of the quarter, an overweight basket of emerging market (EM) currencies (Malaysian Ringgit, Indonesian Rupiah, Brazilian Real and Chilean Peso) versus the euro and US dollar was added to the portfolio. This reflected the strong inflation fighting credentials and prudent fiscal policies of these EM economies.

## Outlook

Looking ahead into the new year, our baseline scenario remains a soft landing for the global economy. The challenge we now face is that after the strong rally in markets into year-end, this scenario is reflected in market prices. This makes it difficult for us to maintain the positive views across asset classes we established over the final quarter of last year. At the same time, it is too early for us to turn negative as we see few signs of an imminent recession in the US. In particular, employment levels remain supportive of consumer demand. As a consequence, we have turned from positive to neutral on equities, bonds and credit.

Under our soft landing baseline scenario, the global economy is set to trundle along at fairly sluggish rates of growth of about 2.2% over the next two years as inflation continues to cool. However, while the headline figures may be uninspiring, less synchronised global activity means that the diverging fortunes of the world's major economies are likely to have important implications for policymaking and financial markets. The US economy remains resilient with strong labour markets supporting consumer spending, although we do expect growth to stagnate this year. The Eurozone is already flirting with a recession, but as a result inflation is falling quickly which paves the way for earlier rate cuts. We see less latitude for rate cuts in the UK as inflation proves stickier despite a recession looking likely over the first half of 2024. In emerging markets, ongoing weakness in China's property sector means that, despite some near-term recovery in manufacturing exports, the slowdown in economic growth is set to continue. The story in the rest of EM is generally one of falling inflation and interest rates. Following some potential softening in activity during 2024, further rate cuts should eventually give rise to some recovery in GDP growth in 2025.

The uncertain global backdrop and less synchronised economic growth mean that the risks around our baseline forecast remain high. As shown by recent resilient spending data, there is a risk that monetary policy has become less effective and that consumption will remain buoyant, preventing a smooth decline in inflation and even forcing interest rates higher. At the same time, there is also a clear risk that the long and variable lags in policy transmission come to the fore more quickly than anticipated, leading to a hard landing in the global economy. In a more positive scenario, euphoria about new technologies such as artificial intelligence could translate more quickly into an investment boom that results in a productivity boost supporting a softer landing than we assume in our baseline forecast. Equally though, there is a risk that negative supply shocks move the global economy in a more stagflationary direction as tracked by our supply side inflation scenario. Geopolitical risk is ever present but looks likely to generate additional volatility this year with elections in 40 countries and increasing tensions in the middle east. The latter forms our final scenario which leads to stagflation through impediments to global trade and resurgent inflation.

As mentioned, we have downgraded our view on equities to neutral as we believe that the soft landing scenario is now largely priced in. We do, however, see pockets of opportunity as equity returns become less concentrated. With the European Central Bank expected to be the first major central bank to cut rates, excessive pessimism and cheap valuations make Europe attractive on a relative basis.

We face similar challenges in fixed income where markets also largely reflect our central view. As a result, positioning reflects a neutral view overall while we seek to exploit relative value opportunities. For example, US bond markets have priced in multiple rate cuts following the latest Fed meeting. However, we think that although inflation continues to move in the right direction and wage growth has peaked, it feels premature for the Fed to cut so aggressively.

Overall then, given our view that the US won't move into recession until the end of 2024, and with cash rates starting to fall, we advocate being invested. But with the soft landing scenario largely priced in, a flexible approach is required to navigate markets and take advantage of buying opportunities as they arise. To use a game playing analogy, the pack of cards needs to be reshuffled to provide fresh opportunities and the next card to be dealt can significantly change the hand you hold.

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