News from the Investment Committee

Q3 2023

News from the Investment Committee – Sept 2023

Dynamic Planner's Investment Committee (IC) met on Monday 24 July with the main task of reviewing the inputs and outcomes from the optimisation process for setting the 2023/24 strategic benchmark asset allocations.

The IC discussed the anticipation of a 'return to normal' for financial markets as yield curves should normalize to an upward slope given higher inflation expectations. The US Federal Reserve's next rate move and its 'higher for longer' policy mantra are predicated on high and sticky inflation.

Inflation may have fallen from its peak, but not enough for the Fed to officially pause rate hikes, given its official 2% inflation target. It is unlikely to pivot and cut rates meaningfully within the next two years. However, whilst unstated, a significant slowdown in economic activity or renewed regional banking problems would also get the Fed to take action. On the subject of US banks, the crisis has ebbed since March, but the dangers haven't gone away.

The dual prospects of slowing global economic and negative earnings growth for the coming quarters raises the risk of 'intermittent' rather than 'deep' recession. Rising interest rates, unrelenting fiscal deficits and high government debt, reversing QE holdings and high levels of market leverage, due to LDI strategies however, increases the risk of currency and bond market volatility.

Conversely, China, the world's second-largest economy, officially slipped into deflation for the first time in two years as consumer prices fell 0.3 per cent. Prices had already flatlined for much of 2023, bucking the global inflationary cycle. The property market debt overhang also continues to cast an ongoing shadow over any resurgent growth hopes in China.

UK gilt yields have spiked again in response to unexpectedly strong inflation and labour market numbers. The persistent underlying strength of core inflation suggests the UK is fundamentally diverging from Europe and the US. The recent interest rate rises have had a negligible impact on demand or the housing market (so far), but the economy is teetering on recession whilst unemployment remains lower than expected at this stage of the economic cycle and strong wage inflation (and industrial action) persists. Market expectations are for interest rates to be 'higher for longer' in the UK than elsewhere.

The IC approved the Capital Market Assumptions for Q3 2023 which signalled significantly large increases for fixed income volatility (around 10 bps), relative to previous quarters.

Expected returns for fixed income were increased given the recent rise in bond yields. There were also increases for equity return expectations (but to a lesser extent), with the exception of the UK, where they have been lowered.

2023/24 strategic benchmark changes

The key themes reflected in the strategic benchmark review can be summarised below as:

- The last two years have seen high volatility as well as extremely low interest rates globally. As previously documented, the Dynamic Planner IC has felt that the risk in Fixed Income was disproportional to the returns provided, as well as lacking negative correlation with Equities. This had resulted in a greater than usual weighting to Cash within the benchmark allocations, to balance out the extended risk in Fixed Income. When conditions begin to normalise, these higher-than-normal Cash allocations would be deployed to more attractive opportunities elsewhere.
- The UK is an outlier due to higher and persistent core inflation. This raises the probability that UK interest rates will be tightened further than the other developed economies.
- With inflation being stickier in UK, this would not be an opportune moment to reduce the allocation to Index Linked Gilts.
- Given the increase in interest rates, yields on Investment Grade Corporate as well as High Yield Bonds have become more attractive. Consequently, the opportunity to reduce the elevated Cash allocations has been taken and moved into Global Fixed Income, rather than UK Gilts or Sterling Corporate Bonds.
- A general softening in the macro environment in developed economies has prompted a move away from Equities for the lower risk benchmarks.
- The trend to further reduce allocations to the UK in favour of Global Equities has continued across the board.
- Due to their greater economic resilience, Asia Pacific as well as Emerging Market Equities have been favoured for the higher risk benchmarks.

Summary of changes by broad asset class

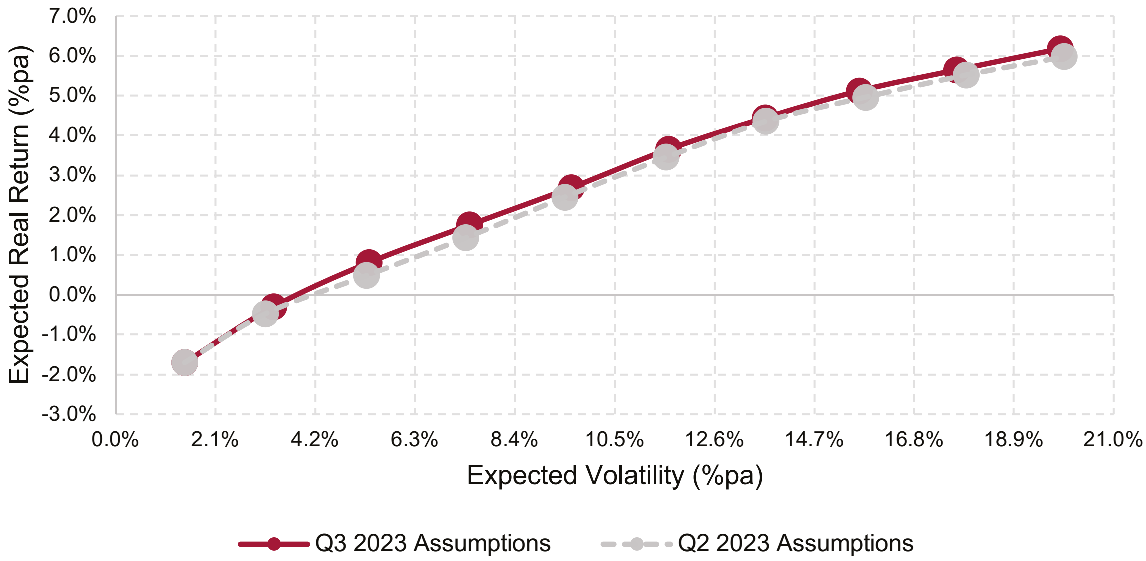
Risk Level	Cash	Fixed Income	Equities
DP Risk Profile 2	-2%	5%	-3%
DP Risk Profile 3	-1%	3%	-2%
DP Risk Profile 4	-4%	5%	-1%
DP Risk Profile 5	-5%	4%	1%
DP Risk Profile 6	-4%	3%	1%
DP Risk Profile 7	-2%	1%	1%
DP Risk Profile 8		1%	-1%

These benchmark changes will be implemented by the MSCI multi-asset index series as part of the re-balancing process for Q3 2023. They are also scheduled for release to all Dynamic Planner users by **Friday 8 September**.

2023/24 strategic benchmark changes by sub asset classes

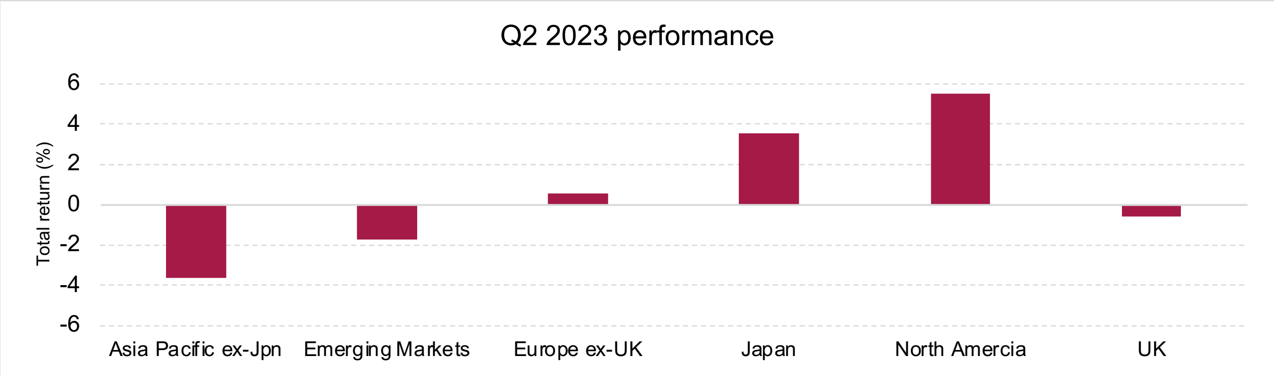
Risk Level	Cash (Money Markets)	Sterling Corporate Bonds	Global Investment Grade Bonds	Global High Yield Bonds	UK Equity	Europe ex UK Equity	North American Equity	Japanese Equity	Asia Pacific ex Japan Equity	Emerging Market Equity	Turnover
DP Risk Profile 2	-2%	2%	3%		-2%		-1%				10%
DP Risk Profile 3	-1%		3%		-3%		1%				8%
DP Risk Profile 4	-4%	1%	4%		-4%	1%	1%	1%			16%
DP Risk Profile 5	-5%	-1%	5%		-2%	1%	1%	1%			16%
DP Risk Profile 6	-4%		3%		-1%	1%		1%			10%
DP Risk Profile 7	-2%			1%	-3%		5%		1%	-2%	14%
DP Risk Profile 8				1%	-5%		2%		1%	1%	10%
DP Risk Profile 9					-3%		1%			2%	6%
DP Risk Profile 10					-6%		1%		4%	1%	12%

Dynamic Planner Efficient Frontier



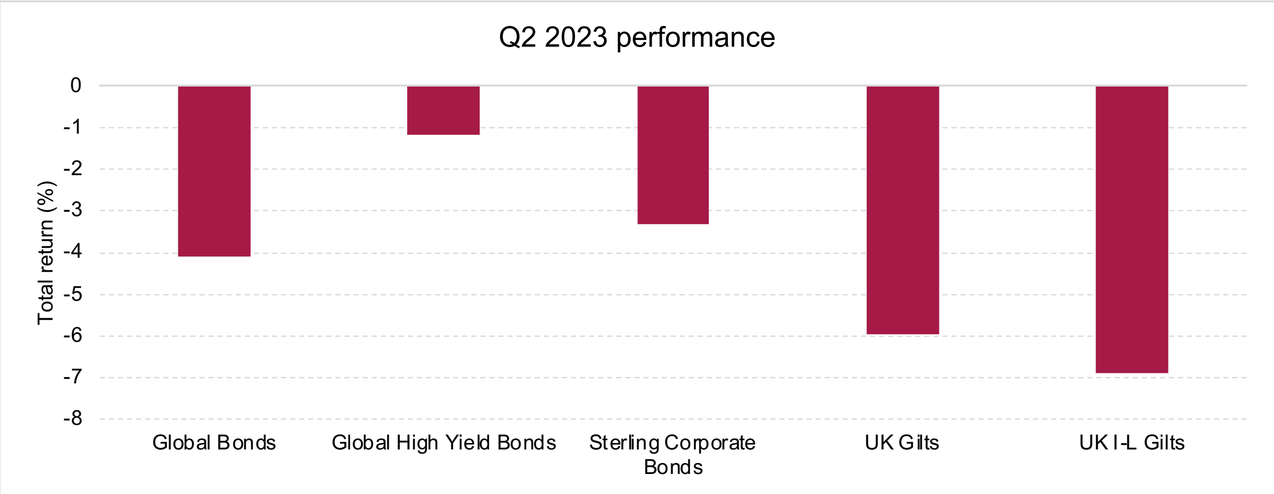
The efficient frontier curve has steepened, and the benchmark allocations have been centralised within their risk boundaries.

Previous quarter market overview – Equities

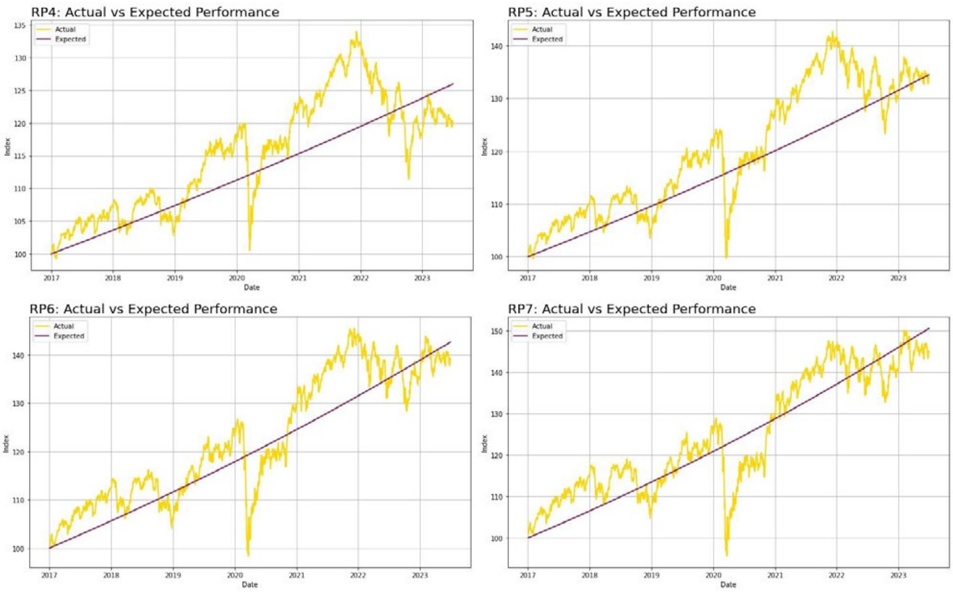


The developed equity markets, notably the US and Japan, saw gains over the quarter, with the exception of the UK. Asia Pacific and Emerging Markets however lagged on growing concerns that the economic rebound in China, following its reopening after Covid-19 lockdown, had started to cool. In the US, gains were driven around moderating inflation, economic resilience in spite of further interest rate hikes and excitement around AI (Artificial Intelligence) boosting technology stocks.

Previous quarter market overview – Fixed interest

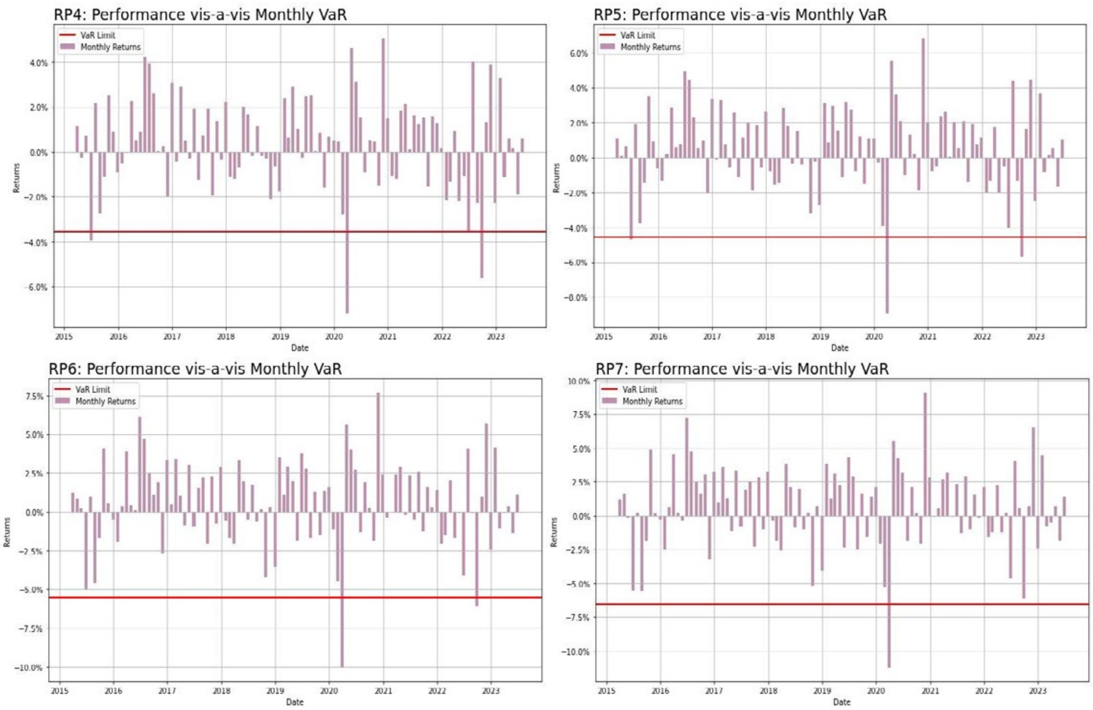


With the exception of Japan, all major central banks raised interest rates over the quarter and bond yields rose as result. However, the US Fed was the first to pause in June, after more than a year of consecutive rate increases. The Bank of England (BoE) raised interest rates twice – in May and June by 0.5%, with the decision to tighten faster from its previous 0.25% moves being prompted by stronger-than-expected employment figures, wage growth and persistently high core inflation, all which resulted in a sharp sell-off in UK gilts over the quarter.



Performance has generally trended in line with long-term linear forecasts (as set in Q2 2017).

Monthly Value-at-Risk analysis



Monthly returns have normalised post-Covid and last September's mini-budget bond market tantrums, as demonstrated via the rolling monthly returns calculated each month versus their expected 95% VaR limit (the horizontal red lines).

Dynamic Planner Investment Committee
September 2023

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