M&G wealth

MODEL PORTFOLIO SERVICE
QUARTERLY INVESTMENT UPDATE
January 2024

Introduction

Welcome to the January 2024 M&G Wealth Model Portfolio Service Investment Update. In this report, we discuss our current market views and what we're keeping an eye on for 2024.

One year ago, all the chatter was about an imminent global recession and potential falls in equity markets. 2023 defied those expectations, with equity markets delivering positive returns in most regions. The returns from our models outpaced cash returns in 2023, rising between 6.79% to 8.49% depending on the approach and risk profile. Please see page 7 for detailed information on the portfolio performance.

Section	What's in it?
What we're watching in 2024	This has our views on the overall economy, including inflation, economic growth and financial markets.
In focus: regions and asset classes	This goes into more detail on equities in specific regions (e.g. Europe, UK) and types of bonds (government bonds, emerging market bonds).
Performance	This shows the performance of our models and highlights some of the key things that drove these outcomes.
Costs	This shows the investment management fee and ongoing charging figures (OCFs) for the portfolios.
Risk Ratings	This shows the risk ratings from third party providers for the portfolios.
Platform Availability	This shows the platforms where portfolios are available.

What we're watching in 2024

We think inflation has peaked and central banks won't raise interest rates much further. Disinflation has finally arrived; the annual rate of price growth is falling in the US, Europe and UK due to lower energy and goods prices. Housing costs are starting to fall, which could reduce inflation more in 2024. It takes time for the impact of higher interest rates to impact the economy. We think central banks are likely to keep interest rates at current levels; with the global economy growing and employment still strong, we don't see a need to cut interest rates.

China and Japan will lead global growth. Economies have coped surprisingly well with higher interest rates so far, helped by resilient US consumers. However, there are signs that higher borrowing costs are starting to bite. Credit card balances are rising and total spending on interest payments has increased in recent months. This is likely to be an issue in economies such as UK, Canada and Australia which are more sensitive to interest rates. A fall in Gross Domestic Product (GDP) appears likely in the Eurozone, with the Q3 2023 data showing a 0.1% contraction in Europe 'real' GDP, which is a measure that is adjusted for inflation. In China, the housing sector is faltering and that's a problem because it makes up circa a quarter of China's GDP. We think China will grow its GDP by the 5% pa target in 2024, but nervous consumers are unlikely to increase spending significantly. In neighbouring Japan, we think a healthy level of inflation will enable the economy to grow faster than other developed markets in 2024.

Politics takes centre stage. In 2024, elections are scheduled in countries that represent 63% of world GDP, including the US, Mexico, India, and Taiwan. In 2023, we saw political dysfunction in the US; Congress averted a government shutdown and avoided default by raising the debt ceiling. The ousting of the Speaker of the House highlighted the polarisation between parties. The outlook for US trade relations, taxation, spending, climate policy and the legal structure could change based on the outcome of the US election. Regardless of the outcome, we think companies will continue to diversify supply chains and build out domestic industries.

Higher interest rates and government debt levels will constrain economic growth, but equities can still perform well. We think US equities will continue to perform well because profits of the major US companies are growing faster than profits at companies in other parts of the world. The key risk is the high prices of US equities relative to other markets. Asia equities are benefiting from companies adding supply chains outside of China. India equities are benefiting from an expanding domestic economy and outsourcing of services. Technology exports are the key factors for Korea and Taiwan's economies. Demand for semiconductor chips is improving.

Bonds have a brighter outlook. A bond is a loan to a company or government that earns you income in the form of interest. We think the outlook is positive for bonds. Returns from bonds over the last three years have been poor, but this means the starting point is much improved for new investors. The yield an investor can earn from bonds in our portfolios varies between 4% and 8% pa. The yield is the annual rate of return that an investor would receive, assuming the issuer of the bond makes all the required interest payments and return the capital. The return on bonds from these interest payments alone is attractive. If economic growth were to weaken, we'd expect higher returns from bonds. This is because interest rates could fall if economic growth were weaker than expected, and lower interest rates would cause the capital value of bonds to increase.

In focus: Regions and Asset Classes

UK Equities

Our portfolios have less in companies with high levels of exposure to the UK economy. The UK economy is more sensitive to interest rates than other developed markets, such as the US. The UK stock market has significant exposure to energy and materials companies. This is different from markets such as the US and Emerging markets, and helps to make the portfolios more diversified. We think the UK market would perform better than other regions if we were to see geopolitical instability and higher energy prices return.

US Equities

The S&P 500 Index once again outperformed most other stock markets in 2023. Seven large companies (such as Microsoft and Nvidia) drove about three-quarters of the index's gains in 2023, in a rally stoked by investor enthusiasm for the potential of Artificial Intelligence. Valuations for firms in this area are high. The price to earnings ratio of the seven companies is an average of 32 times earnings vs 19 times earnings for the S&P 500 Index.[1] These seven companies are forecast to grow earnings roughly twice as fast as the rest of the US market over the next 5 years.[2] We think there is a risk that this level of growth can't be sustained. However, a resilient domestic economy should help the wider US stock market in 2024.

Europe Equities

Economic growth was weaker in Europe in 2023, due to lower demand for manufactured goods and lower economic growth in China. (Europe sends 9% of its exports to China and is the largest partner for EU imports of goods.[3]) This is reflected in equity valuations, which became cheaper relative to other developed markets in 2023 despite many of the companies selling their products and services around the world rather than being dependent on the Eurozone economy. There is potential for the pessimism to change; the European equity market offers exposure to some of the leading industrial and healthcare companies in the world. One of the exciting opportunities next year is the potential of GLP-1 agonists, a class of drugs used to treat diabetes and obesity – a market valued at $100bn by 2030.[4]

Japan Equities

We remain positive on the outlook for Japanese equities. The economy has a healthy level of inflation which is boosting wages and domestic demand. In 2022, a directive was issued to "encourage" Japanese companies to return cash to shareholders, either via buying back shares from investors or paying higher dividends. There is also the potential for the Japanese Yen to rise in value, which could boost the value of Japanese equities for sterling-based investors. We think higher inflation increases the chance that the Bank of Japan will increase interest rates, which would likely boost the Yen.

Asian and emerging Market Equities

China is roughly 30% of the MSCI Emerging Market Equity Index. Chinese consumers have savings, but confidence is weak because of falling property prices. We don't see any near term signs of a catalyst that would change the minds of investors. We think the outlook for other areas of the Asia and emerging market equities continues to look strong. Asian countries are benefiting from companies diversifying supply chains away from China. In India, government policies to increase infrastructure investment and reduce friction in trade between Indian states have improved the prospects for growth. Digitisation and the growth of the service sectors are also growth drivers for Indian equities.

Market Views and Outlook - Bonds

Government bonds

This includes bonds issued by developed market governments, such as UK Gilts and US Treasuries. We recently added more to government bonds and removed our allocation to short-term bonds in portfolios. The yield from short-term bonds is similar to medium and longer-dated bonds. If central banks were to start cutting interest rates then medium and longer term bonds would deliver better returns. Historically, increases in interest rates tends to happen over time whereas interest rate cuts tend to be quicker. We think holding cash is a risk, because it could mean missing out on the rises in bond prices that occur when interest rates fall.

Investment Grade Bonds

These are bonds issued by financially stable companies. Investment grade bonds face two risks: (1) the risk that interest rates rise (which is same risk as government bonds) and (2) the risk that companies default on their borrowing. We think that the longer interest rates remain elevated, the more likely defaults become. At the moment, companies have a healthy amount of assets relative to their debts. We do not expect the number of companies defaulting to spike significantly. The yield of investment grade bonds is between 4% to 5% pa, depending on whether the bond is issued in Europe, the UK or US.[5] Most of this yield is driven by the interest rates set by central banks rather than the default risk.

High Yield Bonds

These are bonds issued by riskier companies. Higher interest rates can make it more likely that these companies default at a much faster pace than government bonds or investment grade corporate bonds. The length of the bonds for lower quality borrowers is shorter, which means they will need to pay back the debt and take on new borrowing and at higher rates sooner. We aren't seeing stress in the high yield debt market right now, but if interest rates are still high 12 months from now we think this will start to cause problems. For now, yields are 8% pa, which we think will be an important contributor to portfolio returns in 2024.[6]

Emerging Market Bonds

These are bonds issued by governments or companies from emerging market countries. They are usually in US dollars or in the local currency of the country (e.g. pesos, reals). Emerging market governments and companies had to contend with a stronger US dollar, China's disappointing growth, military conflicts, and geopolitical tensions in 2023. Despite this, the difference between the yield of US dollar-denominated emerging markets bonds and yields of US government bonds barely moved. Bonds issued in local currency were one of the strongest performing asset-classes in 2023. We have a positive outlook for emerging market bonds due to the attractive levels of interest paid and improving economic outlook. On average, inflation is lower in emerging markets than in previous decades, countries have more currency reserves, and countries are less reliance on short-term foreign capital. Countries with strong credit ratings (AA and A) such as Qatar and Saudi Arabia countries now represent about 20% of emerging market bonds. This has changed significantly since the 1990s, when countries with weaker economies made up more of the index.[7]

[1] Refinitiv Data, 03/01/2024. The ratio of a company's price to the earnings it generates is a way to assess how expensive or cheap a company's shares are.

[2] Refinitiv data based on IBES estimates, 31/12/2023

[3] European Commission, data from 2022

[4] JPMorgan Global Research, 29/11/2023

[5] Refinitiv data, 03/01/2024

[6] Refinitiv data, 03/01/2024

[7] Index weights based on JPM GBI-EM Global Diversified Index

Model Portfolio Performance

Portfolios' performance (to 31/12/2023)

Model	Q4	1 year	3 years	5 years
Passive 1	6.23	7.45	1.71	15.04
Passive 2	6.15	7.82	6.85	24.10
Passive 3	6.06	8.03	11.68	32.88
Passive 4	5.84	8.38	15.83	39.05
Passive 5	5.72	8.49	18.32	41.39
Hybrid 1	6.42	7.47	1.54	14.15
Hybrid 2	6.15	7.82	6.03	22.93
Hybrid 3	5.81	7.87	9.43	31.36
Hybrid 4	5.16	7.79	11.11	36.96
Hybrid 5	4.55	7.61	11.49	38.53
Global ESG Themes 1	7.01	7.55	N/A	N/A
Global ESG Themes 2	6.90	7.41	N/A	N/A
Global ESG Themes 3	6.78	7.27	N/A	N/A
Global ESG Themes 4	6.60	7.02	N/A	N/A
Global ESG Themes 5	6.39	6.85	N/A	N/A
Global ESG Themes 6	6.14	6.79	N/A	N/A

Source: FE Fund Info data to 31/12/2023

Performance notes:

The performance figures are meant to assist advisers with their due diligence process. While M&G Wealth Investments LLP (M&GWI) has taken reasonable steps in the preparation of them, we can't accept responsibility for any errors, omissions, actions taken or advice provided by Advisers based on the information.

The value of investments will fluctuate, which will cause values to fall as well as rise and investors may not get back the original amount invested. The figures refer to the past and past performance is not a reliable indicator of future results. The performance figures are calculated in FE Analytics based on a standard model and may not reflect the performance of individual customer portfolios. The calculation includes the investment management fee and all underlying fund charges. The platform, wrapper and advice fees are excluded.

Current fact sheets are here:
https://www.mandg.com/wealth/adviser-services/investment-solutions/mps/support/factsheets

2023 Performance Highlights

This section provides information on some of the key performance drivers. We offer ranges with different investment approaches, and have noted which ranges each of the comments applies to.

Addition of Indian equity exposure (Hybrid portfolios)

- We introduced a specific allocation to India equities in the Hybrid model portfolio service in June 2023. We use the Franklin Templeton India fund.
- India equities were one of the best performing asset-classes in 2023. Earnings for companies in India were higher than investors expected. Unlike the US equity market, the gains have been broad-based across a range of companies and sectors.
- The Franklin fund has outperformed the MSCI India Index since it was added to the models. This was driven by the individual stocks the fund manager selected.
- Exposure to India equities enables the model portfolio to benefit from the structural trends of increasing consumption and growth of services industries in India. While India equities are expensive relative to other markets, companies are growing profits at a faster rate and there are structural tailwinds like a young working-age population and strong government investment programmes which we think aren't fully reflected yet.

Active bond funds (Hybrid and ESG Themes portfolios)

- While returns from UK government bonds and UK Treasuries were flat in 2023, investment grade, high yield and emerging market debt have delivered between 6% to 12% over the year.[8]
- The actively managed bond funds performed well in 2023, with the Royal London Ethical Bond Fund and Federated Hermes High Yield fund standing out.
- Within emerging market bonds, the M&G Emerging Markets Bond Fund added to performance in 2023. The fund has more exposure to local currency issued bonds particularly in Latin America.

Less in the US mega-cap stocks (Passive, Hybrid and ESG Themes portfolios)

- Within US equities, the portfolios had more in small and mid-cap stocks and less in the large technology companies that significantly outperformed the broader market in 2023.

- The S&P 500 index returned 19% this year vs a 10% return for the small and mid-cap US equity indices (GBP).[9] The majority of returns in US equities came from seven stocks.

- We added more larger US companies in November. While US equities are more expensive than other markets, they are forecast to grow faster next year. We think returns could be driven more by the rest of the S&P 500 companies and less by the large technology companies in 2024.

- While the equities of small and midsized companies are historically cheap versus their larger counterparts, the persistence of this discount suggests there needs to be some new information for investors to turn more positive on this part of the market.

Global thematic funds (ESG themes portfolios)

- 'Thematic' funds invest in companies aligned to a particular sector or theme, rather than focusing on a region. These funds are used in the Global ESG Themes model portfolio service.

- The thematic funds in the ESG range lagged the broader market in 2023. A number of factors caused this:
    - The funds have a bias to smaller companies with nascent technologies and have less in the large technology stocks that have driven the market.
    - Some of the thematic funds in the portfolio have more in healthcare companies. This sector was weak in 2023.
    - Renewable energy companies were weak in 2023. The path to profitability for some of these companies in uncertain.

- We think the long-term structural trends behind the thematic exposures remain in place and many of these companies sit on cheaper valuations than two years ago.

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[8] Morningstar data, 03/01/2024
[9] Refinitiv data, 03/01/2024

Costs

Total costs (OCFs at 31/12/2023) (varies by platform)

Please note the impact of transaction costs and share class availability may mean illustrations from platforms show different (higher or lower) total costs. Costs are quoted in the percentage per annum.

Costs %pa Risk Level	Fee	Est. underlying OCF	Total
Passive 1	0.15	0.17	0.32
Passive 2	0.15	0.17	0.32
Passive 3	0.15	0.16	0.31
Passive 4	0.15	0.14	0.29
Passive 5	0.15	0.13	0.28
Hybrid 1	0.15	0.36	0.51
Hybrid 2	0.15	0.38	0.53
Hybrid 3	0.15	0.41	0.56
Hybrid 4	0.15	0.44	0.59
Hybrid 5	0.15	0.46	0.61
Global ESG Themes 1	0.15	0.50	0.65
Global ESG Themes 2	0.15	0.53	0.68
Global ESG Themes 3	0.15	0.54	0.69
Global ESG Themes 4	0.15	0.56	0.71
Global ESG Themes 5	0.15	0.56	0.71
Global ESG Themes 6	0.15	0.57	0.72

Source: FE Fund Info as at 31/12/2023

Current fact sheets are here:
https://www.mandg.com/wealth/adviser-services/investment-solutions/mps/support/factsheets

Model Risk Ratings

Passive Portfolios

	Dynamic Planner	defaqto	EValue	FinaMetrica	Oxford Risk
Passive 1	3	2	3	Best Fit 24-45	2
Passive 2	4	3	4	Best Fit 46-54	3
Passive 3	5	4	5	Best Fit 55-65	4
Passive 4	6	6	6	Best Fit 66-76	5
Passive 5	7	8	7	Best Fit 77-100	5

Hybrid Portfolios

	Dynamic Planner	defaqto	EValue	FinaMetrica	Oxford Risk
Hybrid 1	4	2	3	Best Fit 23-45	2
Hybrid 2	5	3	4	Best Fit 46-54	3
Hybrid 3	5	4	5	Best Fit 55-65	4
Hybrid 4	6	6	6	Best Fit 66-76	5
Hybrid 5	7	8	7	Best Fit 77-100	6

Global ESG Themes Portfolios

	Dynamic Planner	defaqto	EValue	FinaMetrica	Oxford Risk
GESGT 1	N/A	2	3	N/A	3
GESGT 2	N/A	3	4	N/A	3
GESGT 3	N/A	4	5	N/A	4
GESGT 4	N/A	5	6	N/A	4
GESGT 5	N/A	6	6	N/A	5
GESGT 6	N/A	8	7	N/A	6

EValue ratings are on 1-7 scale, with a 10-year time horizon. Oxford Risk ratings are on a 1-7 scale.

The reports from each risk rating agency are available at:
https://www.mandg.com/wealth/adviser-services/investment-solutions/mps/support

Platform Availability

The Passive, Hybrid and Global ESG Themes portfolios are available on these platforms:

Platform	Passive	Hybrid	Global ESG Themes
abrdn	LIVE	LIVE	
Aegon Retirement Choices (ARC)	LIVE	LIVE	
Aegon Platform (previously Cofunds)	LIVE	LIVE	
Aviva	LIVE	LIVE	LIVE
Fidelity	LIVE	LIVE	
M&G Wealth	LIVE	LIVE	LIVE
Novia	LIVE	LIVE	
Nucleus	LIVE	LIVE	LIVE
Quilter Wealth (Old Mutual)	LIVE	LIVE	
Scottish Widows (previously Embark)	LIVE	LIVE	LIVE
Transact	LIVE	LIVE	

Source: M&G Wealth

Where can I find more information:	
Defaqto	https://www.defaqto.com/advisers/
Selectapension	https://www.selectapension.com/
Langcat Analyser	https://analyser.thelangcat.com
Synaptic Software	https://www.synaptic.co.uk

Key Risks

Investing comes with risk. The value of your client's investment can go down as well as up and they may not get back what they put in.

The portfolios may invest in bonds. Changes in interest rates are likely to affect the value of bonds. In general, as interest rates rise, the price of a fixed interest bond will fall and vice versa. The value of the bonds may fall if the companies or governments who have issued the bonds deteriorate in quality, or become insolvent.

The portfolios may invest in equities. Equity prices fluctuate daily, based on many factors including economic, industry or company news. The portfolio invests in shares of companies that manage and develop property. Property may be difficult to sell and can experience significant declines in value due to changes in economic conditions and interest rates.

The portfolios may contain bonds and equities from emerging markets. The impact of economic, political and regulatory factors can be significant for companies and governments in emerging markets. Investments in emerging markets can experience significant declines in value over extended periods of time.

The portfolios may have exposure to investments that are not denominated in UK pound sterling (£). These investments may be affected by changes in currency exchange rates, which is known as 'currency risk'. There is also a risk that it may be difficult to sell some investments (or sell them without making a loss) due to an insufficient number of buyers in the market. This is known as 'liquidity risk'.

This document is meant to assist you with your due diligence process. While M&G Wealth Investments LLP (M&GWI) has taken reasonable steps in the preparation of the document, we can't accept responsibility for any errors, omissions, actions taken or advice provided by you based on the information.

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