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View from the CIO

Adam Ruddle, Chief Investment Officer

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LV= INVESTMENTS

View from the CIO

Update in brief

- The third quarter of 2024 was another strong period for equity markets carrying on the momentum from the first half of 2024.
- However, strong returns masked a high level of turbulence, particularly in late July/early August, as concerns around the US growth outlook resurfaced.
- Most major central banks (e.g. ECB, FED and BoE) also eased monetary policy through interest rate cuts over this period (a bumper 50bps rate cut in the FED's case), helping to drive a strong market recovery.
- Although this is a third quarter update, it would be remiss not to mention a blockbuster UK budget in October and a set of decisive US election results in November.

Market commentary

In early August, the VIX index, a measure of volatility and uncertainty in equity markets, had an intraday high that harkened back to levels not seen since March 2020, the midst of the market infection by the Covid crisis. A dislocation across two central banks – the Bank of Japan who surprisingly increased their policy rate and the Federal Reserve who opted to hold their rates and instead signal a faster pace of cuts to come – these two measures, on the same day, impacted expectations of interest rates which in turn caused a rotation of a strengthening Japanese Yen and a weakening US Dollar resulting in a rapid unwind of the Dollar-Yen Carry trade.

Volatility was also fuelled by a weaker US jobs report that suggested maybe the Fed had left it too late to cut rates and US was already in a recession. Fortunately, cooler heads returned to the markets helped by resilient corporate earnings, clearer messaging from the Bank of Japan and the signal from the Federal Reserve that a rate cut was imminent in September.

US markets recovered – though in Sterling, the S&P500 was flat over the quarter. Expected rate cuts led to a shift in sector performance with previous winners lagging and technology, which had been the driving force behind the S&P500, delivered an underwhelming, albeit positive, return.

Key — S&P 500 in USD [31.32%]

31/10/2023 - 31/10/2024 Data from FE fundinfo 2024

In fact, global equities continued to climb over the quarter supported by a broadening of strong returns. Emerging markets outperformed developed markets led by China where Chinese stimulus measures were announced in September – and then importantly, the indication that more measures could follow. Thailand and South Africa also performed strongly where, for the latter, policy rate cuts and the smooth formation of their coalition government supported investor confidence.

Closer to home, UK markets have remained largely stable over the quarter, with the exception for a small correction at the end of July/ beginning of August, which followed suit from Japan and the US. The UK initially rallied in July following a large election win by Keir Starmer and the labour party, fuelling hope of a new era of investment and sustainability.

Throughout the period, concerns persisted as to how the new labour government would address the large hole in the public finances. Mixed responses to the UK Budget were unsurprising with many commentators still grappling with a budget dependent on growth dampening the growth prospects of businesses.

Higher National Insurance for employers will need to be absorbed and I doubt it will be through subdued profit margins – more probably passed to consumers – a form of sales tax and, and possible job cuts, and lower wage growth prospects for employees. Increased costs for consumers and the fiscal expansion, the additional government spending, are all inflationary likely to mean that, to tame this future inflation, higher interest rates will be with us for longer.

We have seen this narrative play out in fixed income markets, with yields at longer maturities rising through October and November, dragging on the returns of sterling denominated fixed income securities.

Across the pond, we avoided a contested election which would have hurt markets. The Republicans have captured the elusive trifecta controlling the White House, the Senate and the House of Representatives at the same time. This would make it much easier for President-Elect Trump to push through his policies. Tax cuts and a tariff led protectionist agenda will likely also drive up inflation. Although we've had a rate cut from the Federal Reserve in November, and potentially, one in December too, the US Central Bank will likely have to slow further easing.

We expect interest rates to remain higher for longer. The President-Elect's policies are expected to support the US Dollar but limit growth internationally. This will be particularly challenging for European economies whilst it is widely believed that China will have further stimulus packages waiting in the wings. The tax cuts also extend to businesses, and along with deregulation and support for M&A initiatives, US shares may continue to strengthen.

Smoothed Managed Funds – Investment performance

Our smoothing mechanism acts to dampen market moves, bringing returns towards the long-term average, but despite this, the smoothed 1-year return for our SMF Balanced Fund reached 10.4%, at the end of September.

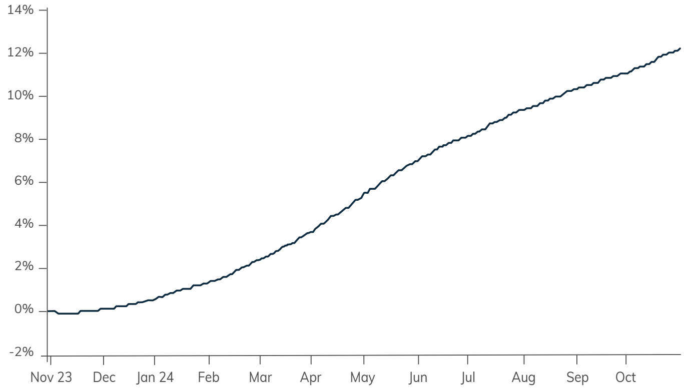
The performance of the underlying portfolios exceeds that of the equivalent ABI sectors, driven in the main by our strategic positioning to US, Japanese and Emerging Market equities markets.

The equity component of our portfolios has done most of the heavy lifting this year, with US and Emerging Market equities the key contributors. This highlights the importance of maintaining a well-diversified portfolio with access to a global opportunity set, with the UK largely underperforming the global market.

The AI theme and associated capital expenditure, remains key in the US, but reassuringly there is evidence of a broadening out of returns across sectors, and slightly less dominance, than previous quarters, by the narrow leadership of the "Magnificent 7" stocks.

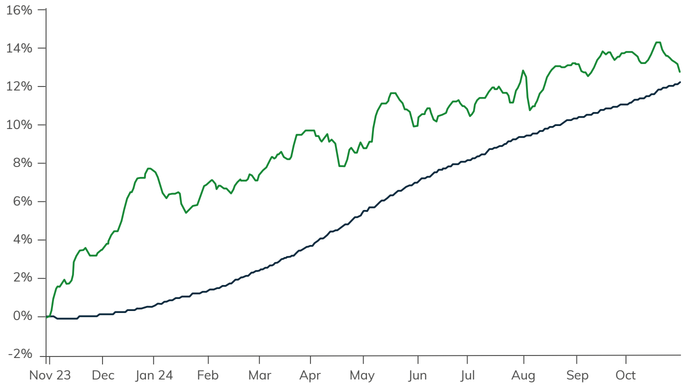
Whilst equities have dominated this year, we have also had strong return contributions across the riskier elements of our Fixed Income allocation; with High Yield Bonds and Emerging Market Debt asset classes also adding meaningful performance to portfolios.

Key LV= Smoothed Managed Balanced Pn GTR [12.58%]



31/10/2023 - 31/10/2024 Data from FE fundinfo 2024

Key ABI Mixed Investment 20-60% Shares in GTR [12.64%]
LV= Smoothed Managed Balanced Pn GTR [12.15%]



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Whilst LV=directs the strategic asset allocation of the funds, we use BlackRock to make tactical asset allocation calls. Coming into Q4, we were positioned overweight to US equities across our portfolios on the view that a continued broadening out of the AI theme, strong corporate earnings momentum, and an easing of financial conditions would be a tailwind. We were also underweight government bonds on concerns over already high fiscal deficits and the prospect of more spending from future administrations.

Following the UK budget announcement and conclusive US election results; the US equity market has strengthened further whilst US Treasuries have sold off. We have taken this opportunity to reduce some of the risk in these positions but continue to evaluate our positioning in what is a very fluid market backdrop. Geopolitical fragmentation will likely persist with tariffs, or the possibility of tariffs, adding further tensions and uncertainty.

In summary

We are particularly pleased that our portfolios continue to benefit from our investment insights, our allocations and our positioning. Whilst we've used volatility to pursue investment opportunities and strengthen our returns, we have also been able to continue to cushion our SMF investors from short-term volatility.

A smoothed return continues to be as important, and as valuable, as ever.

Adam Ruddle
Chief Investment Officer

Smoothed Managed Funds – we've reduced our charges

Our Smoothed Managed Funds are now available from an AMC of just 0.80%*, offering you quality, active management and smoothed returns at a better cost for your clients.

Explore the range www.lvadviser.com/smoothed-investments

**LV= ISA AMC is 0.95%*

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Liverpool Victoria Financial Services Limited: County Gates, Bournemouth BH1 2NF.

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