Investment Insight
Staying Active

Morningstar Investment Management EMEA

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For Financial Advisers to use with their clients

2023 turned out to be a good year for investors with positive returns on all asset classes, which eclipsed inflation. The performance of your Morningstar multi asset portfolio benefitted also from having more than usual in emerging market bonds and Japanese equities and UK corporate bonds, all of these positions being built up in prior periods of weakness. Most importantly, portfolios remained invested in equities and bonds and so benefitted from the late year rally in both.

Economic conditions have clearly weakened whilst avoiding recession and with the fall in inflation, laid the foundation for central banks to consider reducing interest rates. Bond market prices already reflect this expectation though other interest rate scenarios are also possible given inflation wildcards, including war in Ukraine and the conflict in the Middle East.

As we look at the year ahead, we believe vigilance is required to ensure investors remain attuned to shifts in market prices and fundamental drivers of asset cashflows. In recent years we have made more frequent portfolio changes than usual because market volatility has increased, creating more opportunity to enhance returns by buying undervalued assets and reducing risk by taking profits on assets that become more highly valued.

A good example is the selloff in UK bonds that accelerated during the Liz Truss premiership and reached a crescendo in 2023, when we then added exposure. The fall in Emerging Market Debt prices in 2021 similarly created a buying opportunity, gains from both these positions supporting portfolio performance in 2023. An example of using valuation to reduce risk was our sell down of government bonds in early 2020 when yields were at record lows and this reduced the impact of the fall in bond prices that happened later as interest rates rose.

Finding effective diversifying assets is also important for safeguarding portfolios returns when adverse scenarios occur. While we can't know in advance what will happen, we can plan by considering the potential impact of situations that may be highly impactful or highly likely. In the boom like conditions of 2021/22 this mean looking at defensive sectors of the stock market that could perform well if economic conditions cooled, such as consumer staples and healthcare. In 2023 this extended to high quality bonds in general as markets were pricing for higher and higher inflation and if that did not turn out to the case then returns would be good for these assets. More recently global listed infrastructure sold off along with bonds, offering a lower risk asset with higher growth than bonds and lower risk in recession than equities.

So an active approach to reviewing how fundamentals and asset prices are evolving remains key to enhancing returns and managing risk in a faster changing world.

Unless stated otherwise, all data sources are from Morningstar Direct as at 31/10/2023.

Disclosures