Goodbody

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WEALTH MATTERS

STICKING WITH THE PLAN

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What defines investment success?

Joe Prendergast, Head of Investment Strategy

An investor who entered the market at year end 2021 might have not yet seen a good return on their capital. It might be tempting to change your plan but as Head of Investment Strategy Joe Prendergast outlines below, good things come to those who stick with the plan.

What defines investment success? For a wealth manager, the most important metric must be delivery of investor objectives over time. Delivering on those objectives is far from guaranteed, but with the right asset allocation the chances of success can be maximised. Careful consideration of risk appetite and attitude can also help to keep the investor on course through difficult times.

There can still be challenges. Consider the investor who entered the market it late 2021 or early 2022, when equity markets were at the peak of a major rally in 2021 and core bond yield were at or even below zero. Although both equity and bond markets have risen in 2023 thus far, the sensibly well-diversified end-2021 investor is likely still under water.

Is sticking with the plan still the right thing to do? A look at history offers a reminder that time has a powerful effect on multi-asset portfolios. Considering a portfolio of 50% equities and 50% bonds, the chart below shows the experiences of an imaginary investor entering the market at the start of each quarter for the past twenty-five years and then staying invested for five years. There are 100 experiences in all over the shown time period, showing gross portfolio index performance, including some not-yet-complete five-year periods from most recent years.

> *Is sticking with the plan still the right thing to do? A look at history offers a reminder that time has a powerful effect on multi-asset portfolios*

The experiences are highly diverse but there are a few key themes.

First, in the early years, the returns are dominated by volatility. The past quarter century has seen some dramatic crises and phases of volatility, so there are many times investors have entered the market and shown a loss after the first full year.

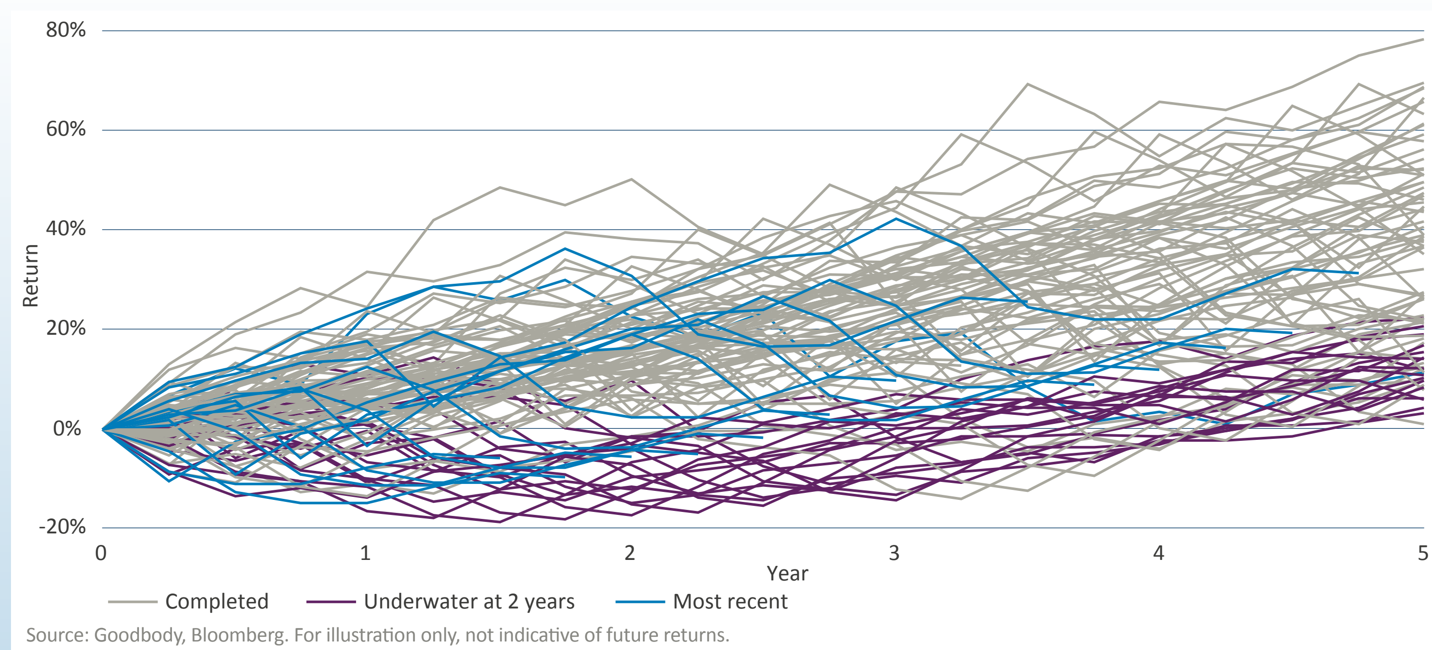
Second, despite many poor starts, in each case the index of gross portfolio performance has ended up above zero in every case.

While the past is not a reliable guide to future, we can ask if there are any grounds to expect the historical experience to be repeated?

There are two main reasons in our view to stick with the multi-asset plan. In fixed income, the losses recorded in 2022 translate into higher yields today, which will provide a significant underpinning to diversified portfolio performance going forward. While bond credit quality is high, positive total returns in line with current yields should accrue. In equities, with no recession appearing in 2023, inflation moderating, and a peak in central bank key rates coming into view, valuations are now more appealing. That may not translate into an imminent bull market, but the resilience of earnings and dividend yields is consistent with at least moderate expected returns from equity.

History, yields and valuations all argue for sticking with the plan.

Figure 1. Five-year investment outcomes since 1998 (50% FTSE All-world Index (EUR) 50% EuroAgg Index)



In focus:
The year that fought inflation

While the much-predicted recession never appeared, inflation dominated during the first half of 2023. The raising of interest rates by central banks had a few casualties in Credit Suisse and Silicon Valley Bank but authorities acted quickly to contain the failures. In the second half of the year, the US showed resilience despite challenges in China and the eurozone. We look back at the year that fought inflation.

Quarter 1

The new year started with the same problems as the old one: rising inflation and rising interest rates. In China, Covid-19 restrictions were finally removed, and the hope was that the economy would follow a similar path to that of Europe and the US in 2020/2021. The US showed strong employment numbers and the eurozone weathered a winter with high energy prices well. Overall, the figures suggested that the once feared global slowdown was unlikely to appear. In early March, the failure of Silicon Valley Bank gave the financial system a bit of a fright, but the fallout was contained quickly. The forced buyout of Credit Suisse by investment bank UBS gave investors similar pause but the actions of the Swiss government managed to prevent any earthquakes. As the quarter ended, it appeared inflation was still the main beast to be slayed, but the mood had darkened.

- January 8 – China reopens its borders
- January 26 – US economy grows 2.9% faster than expected
- February Interest Rates Hikes: US Fed to 4.75%, ECB to 3%, BoE to 4%
- March 10 – Silicon Valley Bank fails
- March 12 – Signature Bank fails
- March 19 – UBS buys Credit Suisse for CHF 3 billion
- March Interest Rate Hikes: US Fed to 5%, ECB to 3.5%, BoE to 4.25%

Quarter 2

Following the mini-banking crisis, the market started pricing in interest rate cuts in 2024, but inflation was still too high. The implemented monetary tightening was starting to have an impact, and earnings were expected to be flat against 2022. The Q1 earnings season was better than expected and there was some earnings resilience. Initial failure to reach an agreement on the US debt ceiling did not upset markets. Falling services inflation drove a lower-than-expected drop in euro area headline and core inflation. Given the emerging buzz around artificial intelligence, there was a resurgence in equity markets led by IT.

- April 28 – AI stocks see a large boost
- April 28 – Eurozone GDP expands by 0.1%
- May 30 – Diageo delists from the Irish stock exchange
- May Interest Rate Hikes: US Fed to 5.25%, ECB to 3.75%, BoE to 4.5%
- June 8 – GDP in Ireland and Germany pulls the eurozone into recession
- June 14 – Pound hits one-year high against US dollar
- June 21– UK inflation reported at 8.7% in May
- June Rate Hikes: ECB to 4%, BoE to 5%

Quarter 3

By July, the US economy proved to be more resilient than expected. Job creation remained strong, and this put a prop under consumption, but the story was less positive in the euro area and China. During the summer, the idea of a 'soft landing' for the US economy gained traction to help equity markets but high interest rates were determined to stick around. In August, manufacturing and services sectors were plateauing as post-pandemic buying faded. Chinese growth was downgraded as a property downturn gained momentum and started impacting on consumer sentiment and consumption. The forecast for the US economy was increased as the US consumer has proved stronger than expected due to scope to use pandemic-related savings to augment spending. The European Central Bank raised interest rates to a record high of 4% in September but indicated that a pause in rate hiking was on the cards.

- July 12 – FTSE 100 marks best day of 2023
- July Rate Hikes: US Fed to 5.5%, ECB to 4.25%
- August 18 – Chinese property giant Evergrande files for bankruptcy in US
- August Rate Hikes: BoE to 5.25%
- September 20 – CRH delists from the Irish Stock Exchange
- September 25 – CRH relists on the New York Stock Exchange
- September Rate Hikes: ECB to 4.5%, BoE holds at 5.25%

Quarter 4

The breakout of the Hamas-Israeli war threatened oil prices and further inflation risks, but markets have been largely unaffected as the oil price remained flat for 2023. The US economy has continued to run ahead of expectations and is showing few signs of weakness. China's economic surprise index has also moved into positive territory recently, but the property market remains challenged. Europe is having difficulty, but the economic surprise index is less bad than it was because expectations have reset. Central banks are expected to pause hiking interest rates but that could change quickly if inflation refuses to die in 2024.

- October 3 – Portugal announces the scrappage of the NHR regime. Read more
- October 7 – Oil prices jump up by 4% after terror group Hamas attacks Israel
- October 10 – Budget 2024 is announced. Read more
- October 19 – Finance (No. 2) Bill 2023 is published. Read more
- October 27 – S&P 500 enters correction territory
- November 7 – Portuguese PM resigns, creating doubt around NHR scrappage
- November 9 – Flutter confirms it will delist from Irish Stock Exchange in 2024

2023 MARKETS DEEP DIVE

Chief Investment Officer, Bernard Swords

2023 was forecast to be a tough year, with nearly all analysts expecting a global slowdown which thankfully did not materialise anywhere. Chief Investment Officer Bernard Swords takes a deep dive into 2023's markets.

For equity markets, avoidance of recession in 2023 in the developed world was the major positive. For bond markets, increased confidence that we have reached the peak in interest rates, at least in the developed world, was a boost, although the returns were held back by the realisation that interest rates are likely to stay 'higher for longer'.

Global growth is now expected to be 2.8% for the year, not much below trend. There were no recessions anywhere and every region delivered higher growth than forecast. In the US, the consumer was much stronger than expected and fiscal policy gave a bigger boost than forecast. In the euro area, it was the avoidance of problems and an energy-related crunch, rather than a positive influence that ended up delivering the better outcome. In China, it was the removal of pandemic restrictions that delivered the boost but, by its nature, that would always be short-term.

> *Every region delivered higher growth than forecast at the start of the year and global growth is now expected to be 2.8% for the year.*

Inflation vs. interest rates

In the early part of the year, inflation was proving 'stickier' than people expected and, as a result, both the European Central Bank (ECB) and the Federal Reserve (Fed) were in tightening mode. However, from H2, there has been a notable step down in core and headline inflation in both regions. As a result, both central banks have indicated a pause and there is a good chance that they have reached the end of the rate hiking journey.

This is a major positive for bond markets as it removes a major uncertainty that has been afflicting them for the last couple of years, but both the ECB and the Fed have been clear that they will have to keep policy restrictive. In the first half of the year, bond markets were pricing in interest rate cuts beginning the middle of 2024. As the economic data showed greater resilience in the global economy during H2, the bond markets began to believe what central banks were saying and started pricing in 'higher rates for longer'. This limited the returns from longer dated bonds.

Total return vs. equal weighting

The MSCI World Total Return Index is up over 11% in euro terms, but if we look at the equal weighted index (where all companies have an equal weighting) the return drops to 3.4%. This can be viewed as a positive. Any euphoria in equity markets is confined to a small part of them which is a good starting point. Where the stronger data did influence equity markets was the pushing of defensive sectors to the bottom of the performance table.

> *The MSCI World Total Return Index is up over 11% in euro terms, but if we look at the equal weighted index, the returns drops to 3.4%.*

Fear and hope

There was some 'breakage' in the financial system during the first quarter with the insolvencies of some regional banks in the US. However, the impact was short-lived as the Fed moved quickly to provide sufficient liquidity and avoided any contagion, ensuring confidence that central banks are alert to the smooth functioning of the financial system.

Investors are having a better year in 2023, even with the challenges around interest rates. Here's to an even better 2024!

Q&A with Head of Fixed Income Strategy, Elizabeth Geoghegan

Elizabeth Geoghegan tells us more about her role and gives us an idea of what to expect from the bonds market in 2024.

Tell us about your position at Goodbody and how long have you been working here?

I re-joined Goodbody in February of this year, having worked here previously up to 2019. I am now the Head of Fixed Income Strategy in our Wealth Management division and contribute to our overall investment offering which is ultimately aimed at meeting clients' financial objectives. I am also on the Goodbody Asset Allocation committee, and I provide investment insights within the fixed income universe, helping to select optimal assets for portfolios.

Have you noticed any client trends in 2023?

There has been an increasing demand from retail clients for low-risk fixed income investments, particularly shorter duration (maturity) government bonds. Goodbody has been working to create a lot of solutions in this area.

What do you think 2023 will be remembered for?

It will be remembered as the year that Fixed Income made a comeback. Yields still rose throughout the year, but it was still possible to make positive returns if investing correctly, unlike 2022 where the rate hikes were so dramatic that there was almost no place to hide.

What can we expect from the bonds market in 2024?

It is very hard to say with certainty what will happen in 2024, especially with the number of geopolitical considerations today. One theme that we are very comfortable with however is that of 'higher for longer'. What we mean by this is that even if rates do fall, we don't expect that they will fall back anywhere near the significant negative levels that we had pre-pandemic.

How do you think the financial services industry has changed? In what ways do you think it needs to change in the future?

The push to sustainability has changed a lot of things, and we've seen big investment in green bonds. I think that there is still a lot more to do in terms of impact but also industry education; we are moving in the right direction.

What is your favourite part of your job?

Collaboration and working with others! When you are working towards constructing the best solution for client objectives, there is always a certain level of cooperation involved.

What are your favourite resources that you use for your job?

Financial Times Daily podcast. It is a short review of everything you need to know for the day ahead in markets. Very accessible, not that long and it is easy to listen to.

What are you currently watching?

The Diplomat on Netflix with Keri Russell and Rufus Sewell. I am excited for season two, delighted that the actor's strike has been resolved!

Best podcast?

Unlocking Us, with Brené Brown, available on Spotify. A series of interviews with extremely interesting and diverse individuals.

A book you really enjoyed...

I read the most when on holiday and this year I could not put down 'The Seven Husbands of Evelyn Hugo' by Taylor Jenkins Reid.

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