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Multi-Asset

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2024: A year for optimism with an eye on headwinds

John Husselbee
Head of Multi-Asset

James Klempster
Deputy Head of Multi-Asset

Our overall view on markets remains positive. While we acknowledge there are short-term challenges posed by sentiment and the potential for an economic slow down, we feel, on balance, that this widely held view is priced into markets, with equity valuations outside of the US sitting at historically attractive levels and bond yields at the highest they have been since the GFC (Global Financial Crisis). As a result, it would be best to refer to our stance as optimistic but cognisant of the potential for short-term headwinds.

More volatility may well lie ahead, but markets have calmed down from the high levels of distress seen in recent years. Sentiment remains fickle, however, and news flow – especially relating to more or less inflationary pressures and the knock-on impact in terms of higher or lower prevailing interest rates - can have a significant influence on investment markets.

The catalysts, as ever, will be unknown until after the event. It might be inflation coming under control or weakness in the economy causing central banks to cut rates, creating a reverse situation to that seen in 2022. While we would normally say bonds are inversely correlated to equities, you could argue that they would respond positively to an interest rate cut. It is important to be positioned for that.

We favour the UK, Japan, Asia and emerging market equities and we are buying what we deem to be attractive equities in various markets around the globe, not just in the fashionable US. In our view, equities do not depend on their domestic economy and could deliver a good outcome even against a backdrop of insipid growth.

The UK is unloved, but that can also mean undervalued. It is easy to see that the FTSE All Share index represents good value that compensates for the political uncertainties and gloomy forecasts for the domestic economy that has weighed heavily on sentiment. UK small caps have been particularly hard hit over the last year and we believe they are likely to have greater potential for future growth than the FTSE 100 index.

UK smaller companies have suffered, like their US counterparts, amid recent sell-offs. But longer term, we continue to believe in the small cap premium, and the short-term re-ratings, could give us an opportunity. Valuations for UK small caps are at multi-decade discounts to international peers.

In the fourth quarter of 2023, we raised our outlook on Japanese equities and small caps from neutral to positive. Japan's stock market has waited more than three decades for its moment in the sun. The combination of genuine structural reforms in the corporate sector combined with the resumption of inflationary forces for the first time in decades are likely to reflect a period of economic reflation in Japan and consumption that we anticipate will benefit the beleaguered stock market.

Asia offers a relatively strong economic growth outlook, benign inflation and potential policy easing. This should translate into generally stronger corporate balance sheets. In a manner akin to the UK, Asia ex-Japan markets have been experiencing a headwind to returns from investor sentiment which has led to a paucity of flows into the market.

Emerging markets' poor performance over the last two to three years has a lot to do with problems in China. But now there is a more pro-growth, stimulus-oriented stance in China, emerging markets could benefit from the relative appreciation of their currencies versus a weakening dollar, and they are set to be boosted by international strategic supply chains being re-ordered.

We are broadly neutral on fixed income, but we are most positive on investment grade corporate bonds. We believe the spreads they offer over government bonds, which themselves have seen yields reach multi-year highs this year, mean that quality businesses could be trading at good value.

Investors' confidence will return. The period between the GFC and the 'end' of Covid was characterised by very low prevailing interest rates enabled by low inflation. This unusual set of circumstances created very singular winners in terms of markets, such as the US versus the world ex-US. Likewise, value and growth styles of equity investing have had a historically mixed relationship but for many years growth had significantly outperformed value until 2022.

We believe these sorts of performance differentials are a consequence of the uniqueness of the inflation and interest rate environment, and that these conditions are unlikely to be replicated in an environment with more elevated inflation and, consequently, interest rates.

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https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested.

The Funds and Model Portfolios managed by the Multi-Asset Team may be exposed to the following risks:

Credit Risk: There is a risk that an investment will fail to make required payments and this may reduce the income paid to the fund, or its capital value. The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay;

Counterparty Risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss;

Liquidity Risk: If underlying funds suspend or defer the payment of redemption proceeds, the Fund's ability to meet redemption requests may also be affected;

Interest Rate Risk: Fluctuations in interest rates may affect the value of the Fund and your investment. Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;

Derivatives Risk: Some of the underlying funds may invest in derivatives, which can, in some circumstances, create wider fluctuations in their prices over time;

Emerging Markets: The Fund may invest in less economically developed markets (emerging markets) which can involve greater risks than well developed economies;

Currency Risk: The Fund invests in overseas markets and the value of the Fund may fall or rise as a result of changes in exchange rates.

Index Tracking Risk: The performance of any passive funds used may not exactly track that of their Indices.

Any performance shown in respect of the Model Portfolios are periodically restructured and/or rebalanced. Actual returns may vary from the model returns.

The risks detailed above are reflective of the full range of Funds managed by the Multi-Asset Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

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