

TRANSCRIPT: EPISODE 296

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[INTRODUCTION]

**Staci West (SW):** Hello and welcome to the Investing on the go podcast, brought to you by FundCalibre. I'm Staci West and today I'm joined by Darius McDermott and Juliet Schooling Latter for our quarterly market update. We'll be looking back over Q4 of 2023 but also looking forward to what 2024 may have in store for investors. Darius, Juliet, thanks for joining me.

**Darius McDermott (DM):** Delighted to be here, Staci, Happy New Year to you.

**Juliet Schooling-Latter (JSL):** Yes, Happy New Year!

**SW:** Happy New Year.

[INTERVIEW]

**SW:** Well, speaking of New Year's, let's start by just reflecting on last year. So, for both of you, what were some key moments from 2023 and what did that tell you as an investor?

**JSL:** I suppose reflecting on 2023 from an investment point of view was the relentless interest rate hikes across developed markets. And the UK went from three and a half percent a year ago and ended the year at five and a quarter, which is the highest it's been since 2008. And the surprise was how resilient markets and economies were in light of these rises, I think, with the recessions that were flagged for so long, and never actually materialising. Labour markets also remained remarkably tight. Although there are signs and this is starting to ease now.

Slightly closer to home: the collapse of SVB, which was swiftly followed by the collapse of Credit Suisse, was particularly memorable for me. It was such a large and established institution and my husband worked for them.

**DM:** Yeah, I think the dominating investment theme was inflation and rates, a continual hike up to the summer. I think central banks were desperately waiting for inflation to stop going up and potentially come down so that they could stop raising rates. And that is indeed what happened.

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The other major event for me was the next phase of AI and I'm sure most people have heard of ChatGPT now there are other versions, but that's the sort of most common one. And what that led to was a substantial re-rating to what is now known as the Magnificent Seven stocks, which are basically US large tech stocks, which have some link to the AI theme. They were already motoring actually in the early part of the year, but post the sort of AI announcement and Nvidia being the poster child was up over 200% in 2023. It makes chips, if not the leading chip maker in the world and it will be a direct beneficiary of the extra computing power that AI demands.

I absolutely agree with Jules. The recession, we've been talking about recession for two years nearly, and it's never quite got there on a technical description of recession. That said, if you talk to managers who run UK small cap funds, they've been beaten up heavily over two years. So really for me, the investment story on equities 2023 was these Magnificent Seven driving a) the US market and b) the global market being the main beneficiaries. And when rates stopped going up - even though they haven't yet come down - you saw positive performance from bonds, fixed income, on all fixed income assets, which again, we were predicting slightly earlier this time last year. So broadly positive for equities, even if the leadership was quite narrow.

Second half was positive for fixed income. So yeah, those are the main investment themes, but we've been talking about rates of inflation for a couple of years and who knows ... we had one of our investment meetings this morning and we talked about it again. So, I think rate cuts, which are now expected sometime in 2024, will be the next headline number or headline figure. And that might be a good boost to both bonds and equities.

**SW:** I suspect it'll be something we continue to talk about on these quarterly podcasts well into 2024, so that's not going anywhere anytime soon. But you mentioned the Magnificent Seven and it's probably no surprise that the best performing sector of the year was technology. However, it was followed by Latin America, India and Europe were all top of the table with technology. Did any of those areas surprise you?

**JSL:** Well, India's continued outperformance was quite a welcome surprise because it was sort of flagged as quite an expensive market. But perhaps when you look under the bonnet, it was a little bit less surprising. Last year, India actually surpassed China as the world's most populous country. And if you look back, way back, to sort of 1990, India's GDP was actually greater than China's, but over the past 30 years or so, China has grown much faster and it's GDP is now five times that of India. So the question is, are we going to see this trend reverse?

**DM:** Yeah, I mean the Indian market always trades at a premium to emerging markets broadly, certainly trades at a premium to China and for greater because of 2023. That's because they have more established companies who make better returns. Maybe just touching back into technology, it's not that long ago, but actually technology and not just the Magnificent Seven, but the whole sector had a very bad 2022: stocks got overvalued, and generally technology is deemed, or these massively cash generative companies, are deemed to be long duration assets. By that I mean you can see the

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cashflow well into the future and long duration assets do behave a little like bonds. So, in 2022, when the rate rising cycle started and accelerated, technology sold off really quite heavily and actually looked a good investment opportunity. I'm not going to sit here a year later and say I expected the majority of tech funds to go up 50% because I didn't. But then the AI thing happened in Q1 / Q2 of 2023 and that really accelerated the Magnificent Seven stocks.

Jules has touched on India.

Latin America is just a very, very niche marketplace dominated by Brazil actually in 2022-23. We've seen a shrinking of the number of funds available in Latin America. There are barely a handful of Latin America funds left because they got too small. It's a tricky area to invest in. Sometimes markets just get cheap. I don't know individually if Brazil was cheap, but we had some political stuff in Argentina in the latter end of 2023. And actually Argentina was one of the best performing countries on a global basis last year, as it was seen to be a bit more business friendly and a little bit left wing - or a lot left wing. So, I've well and truly given up trying to make predictions on Latin America. Broadly, it's commodity producers, so if commodities do well, Latin America tends to follow.

I think India's a really interesting region for us to keep an eye on. And yes, who knows what will happen with AI and those sort of Magnificent Seven stocks this year. What I can say is they're not nearly as cheap as they started 2023. But in the case of India, just because something gets expensive doesn't mean it doesn't get more expensive. So yes, we still like technology, but it was definitely by far and away the best performing sector.

**SW:** Well, it's just technology and artificial intelligence, which you mentioned, I mean, as you said, it drove so much of the performance last year, specifically artificial intelligence. But do you see this continuing in 2024 or do you think investors have missed the boat if they're not already in it?

**JSL:** Well, I mean, as Darius just said, I think, certainly there's a bubble of excitement around AI, but these bubbles can get quite a lot bigger before they burst. So, I wouldn't like to say on that really. And I believe in technology for the long term, so I think it's as well to remain invested throughout really.

**DM:** Yes, and I don't think Jules and I are necessarily AI experts. We have a colleague James and if he was on the podcast, I suspect you'd be listening well into 2025 on the subject, because he is extremely knowledgeable and very passionate. But to condense it down, I think it's about increases in productivity where AI can help companies, individual companies, to make more sales, make more margin, make more profits. And it's not just technology companies. Somebody spoke last year about McDonald's; globally, they have more than 50 million people use the McDonald's app and what do they get from that? Lots and lots and lots and lots of data. So, you know, if you are thinking about ordering a Big Mac, they probably know before you do and hence they will push via their app promotions or reminders. So I know it's a sort of a slightly humorous way to talk about AI, but this

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is not just about tech companies, it's about retail and the future of lots of different things which are slightly above my pay grade! But we try and read as much as we can, but for me, I think it's about productivity. There are lots of conspiracy theories both on the positive and negative side on AI; I'd rather try to avoid those and just look at the potential investment opportunities.

**SW:** Well, I'll be impressed with AI when it can do this podcast for us, then we've made it. [**JSL:** Me too!] Okay, well you've already alluded a bit to China, so let's just touch on that. China was well into the other side of the table as one of the worst performing sectors of the year. So, what's the story with China? Should investors be worried or do you just now see it as a good entry point?

**DM:** I mean, from a valuation point of view, I would always say something that's really cheap is a good entry point. Where I think the debate has moved on - and I'm not saying this is my view - but the view of many is whether China is investable at all. Their politicians, particularly President Xi, is gaining more of a stronghold on the communist party there. Very recently he has talked about reunifying China and Taiwan. That would be probably a bigger geopolitical issue than Russia/Ukraine. And as a colleague said to me this morning, he said, why take that risk? So yes, there could be short bursts of period where China performs really, really well, but there is now a noticeably increased political and geopolitical risk with investing in that region so it's definitely something to be careful of. I certainly wouldn't be putting a huge amount of capital to work in China at the moment, even though I do accept it is optically cheap.

And when I talked to Chinese managers in the second half of last year, they were saying that the Chinese market as a whole was a bit cheap, but the really good companies that they owned were really, really cheap because of sentiment dragging the market down. But I think you have to maybe take a bit of a top down view on China as an investable opportunity before looking for funds or investment trust that may give you those good returns if it's not as bad as people think.

**JSL:** Yeah, I mean I think you could, as Darius says, it is very cheap. But I am quite concerned about the political and economic risks there. So, you know, whilst you might make quite a bit of money in the short term, I prefer personally to invest for the longer term, and I think there's quite a lot of risk there.

**SW:** Well, as our first podcast of 2024, it would be remiss of us not to actually look forward to the new year. So, what is your outlook for 2024? Do you think that the current state of affairs will continue or other asset classes might do better this year?

**JSL:** Well, I think, we've actually had been having this discussion this morning actually about sort of global growth this year. I suspect it's going to be rather lacklustre as the effects of these interest rate hikes weigh on developed economies. There's been a decline in job vacancies, so that's likely to lead to income growth slowing. And as more people have to remortgage at higher rates, spending is going to be curtailed.

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There is, on the plus side in Europe, we still do have some sort of covid piggy bank saving, but the fact that that remains shows that actually people are a little bit nervous about the economy. So as inflation pressures ease, as we've said, we're likely to see interest rate cuts starting to come through. When we'll see them is going to depend upon economic data that comes through. So possibly Q1, but more likely later in the year, I think. And as soon as there's a sniff of an interest rate cut, you know, then bonds should do particularly well. But the question mark is still over whether there's recession and markets will just be looking at economic data.

**DM:** Yeah, I mean this annual prediction is the opportunity to make me look silly. Some would say I do a very good job of that all year round, we don't have to wait just for this particular predictions type of podcast, but I'm going to stay well away from equities and just keep it simple.

Fixed income, investment grade bonds, actually are now paying a decent yield regardless whether rates go down or stay flat. The one thing we know is not good for bonds is rates going up. For that to happen, you would need to see inflation really start to steepen again. And I hold a fairly low probability that rates will go up in developed markets, much higher probability they will go down, hence I'm getting a good starting yield from bonds. And then there is the potential for some capital gain if rates do indeed fall. But if they don't, at least I'm going to get paid certainly north of five - and sometimes six and seven with good active managers - percent of yield, which obviously we can take as yield in our pockets or reinvest for total return. So, that would be my most obvious prediction for the year based on future rate environment.

**SW:** And one thing that I have seen a lot about is 2024, "the year of the election". Now, 2024 is going to have elections all over the world and it's going to impact over 4 billion people over the course of the year. So, we have talked previously on this podcast about the US election and how that can influence the stock market as investors consider, you know, what the election will mean for economic policies, for example, but how much do elections really impact the stock market? I mean, are we in for a turbulent year? We have over 70 elections in the next year. Should investors be keeping an eye on the headlines for various politics?

**DM:** Yeah, I mean, Ronald Reagan said, it's the economy stupid. So, if people feel better, they're more likely to vote for the incumbent president / prime minister, or whatever he or she may be called in those multiple countries. That said, most central banks are independent of the politicians and should do what's right for the economy. So, if we think, as the market is predicting, we might get some rate cuts later in the year, that could be stimulus to both equities and bonds unless there is a horrible recession, in which case, you know, rates will be cut much quicker to try and re-stimulate the economy. But you're not going to feel good in recession because most households will be suffering and stock markets tend to do badly ahead of recession, but also during recession.

So, do I think the elections are...? I think they're interesting. I think the policies that come out of the next electorate or elected politicians are interesting and may have an investment impact going forward. It's a bit too early to call that as we begin 2024. We don't know when the UK election -

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obviously where we live - will be, it will be no later than January 2025. I suspect as soon as the current Prime Minister thinks he's got a small chance of winning will be as soon as he will call the election. But I guess we'll also be in Q4 of this year. So, it's important, yes it is, because it shapes future policy, but unless politicians can make stock markets go up, then I think it's possibly less impactful on stock markets.

**JSL:** Yeah, I think elections can have an impact. It's generally temporary and can give a bit more volatility but you can just use the dips as buying opportunities, if you are buying. There's talk of it being a UK election in November possibly, and obviously everybody's heard about the talk that Labour may well win that, but the Labour party is considerably more business friendly under [Keir] Starmer than his predecessor. And the word is that companies are quite comfortable with the prospect of a Labour government.

**DM:** So, I think they'd better prepare for one. [**JSL:** Yes, well yes] If you look at the odds, there's pretty much very little doubt who's going to win the UK election.

**JSL:** Well, that's true, but polls are notoriously bad at predicting things, aren't they? So you know...

**SW:** Is that Darius' annual [prediction]?! Moving on then: if you had today 10,000 pounds, where would you invest it? How would you invest that money as we sit today?

**DM:** Well, I'm going to steam in quickly because I suspect we're both going to offer the same answer. And I think one does depend on the timeframe, but on a 5+ year view I would buy UK smaller companies. I would put the contract note in the draw and I would not look at it for that five year period and I would be highly confident we would have made some good money.

On a one year view, I think I go back to my fixed income, not saying equities may massively outperform, but I suspect we can get between 7% and 10% in fixed income this year, not a bad return.

**SW:** What about someone who's thinking about maybe opening a Junior ISA for example, and dripping let's say £100-£200 a month, so very long term, you know, 15, 18+ years time horizon. Would you be looking at something different for them or are you still backing UK small caps?

**JSL:** Well, I mean, I still like UK small caps. Darius was right, that's what I was going to say too. Yes, but hopefully nobody can remember last year when I also said UK small caps because I've been saying it for a while.

**DM:** Yes, it's been a couple of consecutive years now where large cap globally has outperformed small cap, not in every single region, but certainly in the UK, certainly in the States. And I wonder when that market opportunity ... certainly a lot of not so much commentators or people who do financial predictors, but analysts were really talking in Q4 about quite how cheap UK smaller

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companies are. I suspect we might see a bit more M&A in that area and maybe get some stimulus, but I mean normally I think Jules and I would also say Asia and emerging markets for maybe the second half of our regular savings, but there is that whole China issue overhanging. So yeah, I think UK smaller companies, even global smaller companies, might be an area to just drip feed in something like a Junior ISA to potentially make some decent long-term returns given you are talking proper long term 10-20 years.

**JSL:** Yes, I think that's the thing about Junior ISAs, you can afford to be more aggressive because it is a longer time period. So yes, you know, as Darius says, smaller companies almost anywhere, generally over the long term they do better and generally the more aggressive the investment, the the better it does.

**SW:** And then finally, as we sit early January, as I said, first podcast of the year, so it's certainly a popular time for New Year's resolutions. Do either of you have any financial resolutions for listeners to consider adding to their agenda?

**JSL:** Well, mine personally is to sort my pension out and to add a bit more to it so that I can do a bit more travelling in retirement hopefully. But yes, if we're talking about other investors, I'd also urge them if they have children to look at Junior ISAs as well because just drip feeding any small amount you can into a Junior ISA can help to pay for university fees or deposits on houses, so that hopefully your children aren't tapping you for those.

**DM:** Yeah, I think my new year's resolution is to not make any further financial projections and financial guessing. So to get down to the nitty gritty, it's just to invest for the long term.

I suspect with this cloud of recession, which has been over the markets for two and a half years, hasn't actually stopped markets going up. It has been mostly driven by rates and inflation and making these predictions is actually really, really difficult. Hence my slightly flippant opening to this question. It's don't try and do it; it's just invest for the long term by all means. Timing markets is impossible, so whether it's your Junior ISA or your ISA or your general savings account, try and save consistently for the long term and just review your investments, probably annually/half annually, just to make sure that something hasn't changed, whether it's your view on rates or a fund manager has moved as often is the case.

So yeah, stop making predictions, stay invested for the long term. Try not to be too clever.

**SW:** Perfect. Well thank you both, one podcast down, 60 to go this year.

**DM:** Good luck Staci

**JSL:** Thank you.

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