Pavis Premier Model Portfolios

January Quarterly Rebalance

At the end of each quarter, a rebalance takes place to bring all our Premier Model Portfolios back in line with the desired allocations. This is to ensure that the portfolios are always positioned to deliver the level of risk and return that investors expect and will result in reducing the holdings where prices have performed most strongly and buying those which have become more attractively priced.

As you are invested in the Premier Models, your portfolio will be rebalanced on 31st January 2023 and you will receive contract notes reflecting the sales and purchases that result.

Equity Weightings

We reduce our weighting to equity markets that appear expensive. We use a rules-based approach to measure markets based on the ratio of price to average earnings. This is known as the 'Cyclically Adjusted Price Earnings' (CAPE) ratio.

Below is a summary of the resulting positions for the next quarter:

Region	*Move this Quarter*	*Current Position*
UK	No Change	In line with long-term weighting
North America	No Change	20% below long-term weighting
Europe excl. UK	No Change	10% below long-term weighting
Japan	No Change	10% below long-term weighting
Developed Pacific (ex. Japan)	No Change	In line with long-term weighting
Emerging Markets	No Change	In line with long-term weighting
Developed World (i.e. Global)	No Change	10% below long-term weighting

The CAPE ratio is a comparison of a stock or index price to its total earnings, which is used to tell whether it's over or undervalued. It's an extension of the traditional price-to-earnings ratio (P/E) that monitors a ten-year period to account for variations in profitability due to economic cycles. Therefore the recent market volatility has not led to sufficient changes in the ten-year ratio to warrant adjustments to the current long-term weightings as shown above.

pavis
Chartered Financial Planners

Investment Commentary January 2023

Economics & Markets

Before taking a look at what happened during 2022, we would first like to refer you to our comments in the January 2022 update:

"We believe that 2022 will be dominated by interest rates and inflation. Companies are likely to report strong profit figures, but markets will be looking to the future. Global corporate debt is in the region of £55tn so an increase in borrowing cost of just 0.5%pa increases debt servicing costs by a huge £275bn per annum. This directly impacts company profitability."

For all the reasons that we hear about on the day-to-day news, 2022 was very poor for global investment markets. The cost of living crisis, war in Ukraine, interest rate rises, inflation etc have all taken their toll. Virtually every asset class has seen a fall in value over the last 12 months. It is times such as these that we need to stick to our knitting and do the basics. This means taking advantage of lower values to ensure that we have the correct weighting to assets for when recovery comes and not being overly exposed to markets which are, based on sound historical evidence, very expensive.

During 2022 a global equity portfolio has typically lost in the region of 9% but this hides the true asset performance as it includes the currency gain from the £GBP devaluing against most major currencies. If it weren't for this, a typical global equity portfolio would have been down more like 20%. We have also seen very significant falls in the bond markets both UK and globally. The price of investment grade bonds fell approximately 28% since the 1st of January to the end of September. Since then, we have seen a recovery of about 10%.

On a brighter note, some of the best performance has actually been from UK equities with the FTSE 100 index little changed during the year but delivering a dividend yield of close to 4%. The good performance of UK shares is mainly attributable to their low valuations compared to overseas companies and overweight exposure to mining, oil and commodities. Further, with about 90% of FTSE 100 turnover coming from overseas operations these profits when converted to a weak £pound buy more and thus boost the profitability. Companies that have benefited in this marketplace tend to be higher dividend paying companies and this is reflected in our performance generally. Our Cautious, Balanced and Moderate Growth Income portfolios with their higher dividend yields have all outperformed their benchmarks. Despite a tumultuous year, Moderate Growth Income, Balanced Income and Cautious Income recorded losses of 2.69%, 3.88% and 5.65% respectively.

We have been doing some research to see if our investment management methodology adds value and can it be improved. To get a like for like comparison we take the data from an independent research firm called ARC. They collate data from lots of companies in the investment management sector and use this to compile indices. Rather than exploring every possible portfolio we have looked at how we have performed each calendar year for the last 7 years. Because we have 2 versions of a Balanced Portfolio we have assumed clients have 50% in each and then compare this to ARC Balanced. The results are staggering. Compared to our peers we have outperformed in 6 of the last 7 years:

	2016	2017	2018	2019	2020	2021	2022
ARC Balanced	8.64%	6.69%	-5.10%	11.73%	4.31%	7.64%	-8.75%
Pavis Balanced	14.00%	7.44%	-4.21%	13.12%	1.06%	8.30%	-6.97%

*Source: FE Analytics Jan 2023

What we do know is that 2022 is now history and we need to be focused on where returns will come from in the future. We cannot emphasise how much of a game changer 2022 has been. At the start of the year the yields on investment grade bonds were in the region of 2% per annum. They have finished the year at 5.65% per annum. With the FTSE 100 index predicted to produce dividends in the region of £88 billion in 2023 this should mean the adjusted yield on a typical balanced portfolio should be in the region of 5% per annum over the next few years.

Adjusted yield is the sum of dividends on shares plus the yield to maturity on bonds. It is a good indicator of the cash flows which a portfolio should generate over the next few years. The reason we use an adjusted yield is because of the mechanics in the bond market. You could have a bond priced at £100 paying interest of £6 pa which is due for redemption in 12 months' time. At maturity the investor gets back their £100. This gives a yield to maturity of 6% which is all delivered by interest payments. Alternatively, you could have a bond priced at £95.25 which pays £1 pa interest and also matures for £100 in 12 months. The increase in capital value from £95.25 to £100 plus the £1 interest also equates to 6% pa. These bond yields are now at their highest levels since the start of the banking crisis in 2008 and means we can now secure bank deposit rates of over 4% pa. For investors that hold their nerve there is plenty of reason to be optimistic about future returns.

Outlook

In the current environment it is difficult to predict anything other than much of the same. The situation in Ukraine along with inflation and interest rates are going to determine market direction. The fact is we don't know what's going to happen tomorrow let alone the rest of 2023. What we can tell you with a good degree of certainty is that higher interest rates and equity dividends will underpin your performance.

As part of our financial planning process, we like to base the growth assumptions on the cash flows being generated by the portfolio rather than short term changes in capital values. We shall therefore stick to our tried and tested system of allocating assets on a global basis, keeping the charges as low as possible and reducing exposure to markets which are particularly expensive.

Kind regards,

The Pavis Investment Committee