**PORTFOLIO PERFORMANCE REVIEW**

Everyone has received the rebalance packs and will see the performance for the year-to-date 2023 is flat.

This comes on the back of last year's negative returns.

Our job is to invest your money to make it grow and recently that has not happened.

WHY NOT?

This report will review:

How we construct the portfolios and why.

What has caused the underperformance in 2022?

What could we have done differently?

Where are we now in markets?

What can be predicted going forward?

OUR INVESTMENT STRATEGY

Many investment portfolios used by the investment industry are effectively trackers of a whole market in all but name and are often more expensive. The weightings to countries and sectors are carefully constructed to vary little from the overall index.

Why?

The aim is to avoid underperforming to the benchmark, rather than trying to outperform it.

Underperformance gets you fired! People hate losses.

And

Clients can't miss what they didn't have due to lower growth. It's very much a real loss but an invisible one.

From outset we said we would seek to achieve the best returns we could by leaning into the areas that fairly obviously are where investment return outperformance will originate. We would do this by researching and finding investments that consistently added value above the index return.

We made the success or failure of this easy to measure by creating a benchmark for each portfolio with the same allocation to markets as the LWM portfolios but in the tracker funds referenced above.

COMPARING PERFORMANCE

Comparing the performance of Balanced portfolios provided by:

A LWM
B Jupiter

C Brooks MacDonald
D Quilter
E 7IM

All are highly regarded and used extensively to provide clients with discretionary portfolio management either directly or via IFA’s.

The two graphs show the performances since Jan 2009 (when LWM started) of each manager. The first graph stops at the end of 2021 and the second is up-to today’s date.

01/01/2009 - 31/12/2021 Data from FE fundinfo2023

The cost of each portfolio on an annual basis is

LWM 0.84% pa
BM.  1.12% pa
Quilters 1.73% pa
Jupiter. 1.44% pa
7IM.  1.86% pa

Pricing Spread: Bid-Bid • Data Frequency: Daily • Currency: Pounds Sterling

01/01/2009 - 28/04/2023 Data from FE fundinfo2023

The performance up to the end of 2021 was as we believed would be the case. The general movement of each of the portfolios being similar but the compounding growth rate of the LWM portfolio consistently higher. Primarily because the investments within the portfolio were weighted to areas of improved earnings growth so increased asset price performance.

2022

The performance in 2022 of the LWM portfolio was however significantly poorer and this needs to be understood and explained.

We are conscious that any explanation here is going to be overly simplistic but the key elements in essence being:

*2022 was a historically bad year for most markets and types of investments (with a few exceptions)

*The investments punished the most being the more growth orientated areas. Why?
Because in periods of high anxiety in markets, investors retreat into what they consider safer places. They want the certainty and comfort of the time tested and familiar.

*The severity of the fear in markets in 2022 as measured by comparison to previous years was the highest ever recorded.

*We experienced a similar but shorter example of this at the end of 2018.

PREVIOUS PORTFOLIO EXAMPLE

A similar but far less severe bout of market anxiety occurred in 2018 with an aggressive late year market dip focusing on growth/technology stocks, which caused the Balanced portfolio to be down by 7% for the year,

underperforming the benchmark by 1%.

The Balanced portfolio bounced back in 2019 to record a +18.8% return beating the benchmark by 4%.

PERFORMANCE COMPARISONS – AGAINST BENCHMARKS

If we look at the cumulative performance of the Balanced and Adventurous portfolios since creation and over the 5-year period prior to 2022 (2017-21 inclusive) these figures are:

SINCE INCEPTION 01/01/09

BALANCED + 294.89%: Benchmark. +157.25%

ADVENTUROUS + 342.28%: Benchmark: + 195.39%

5 YEAR PERFORMANCE 1.1.2017-1.1.2021

BALANCED + 62.34%: Benchmark + 41.45%

ADVENTUROUS +74.15%: Benchmark +53.96%

The portfolios both outperformed the benchmark from inception and over the 5 years to 2022.

This outperformance over a longer time scale makes a surprisingly large difference. Over 20 years for example, if the portfolio is 2.5% pa above benchmark:

£250000 grows at 6% per annum over 20 years: VALUE £801,784

£250000 grows at 8.5% per annum over 20 years: VALUE £1,278,011

ADDITIONAL RETURN £426,227

WHAT HAPPENS IN PERIODS OF HIGH MARKET FEAR

What is favoured in periods of market anxiety is lower growth but stable assets such as utilities, healthcare and consumer staples such as a PepsiCo or Unilever.

As an example, currently the average cost of a company stock is around 17 times their annual earnings, this is their Price to Earnings Ratio (P/E).

PepsiCo is currently 40 times earnings. It is growing at around 6% per annum.

Google by comparison is 24 times earnings currently growing at around 20% per annum.

PepsiCo shares were UP around 7% in 2022

Google shares were DOWN 32% in 2022

Given Google's profit prospects against that of PepsiCo, this plainly makes no long-term sense and will correct, but only once anxiety levels reduce. The key to this and the reason why we can be confident is that we know at some point they will.

WHY DOES IT MAKES SENSE TO INVEST IN GROWTH?

Rather than talking about an unknowable future let's go "Back To The Future" and think of how our year 2000 self would think about investing for the next 25 years (to 2025) to produce above market returns.

TOP 5 LARGEST US COMPANIES IN 2000

1 General Motors (cars)
2 Wal Mart (supermarket)
3 Exxon (oil)
4 Ford (cars)
5 GE (industrial manufacture)

Our year 2000 self is reviewing options and expert commentary. Some are saying the internet will be transformational. Many are saying it doesn't impress, it's clunky and limited. What's it going to be used for?

We decide prudently to put most of our funds in solid time-tested stocks like the top 5 above, all previously consistent performers. We allocate a small amount into Apple and Amazon.

A year later: This looks a horrendous mistake

Amazon is down 76%
Apple is down 71%

Both then have a market capitalisation of around $3 Billion.

As of 2023 the largest 5 companies in the world are

1 Apple $2.7 Trillion
2 Microsoft $2.28Trillion
3 Alphabet $1.36 Tn
4 Amazon $1.09 Tn
5 Nvidia $775 Billion

£10,000 invested in Amazon in 2000 is worth around £770,000 today.

In the top 10 are also Tesla, Visa, Meta.

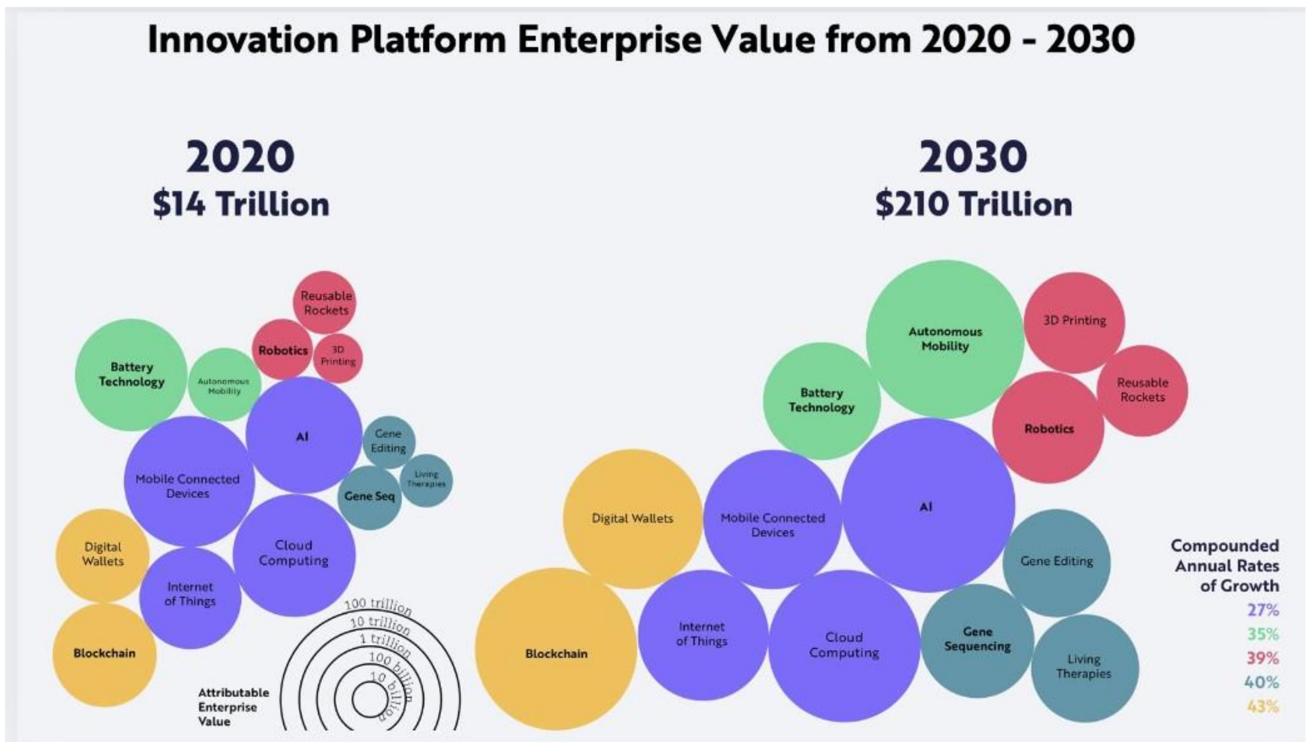
Visa went public in 2008, Tesla in 2010 and Facebook (Meta) in 2012.

All but Tesla have been products of the internet.

WHAT'S COMING IN THE NEXT 10-20 YEARS?

Plainly it's either more of the same or the world goes backwards. We will see a number of currently small companies grow extremely quickly into huge companies even faster than previously.

Likely areas this will happen:




Source: ARK Invest

A recent quote from Bill Gates:

“The development of AI is as fundamental as the development of the microchip. Entire industries will reorient around it”

The CEO of Octopus Energy talking in May 2023 about the customer relations department’s use of AI:

## On integrating AI into Octopus Energy's operations post-Chat GPT

"We started trialling [AI] with a handful of customer emails with a person supervising it [in] February. By the end of April, it was answering 34% of all customer queries. That's the work of 250 people in the UK alone — and it is doing it with an 80% satisfaction rating. Humans get 65%.

As an example of the exponential growth of AI, GPT4 (which was released less than 2 months ago) had over 100 million new users in 4 weeks.

James Anderson, formerly of Baillie Gifford, announced his return to fund management this week and he shared his thoughts in a recent FT interview:

“One of the great puzzles to me is that markets have become so sceptical and short-term at a time when the pace of innovation and change, and the prospects of returns over five, 10 and 20 years has got greater than less…it’s essential that we carry on investing in these sectors rather than worrying about what the Federal Reserve is going to do next.”

2022 IN MARKETS

The losses in virtually all markets and asset classes globally were historically bad in 2022. I wrote about this in detail in the annual review.

The causes were easy to identify but the severity of the reactions and the extraordinary effects were not.

The catalysts were inflation, the Ukraine invasion and the unprecedented raising of interest rates in response.

To illustrate the almost total switch in patterns and past performance these events created we only need to look at the performance of the FTSE 100 index (U.K. 100 largest companies).

From 2000 to end of 2021 this index returned to investors an average 0.3% pa (excluding dividends). In 2022 when mostly everything was down, it was UP around 4%.

Why?

Because it has a large weighting in oil and commodity companies which were amongst the worst performing sectors over the previous decade but the best in 2022.

By comparison the NASDAQ 100 which is the US index of companies such as Apple, Google, Nvidia, Tesla etc (not just tech but mostly newer companies),

DOWN 32% in 2022!

But an investor who put funds into the NASDAQ 100 in 2012 and lost 32% in 2022 was still up *358%* in total over that period.

The graph below illustrates that while the outperformance is vast, it is more volatile.

WHY DIDN'T WE CHANGE THE PORTFOLIOS IN 2022 TO PROTECT THEM?

What people want to know is what's going to happen next. They don't know, so they look for people who say they do. The Finance industry is only too pleased to offer up people who say they know. The glaring reality however is that no one in history has ever been able to predict short term outcomes. Not one person EVER!

What is 'very predictable' however are outcomes over longer periods and we'll return to this vital theme shortly.

We absolutely believe we can predict how to make outsized returns over time. We equally know we have nothing to add to what's likely to happen in the short term.

SOUNDS LIKE EXCUSES

It's not to say that we shouldn't have done things differently in retrospect in 2022, plainly we should. But it's only knowable in retrospect. The damage was mostly suffered in the first 6 months of '22 and portfolios are pretty much flat since then.

What could we have done differently? We *could* have suggested everyone sell everything and sit in cash at the end of 2021, but equally there were 10 or 15 moments in previous years that something looked concerning, and this may have been the right suggestion, but then nothing bad happened.

So which ones do you act on if you cannot know what the outcomes will be? Logically it's either all or none.

The other significant negatives with chopping in and out of investments are trading fees, capital gains tax and the question of when to buy back in.

It will be hard to buy back at a lower price because presumably fear will be even greater so it's at the same price or higher. At best then you break even, and you've created big costs (losses).

SECRET SAUCE OF SUCCESS

If you own great investments their valuations will over time go up, this is a certainty if they keep being great.

If valuations dip for a time, then knowing this it's absolutely logical to add to holdings, not sell.

All the greatest investors, the multi-Billionaires, not one has made their fortune by trying to time markets. None.

Two of the best, Warren Buffett and Terry Smith, are 'very very' vocal that market timing is a ridiculous concept sure to destroy value and a curse of the finance industry.

THIS IS THE WAY!

ALL the best investors follow the same exact strategy.

Buy great investments at good prices and leave them alone to be great. Prices to buy being better when markets are down.

The only time to sell is if a top quality holding individually starts doing something which will negatively change how great they are. The next chart shows a plethora of 'reasons to sell' but the trend of valuations continues to rise overall.

WHAT IS THE CURRENT SITUATION WITH MARKETS?

As of the last US Central Bank meeting they signalled reaching peak rates, which is the end of the up cycle.

- Rates will start to come down as inflation falls and the economy starts to struggle.

- Markets are forward looking and by the time economies are registering recessions they historically are already moving up in anticipation of Central Banks loosening policy.

- Inflation is now falling across the board. It's not just going lower it's going negative in many cases. The official figures are slow to reflect this fall in key areas just as they were late to reflect a pick-up in 2021 but it's irrefutably happening.

- Markets react very positively to rates coming down and the winners by a large margin will be many of the stocks that got hammered as rates went up. Expect growth (meaning tech plus) and the Nasdaq to outperform in this environment.

- We should look to invest in assets where we can be reasonably certain that the stock or bond or property is worth at least the price being asked at purchase and will steadily increase earnings. There is particularly compelling value in Bond funds for the first time in many years. The portfolio rebalance strongly leans into this opportunity (see the rebalance report for more detailed analysis).

IF IT WORKED ALL THE TIME!

This is not meant to sound trite but plainly no strategy, market or sector works all the time. If it did then everyone would do it the same way, with everyone consistently making money.

We have underperformed primarily due to the market reaction to interest rates going up so far so fast and that's now closer to the end. It is absolutely clear that rates can't and won't stay at current levels for an extended period.

We've suffered big time as rates rose and we're now waiting to gain big as they go down. The question obviously is when do we start making gains again?

THE KEY TO CONSISTENT SUCCESS

As much as the current situation is deeply uncomfortable I know that these times are when we are most valuable to clients. It's easy when it's easy.

Periods of losses, doubt, fear and anxiety are absolutely part of the investment journey. In these times it looks like things are broken. Was the previous period of good times a fluke, bubble, hoax and therefore not to be trusted any longer? The financial media is full of stories of more doom to come and it's horrible.

If we look at history, markets always turn around, they mend, they go up again. Every time. No exception.

The key to long term success is so simple – it's all the very best investors have ever done:

*BUY GREAT ASSETS WHICH GROW EARNINGS CONSISTENTLY AT A SUPERIOR RATE THEN KEEP THEM*

Given what I've outlined above I hope it provides evidence and comfort that although it currently doesn't feel much like it, we are on the right path. The long-term direction of travel is clear.

One of the most difficult elements of being a successful long-term investor is having the emotional fortitude needed to stay strong and keep to a winning strategy when times are turbulent, and anxiety is heightened.

Making money is not difficult over time. Any investor who bought great stocks in growing companies over the last 20 years and then stuck with them (doing nothing which is the toughest bit) would have made stellar returns.

Exactly the same will be true in the next 20 years.