Navigating 2024 and beyond

16th February 2024

Market extremes, whether excessively positive or pessimistic, pose risks to investors beyond the obvious ones. They can lead to irrational decision-making, and we've observed the entire spectrum of sentiments in the past year – from recession fears to concerns about rising rates to a Goldilocks scenario. The "fear of missing out" (FOMO) during bull markets can quickly give way to "fear of being involved" (FOBI) when markets turn. As we navigate unpredictable terrain in 2024, we emphasise the enduring importance of holding firm during the inevitable fluctuations.

At the start of every year, Edison's Investment Committee convenes to update our capital market assumptions (CMAs). These assumptions serve as a compass, distilling complex economic and financial data into usable insights. They help us understand what returns and risks to expect from different types of investments over the decade ahead, and how best to combine them into a diversified and optimised portfolio.

In this process, we've made some strategic adjustments that are aimed at enhancing the resilience and performance of our strategies. It's not about chasing short-term market trends but about reinforcing the foundations of our long-term investment approach.

Imagine your portfolio as a sailing ship, traversing the vast ocean of global markets. Your long-term strategic asset allocation acts as the star chart, guiding you towards your financial objectives, a distant yet unwavering beacon. However, just like the ocean currents and winds can shift, so too can the economic landscape and investment opportunities. This is where annual reassessments come in, akin to adjusting the sails to ensure your ship stays on course.

Over the course of a year, the economic winds can change direction. Interest rates might rise, inflation could fluctuate, and new investment opportunities emerge. Just like a skilled sailor constantly monitors the sky and sea, a regular appraisal allows us to identify these shifts.

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Insight: Navigating 2024 and beyond

We take a multifaceted approach to updating our CMAs. History can tell us part of the story, but we think there is value in looking ahead too. Our equity expectations consider a range of drivers including earnings growth, valuation changes, and dividend/buyback yield. Within fixed income, the building blocks of return include inputs for growth and inflation, real cash rates, defaults, government bond yield curves, interest rate changes, and spread forecasts. Ensuring a set of robust, objective estimated risk and return figures is a foundational step in the investment process.

Our quantitative optimisation then reallocates assets between different constituents, whether that's growth areas such as equities, or more defensive assets like bonds. We also look to embrace new assets classes and investment strategies which thematically align with the long-term goals of the portfolio and the changing market landscape. We end up with an optimal mix – or in other words, one which is maximising expected return for a given level of risk.

The new asset mixes also give us an idea of how we expect them to behave on average over the long-term. We call this figure our *target return*, which we link to inflation (CPI). A list of the new target returns for each broad risk level is in the table below.

It's crucial to remember that the annual target return is not a crystal ball prediction for the next twelve months' performance. Instead, it serves as a guide to the average expected return over a much longer horizon. While individual years may experience higher or lower returns, the long-term target smooths out these fluctuations, providing a broader picture of the strategy's overall growth potential.

To that end, we also produce range estimates of likely outcomes – the columns labelled "Upper Range" and "Lower Range". These figures simply show the expected return for the best year in every ten years, and the worst year in every ten. Therefore, 80% of time we would expect to generate returns within these two parameters.

While an annual target return offers a single point of reference, looking at the range of the top 10% and bottom 10% of *likely* returns paints a more realistic picture. This wider lens captures the inherent uncertainty of investing, acknowledging both the best-case and worst-case scenarios, and allowing better understanding of the potential volatility around the target return.

Accepting these fluctuations and recognising them in the context of an expected range of outcomes, is an inherent part of successful forward-looking investing. Rather than succumbing to emotional responses during extreme periods, our thinking is rooted in science, allowing us to make informed decisions that ultimately help to achieve long-term objectives.

If you have any questions on the above or to find out more about our investment service, please call 020 7287 2225 or email hello@edisonwm.com.

You can read more about us by visiting our website www.edisonwm.com.

	Target Return	Upper Range	Lower Range
Cautious	CPI + 3.4%	+15.7%	-4.3%
Cautious-Balanced	CPI + 3.6%	+16.9%	-5.1%
Balanced	CPI + 4.0%	+19.3%	-6.4%
Balanced-Adventurous	CPI + 4.5%	+22.7%	-8.5%
Adventurous	CPI + 4.9%	+27.2%	-11.4%

Important Information

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This document does not constitute advice.

The value of investments and the income arising from them can go down as well as up and is not guaranteed, which means that you may not get back what you invested. Past performance is not necessarily a guide to the future.

Insight piece table source: Edison Wealth Management, 2024.

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