TRUE

INSIGHT

True Potential Portfolios | Issue 33 | Winter 2023

SHAKEN NOT STIRRED.

The power of bond market volatility. **pg. 20**

ALSO INSIDE

What's in store for 2024? **pg. 10**

How to achieve financial fitness this year. **pg. 16**

Everything you need to know about workplace pensions. **pg. 18**

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Contents.

04

Performance update

A review of how the True Potential Portfolios are performing.

06

Review of the markets: Q4 2023

A look back at the markets in Q4 of 2023.

08

Market outlook

We share the views of our investment partners on the future direction of the markets.

10

What's in store for 2024?

We look forward to the year ahead and what it could mean for investors.

14

Portfolio changes

An update on the alterations we have made to the True Potential Portfolios.

16

How to achieve financial fitness this year

We share some healthy steps to help get you on the path to financial fitness in 2024.

18

Workplace Pensions

Everything you need to know about Automatic Enrolment.

20

Shaken not stirred

We explore the power of bond market volatility.

22

Five year performance

A full five year breakdown of the performance of all True Potential Portfolios.

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Mark Henderson
Chief Executive
True Potential Investments

+ The year ended well for investors as positive sentiment moved markets resulting in all True Potential Portfolios showing strong growth in the last quarter and posting positive returns for 2023.

As you will read in this edition of True Insight, expectations are that falling inflation will allow central banks to cut interest rates for borrowers and savers with the inevitable lower returns on cash. Bond markets are signalling this, a topic we cover in depth on page 20.

In the US the Federal Reserve, led by Jerome Powell, has delivered the soft landing we wrote about in our last edition, with the suggestion of early spring seeing the first of four anticipated interest rate cuts.

The 'higher for longer' theme has been revised significantly.

Domestically inflation is falling, from a peak of 11.1% in October 2022 to 4.0% at year end. Still above the target rate of 2% but much more manageable and a very useful data point from which the Bank of England can consider their rate setting policies for 2024.

What's in store for 2024? (see our article on page 10). Politically we have elections in the US and most likely here at home. Our portfolio diversification generally shelters you from politically induced shocks and we see this continuing even with elections looming on both sides of the Atlantic. I will not predict the outcomes but domestically we must be aware of any tax changes a new government would bring.

Before making any big financial decision, it is prudent to take advice. Studies show that clients taking advice receive a better return and the benefits of taking advice as well as long term planning are covered on page 16.

The advice to stay invested in 2023 paid off. Despite the month-by-month volatility we witnessed with declines in six months of the year, this was more than compensated for by the six months of positive returns generating growth. Over the year, investors in our Balanced portfolios achieved growth of 8% while the portfolios holding the highest equity weighting for the longer term investor saw growth of over 9.5%.

With economists predicting global growth over the next 12 months we will mix optimism and opportunity as we diligently manage your investments.

Here's to a healthy and prosperous 2024 from all of us at True Potential.

4.46%

The True Potential Defensive Portfolio was up 4.46% in the fourth quarter of 2023.

7.97%

The True Potential Balanced Portfolio has grown by 7.97% in the last 12 months.

83.21%

The True Potential Aggressive Portfolio has grown by 83.21% since launch (October 2015).

Figures shown after Ongoing Charges Figure (OCF) has been deducted.

Performance update.

Jeff Casson
Chief Investment Officer
True Potential Investments

+ The fourth quarter of 2023 saw positive returns from all True Potential Portfolios and funds. The strongest performance came from the Capital Growth + portfolio returning +6.02%.

Global stocks benefitted from inflation continuing to fall. Markets now expect central banks in the US, UK and Europe to begin cutting interest rate cuts in 2024. Investors taking less risk also benefitted from a sharp fall in bond yields in the fourth quarter, resulting in a rise in the value of both sovereign and corporate bonds.

> “Looking back over 2023 as a whole, all of the True Potential Portfolios provided a positive return.”

Portfolios	3 months	1 year	Since launch (1 Oct 2015)
Defensive	+4.46%	+4.39%	**+20.07%**
Cautious	+5.25%	+6.02%	**+34.34%**
Cautious +	+5.34%	+6.95%	**+35.71%**
Cautious Income	+5.86%	+7.18%	**+42.58%**
Balanced	+5.92%	+7.97%	**+49.39%**
Balanced +	+5.73%	+8.07%	**+55.51%**
Balanced Income	+5.87%	+8.27%	**+48.19%**
Growth	+5.80%	+8.73%	**+69.43%**
Growth +	+6.02%	+9.77%	**+69.24%**
Aggressive	+5.98%	+9.64%	**+83.21%**

Source: True Potential Investments, data as of 31 December 2023.

Looking back over 2023 as a whole, all of the True Potential Portfolios provided a positive return, supported by a rapidly evolving environment for investors with a changing inflationary backdrop and a more positive outlook for monetary policy.

The Capital Growth + portfolio produced the strongest returns over the year. The portfolio benefitted from a large equity allocation and exposure to the US. The largest position within the portfolio is the True Potential UBS Aggressive fund, generating 12.2% in 2023, ranking it the top performing True Potential fund of the year.

Since the launch of the proposition, investors have been rewarded with solid long-term returns. The True Potential Growth + Portfolio is up +69.24%, illustrating the power of staying invested over the long-term.

Full five year past performance data for the True Potential Portfolios can be found on page 22. Figures shown after Ongoing Charges Figure (OCF) has been deducted.

Scan and log in to your online account to view and manage your investments.

With Investing, your capital is at risk. Investments can fluctuate in value, and you may get back less than you invest. Past performance is not a guide to future performance.

Review of the markets: Q4 2023

4.0%

UK headline inflation is at 4.0%, compared to 6.7% at the end of September.

3.1%

US headline inflation is at 3.1%.

2.4%

Europe headline inflation is at 2.4%.

+ Asset markets finished the year on a high. Strong returns came from both equities and bonds over the quarter. Investors moved from expecting "higher for longer" interest rates to interest rate cuts in developed markets over the coming years after a lot of the key trends experienced during the earlier part of the year reversed.

All developed market central banks paused interest rate moves during the quarter. Interest rates in the UK remain at 5.25%. Pleasingly, headline inflation has come down dramatically, with the UK at 4% year-on-year for December, compared to 6.7% at the end of September. Although still above the Bank of England's 2% target significant progress has been made. A similar story can be found in the US and Europe where headline inflation is now at 3.1% and 2.4% respectively.

Within equities, real estate investment trusts (REITs) provided some of the strongest returns after a challenging two years. Higher interest rates led to a higher cost of debt and higher bond yields. This meant investors could find yield from perceived lower risk bonds, all pushing down on REITs prices. However, through Q4, the expectation of a cut in interest rates led to a rally in the sector.

> "Within equities, real estate investment trusts (REITs) provided some of the strongest returns after a challenging two years."

Moving to UK equities, medium capitalisation stocks outperformed their larger counterparts, currency strength benefitting more domestically focussed companies with Sterling gaining over 4% compared to the US Dollar.

Regionally, holding European equities was beneficial, Germany and Italy being particularly strong. Sectorally, real estate and information technology were favoured by investors, rebounding significantly.

Fixed income enjoyed strong returns over the period, bouncing back after a challenging 2022. In a reversal to what was experienced earlier in the year, longer dated bonds outperformed. Investors flocked to the asset class citing favourable valuations and the higher yields on offer.

Within corporate bonds higher yielding issues offered the best returns, with yields of over 7% attracting investors to the asset class.

The oil price lost around a fifth of its value over the quarter. Lower prices came partly as a result of the US pumping a record amount of oil, flooding markets with a glut of supply in defiance of OPEC's attempts to boost prices by slashing production.

Looking east, the Chinese economy continues with its struggle to stage a comeback. Beijing has tried to shore up the economy with measured stimulus but many investors do not see this as enough. The Chinese economy has been plagued with difficulties in the property sector, high youth unemployment and mounting financial stress within local government. The trajectory from here will depend on China's willingness to dig deeper to boost growth.

Our focus continues to be the successful management of the True Potential Portfolio proposition, providing a well-diversified solution accessing areas where valuations are attractive.

With Investing, your capital is at risk. Investments can fluctuate in value, and you may get back less than you invest.

Market outlook.

> Looking ahead into 2024, many of the headwinds to asset market returns over recent years are abating.

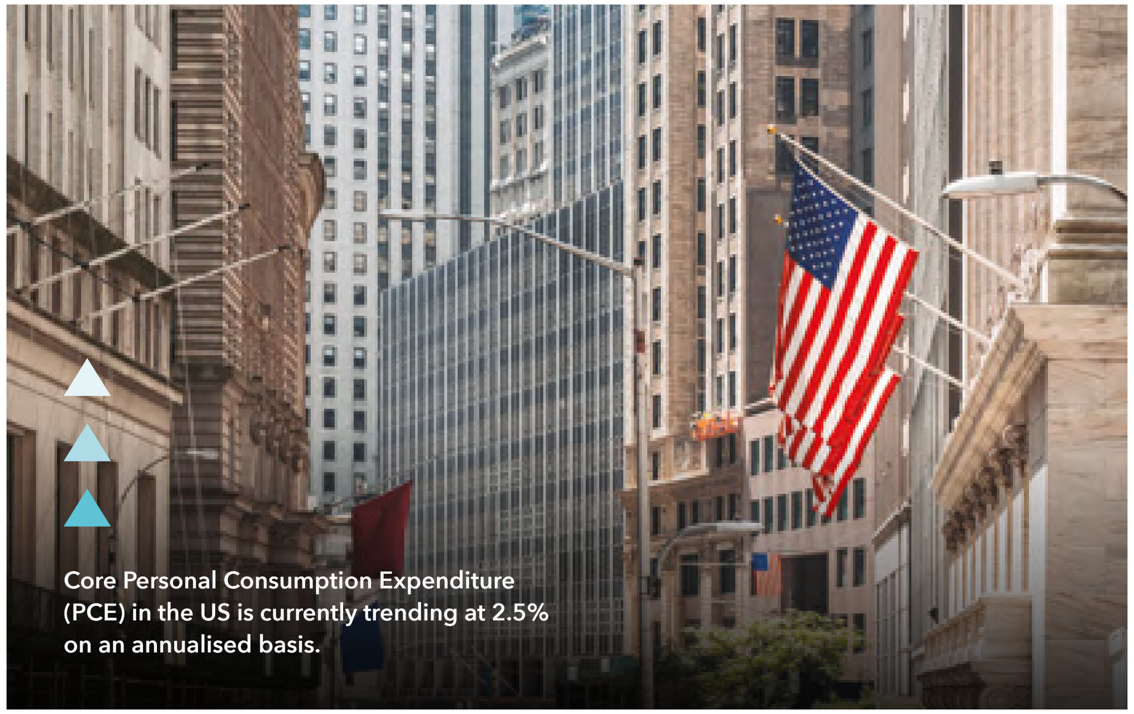
Looking ahead into 2024, many of the headwinds to asset market returns over recent years are abating. The likelihood of interest rates moving higher in developed markets is now very low and investors have moved to pricing in interest rate cuts for 2024. This environment is offering up significant opportunities to both the internal True Potential investment team and our external fund manager partners.

In this article, we share the key components of our investment outlook.

Inflation.

We expect the disinflation cycle to continue as both base effects and slowing price pressures evolve: 6-month Core Personal Consumption Expenditure (PCE) in the US is currently trending at 2.5% on an annualised basis. Based on this momentum, the Fed's 2.0% target could be achievable by Summer 2024. These phenomena are not unique to the US, similar trends can be seen in the UK and Europe.

The Bank of England (BOE) and European Central Bank (ECB) have indicated that further policy rate increases are unlikely.



Core Personal Consumption Expenditure (PCE) in the US is currently trending at 2.5% on an annualised basis.

Japan offers up favourable valuations compared to historical levels together with improving shareholder governance.

Economic growth.

Nominal GDP growth in the US has slowed by one third in 2023 (from 8.7% to 6.4% as at end Q3) but remains above trend. The latest Atlanta Federal Reserve Nowcast data for GDP is coming in at 2.3% for the end of 2023. It is reasonable to conclude that the increase in Fed fund rates to 5.25-5.50% in July was the last of this cycle.

Outside of the US, the Bank of England (BOE) and European Central Bank (ECB) have indicated that further policy rate increases are unlikely. China continues to struggle, with little evidence of a sufficient growth impulse or an ability to stimulate demand and combat credit challenges within the property sector.

Opportunities for growth.

With the potential for lower interest rates in developed markets, sovereign bonds remain attractive. Yield levels have fallen from their highs in late 2023 but remain significantly above what was seen pre-2021. Corporate bonds are interesting at this point in the market cycle, although spread levels - the amount of extra yield investors demand over government bonds - remain tight.

We are modestly overweight equities, given the pockets of valuation opportunity and stronger economic data than many thought possible earlier last year. Within equities, we favour the US and Japan. Japan offers up favourable valuations compared to historical levels together with improving shareholder governance. Although valuation levels are at a premium in the US, we believe the US economy is the strongest in the developed world and earnings from US companies could prove more resilient.

In summary, headline inflation continues to fall. Expectations are no longer "higher for longer" in respect of interest rates, with cuts now priced in for 2024 and opportunities continue to present themselves, particularly within fixed income.

What's in store for 2024?

It's about this time of year that Yogi Berra's quip about predictions being difficult, especially about the future, is routinely trotted out.

And yet, despite uncertainty surrounding the outcome of a Presidential election in the United States and a general election here in the UK, forecasting may be easier this year than others.

Politicians are generally credited with undue influence in determining the direction of financial markets. In reality, like the farmer, they can look to make the conditions for growth as favourable as possible, preparing the economic sward and providing financial fertiliser from time to time.

However, as every farmer knows, the final harvest will depend upon ungovernable climactic conditions. "Events dear boy, events" as Harold Macmillan famously observed. Returns from the global economy and its financial markets ultimately derive from uncertain and unknown factors.

So, looking ahead into 2024 what do we know?

Well, quite a lot actually.

Inflation. It has fallen. And likely to fall further. The big jumps in the price of oil and basic food stuffs as a result of the war in Ukraine not only cease to have an impact on inflation after twelve months but have, themselves, started to fall back as the world has found other sources of grain and invested heavily to increase energy independence and reduce reliance on oil and fossil fuel imports from areas of conflict.

In addition, China, the world's biggest exporter, is suffering an economic slowdown and is looking to revitalise its economy by lowering prices and increasing overseas trade. As buyers of these cheap exports, the west, including the UK, is effectively "importing deflation", which, again lowers our own inflation rate.

In the fight against inflation, the Bank of England has been very aggressive in putting up interest rates. Since December 2021 the Bank has raised rates from a record low of 0.1% to a fifteen year high of 5.25%. Historically, it has taken 18-24 months for higher interest rates to take effect. However, the advent of fixed rate deals mean that many mortgage holders have been insulated from the Bank's rate rises.

But not forever and when the fixed term ends, during the coming year for many homeowners, the impact will be more severe, damping down inflation still further.

Finally, falling inflation will also help to mitigate the wage claims and strike action that has characterised much of the last year. It's harder to make the case for a double digit pay rise when inflation is nearing its target level of 2.0%.

Why is this so important?

Well, despite all the uncertainty that global geopolitical events can exert, markets tend to be driven by liquidity. A fall in inflation will allow the Bank of England to cut interest rates, perhaps aggressively, and even the prospect of this will be enough to boost equity and bond prices.

What else do we know?

Elections are coming on both sides of the Atlantic and politicians like to get reelected. What better way to improve prospects at the ballot box than through the medium of tax cuts?

> "Inflation, already down from over 11% to 4%, is likely to keep falling as the year progresses."

Paradoxically, the higher prices and elevated pay settlements witnessed over the past couple of years have benefitted the Treasury coffers through higher VAT receipts and a bigger income tax take as wages have risen while tax thresholds remained static.

This has provided the Chancellor with more headroom for tax cuts and public spending giveaways as we go into this election year.

As if the prospect of falling interest rates and lower taxes wasn't enough, equity markets are cheap. Particularly UK companies relative to their US and European counterparts. This anomaly is unlikely to persist in perpetuity and will likely be reflected in a wave of merger and acquisition activity as overseas investors take advantage of underpriced UK assets.

A final prediction is that the financial press will spend much of the next twelve months printing headlines about the grey fog of uncertainty surrounding election outcomes and debating the pros and cons of differing political regimes in the years ahead.

In the meantime, canny investors are already planting seeds in fertile ground.

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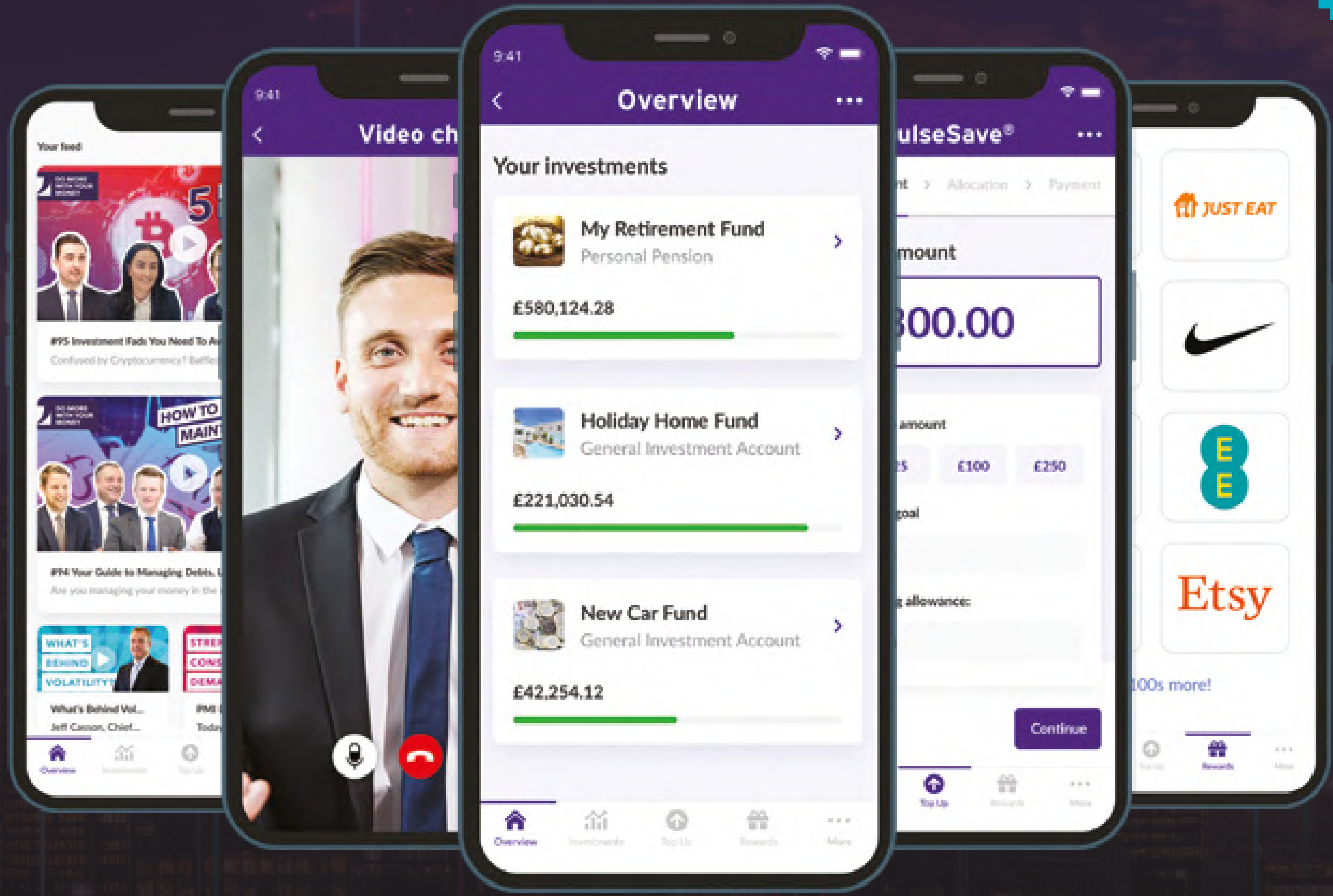
With investing, your capital is at risk. Investments can fluctuate in value and you may get back less than you invest.



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Portfolio changes: Q4 2023

As a result of changes made both at the portfolio and underlying manager level, overall equity exposure was rotated over the quarter reflecting a reduction in UK holdings and small additions to European stocks. Fixed income exposure increased through additions to UK Gilts although exposure to global sovereign bonds moderated.

Disinflation momentum continued within major developed markets over the quarter with headline inflation in the US down to 3.1%, UK 4.0% and Europe 2.4% by year end. Asset markets rallied on the view that central banks have reached the peak of their interest rate hiking cycle, giving scope to cut rates in 2024. Interest rate expectations for the coming year moved materially, pricing in more cuts sooner. Global equities finished up +6.28% led by the US. Fixed Income markets also benefitted as yields moved lower and investors were rewarded for positioning long duration, lending to governments for longer periods of time, as yields fell more at the long end of the yield curve.

Regarding fund manager allocation changes, the Growth Aligned range was increased in both Core and Plus portfolios. This reflects the view that sovereign fixed income is attractive, duration management remains an important consideration.

In the Defensive portfolio, the allocation to SEI was also increased for similar reasons and to moderate exposure to the US equity market.

In the Growth Plus portfolio, Allianz was added to trim US equity exposure and fixed income duration.

In the Cautious Income portfolio, Close Brothers and Goldman Sachs Income Builder were reduced to fund additions to Schroders to ensure risk management consistency within the cautious client profile.

Underlying managers have also been active over the quarter. Within equity, managers started to move from cyclical value equities into quality. Growth Aligned rotated some of their global small cap and US equal weight exposure into S&P 500 market cap equities. Similarly, UBS tactically switched their US exposure from equal weight into market cap and, as part of a portfolio construction change, increased factor exposures to quality and momentum from value and minimum volatility equities.

Within fixed income sovereign bonds have been added, primarily through UK Gilts. Our manager partners here include Growth Aligned, Waverton and Allianz. Close Brothers have rotated some of their US Treasury exposure into UK Gilts, moving towards a target of 50/50 UK Gilts/US Treasuries. Managers who have added to US Treasuries, such as Goldman Sachs Balanced 4 and Schroders, have focussed on the mid part of the curve, favouring 7-10 year Treasuries. We have also seen some caution exercised in the Corporate Bond market with Allianz and 7IM further reducing their holdings.

Managers have also moderated their alternatives exposure, mostly by 7IM, Allianz and Goldman Sachs Balanced 4 as they redeploy capital.

HOW TO ***ACHIEVE FINANCIAL FITNESS*** *THIS YEAR.*

Many of us prefer to bury our heads in the sand rather than getting our finances in order, but it's never been more important to ensure you're as financially fit and well as you can be.

To get you started here are some healthy steps to help get you on the path to financial fitness in 2024.

STEP 1 Setting financial goals.

Like a balanced diet for your physical health, setting goals, how much would you like to have and by when, can be the first step to better financial fitness.

To get started review your income, expenses, debts and savings to get a clear picture of your financial situation. Then you can set achievable goals and create a monthly budget to help make them a reality.

Alternatively, you may have a longer-term goal in mind.

STEP 2 Investing in a Pension.

It's a good idea to save and invest as early in life as you can. Saving early means your money is invested for longer and has more time to grow in a tax-sheltered environment.

A Pension is an excellent vehicle for returns and tax benefits. You can get tax relief on private Pension contributions worth up to 100% of your annual earnings. The size of your Pension pot when you retire will depend on how long you save for, how much is paid into your Pension pot over the years and how your investments have grown tax-free.

When you get to age 55 you don't have to draw upon it - you can continue to save as much as possible and protect an accumulated pot of money for later in retirement. Doing so can provide freedom and flexibility when it comes to retirement.

> "It's never been more important to ensure you're as financially fit as you can be."

On the other hand, you can take up to 25% of the amount built up in any Pension as a tax-free lump sum but once this money is withdrawn from your pension, the tax advantages are also lost.

Then you may end with a residual amount you can pass to beneficiaries free of Inheritance Tax and outside of your estate. This can be of significant benefit to your dependents and we recommend you complete an expression of wish informing pension trustees of your wishes. Your adviser is on hand to help you with this.

STEP 3 Naming a beneficiary.

Intergenerational wealth planning helps families to pass on money in tax-efficient ways, helping younger generations to attain financial goals and giving children a good head-start in life.

Recently, we extended our services at True Potential to the beneficiaries of our clients - ensuring they are in the best place to get financial advice when the time comes and so protect their investments.
It means we can protect our clients' financial legacies and make the intergenerational transition of wealth easier post-bereavement.

STEP 4 Using your annual ISA allowance.

Essentially, an ISA is a tax-free account as you do not pay tax on interest, income or capital gains tax from investments in an ISA.

Your annual ISA contribution allowance of £20,000 applies to each tax year. Any unused allowance is lost if you contribute less than £20,000 in the 12-month period. You can see how much of your annual allowance you have available on the True Potential App and Client Website.

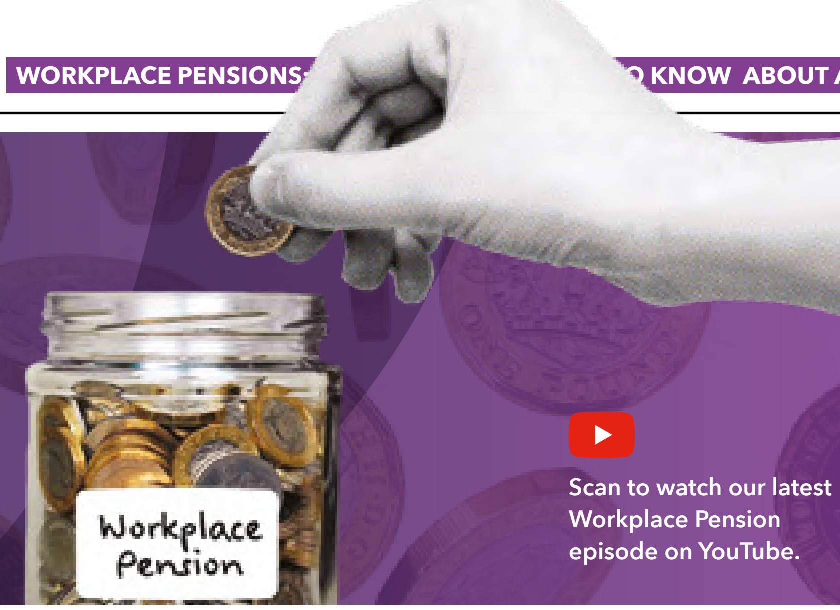
The True Potential ISA is a flexible ISA to maximise the tax savings available. If you make a withdrawal from your ISA you can replace the amount you have withdrawn in the same tax year. This replacement of capital is in addition to the annual allowance. This is a valuable and often under-used benefit.

We're here for you any time.

Just like working with a personal trainer, a financial adviser can help maintain your financial fitness. You can also get help and guidance on the MoneyHelper website.

By investing in financial health, you're investing in yourself, and it's about making small, sustainable and clever choices that you can build into your lifestyle that will reward you in years to come.

Workplace Pensions:
Everything you need to know about Automatic Enrolment.



Scan to watch our latest Workplace Pension episode on YouTube.

People are living longer and saving less, so it's important that everyone gets a helping hand in planning for a comfortable retirement.

With Workplace Pensions you, your employer and the Government put money into your pot so you build up more savings over time. This is a topic we cover regularly on our Do More With Your Money podcasts, available on our YouTube channel.

What is Automatic Enrolment?

Automatic Enrolment is when an employee is made a member of a Workplace Pension scheme without needing to ask to be part of it.

As a result, more people are able to build up retirement savings that they can use to provide them with an income from age 55 onwards. This will change to 57 in 2028.

Prior to Automatic Enrolment, it was up to workers to decide whether they wanted to join their employer's pension scheme. However, Auto Enrolment came along and was phased in from 2012.

Do you need to be automatically enrolled into a pension?

By law, every employer with at least one member of staff needs to provide Automatic Enrolment for those who are eligible for a Workplace Pension scheme and contribute towards it.

This helps lots more people save for retirement. Whether you work full-time or part-time your employer will have to enrol you in a Workplace Pension scheme if you meet certain Automatic Enrolment rules. Alternatively, you can opt out of Automatic Enrolment by informing your employer.

Enrolling beyond minimum contribution rates.

Minimum contribution levels are a key feature of Automatic Enrolment. These contribution levels effectively serve as a 'default' option for employers and employees when setting up pension contributions.

You and your employer may pay in more than the minimums, but you cannot remain in the scheme and pay in less.

The current minimum contributions, based on your qualifying earnings are:

1. Minimum employee contribution – 4%
2. Minimum employer contribution – 3%
3. Tax relief from the Government – 1%

As part of your Automatic Enrolment your employer can choose to pay the minimum employer contribution or a greater amount. If they choose the minimum employer contribution, you must pay in at least enough to reach the minimum total contribution.

Automatic Enrolment: Our most asked questions.

What if I work for more than one employer?

If you meet the criteria for an eligible jobholder with each employer they should ensure your automatic enrolment within their Workplace Pension.

If you meet the criteria for a non-eligible jobholder or entitled worker with each employer, you'll have the right to join a Workplace Pension through each of your employers.

You may also find that you are in different categories for each employer, so you may be automatically enrolled by one employer and have the right to join another employer's Workplace Pension. You could end up being in two (or more) different Workplace Pensions, one for each employer.

What if I leave my job to become self-employed or stop working?

You should think about what income you'll have to live on in later life. Your employer will stop paying into your Workplace Pension, but you will be able to continue contributing, if you want.

Alternatively, you could consider a Personal Pension to ensure you are saving effectively towards your retirement.

How does tax relief affect my Workplace Pension?

The Government takes tax off your income – you can see this on your payslip. Tax relief means some of your money that would have gone to the Government as tax now goes into your Pension instead. There are two ways in which tax relief can be added to your pension pot.

1. Pension relief at source.

Under this arrangement, if you're a Basic Rate taxpayer, you don't have to do anything to get the tax relief paid into your pension. Your pension provider will claim this on your behalf from the Government.

If you're a Higher or Additional Rate taxpayer, to get full tax relief, you need to claim back some of your tax from the Government. This is because tax relief is added to your Pension at the basic rate of 20%.

To get all the tax relief that is due to you, you need to claim back the difference on your annual tax return or alternatively, if you are a Higher Rate taxpayer, you can contact HMRC.

2. Salary sacrifice.

Under this arrangement, you agree to sacrifice, or give up, part of your gross salary in order for your employer to pay this as a Pension contribution on your behalf. As such, you will receive tax and National Insurance savings, along with your employer.

This, therefore, results in an increase in the value of the overall pay package you receive. As such, you are not taxed on the element of pay you sacrifice to make your Pension contribution and so will receive tax relief at your highest Income Tax rate.

Your employer can tell you which arrangement out of the above two options they use.

Will the amounts paid into my Pension change?

Yes, the amounts will vary depending on your earnings. If your earnings are variable and change each month, your contributions will vary.

What if I move jobs?

If you're moving jobs you'll automatically be enrolled into a new Workplace Pension if you meet the criteria for an eligible jobholder. Under government guidelines all firms have to provide you with a Workplace Pension. If you start a new Pension (either 'Workplace' or 'Personal'), you may be able to combine your old Pension with your new one. Your new Pension scheme provider will be able to tell you if this is possible and, if so, how to go about doing it.

Combining your Pensions might give you greater freedom and choice with your retirement savings. However, it is worth considering that any previous workplace schemes you hold may offer valuable benefits that would be costly or inconvenient to give up if you were to transfer your money out. Your current providers may also charge exit fees.

Workplace Pensions are a great way to start retirement saving and should be part of your long term investment planning but not necessarily your only plan.

With investing, your capital is at risk. Investments can fluctuate in value and you may get back less than you invest. Pension eligibility and tax rules apply. Tax is subject to an individual's personal circumstances, and tax rules can change at any time. This article is not personal recommendation or financial advice.

Shaken not stirred: the power of bond market volatility.

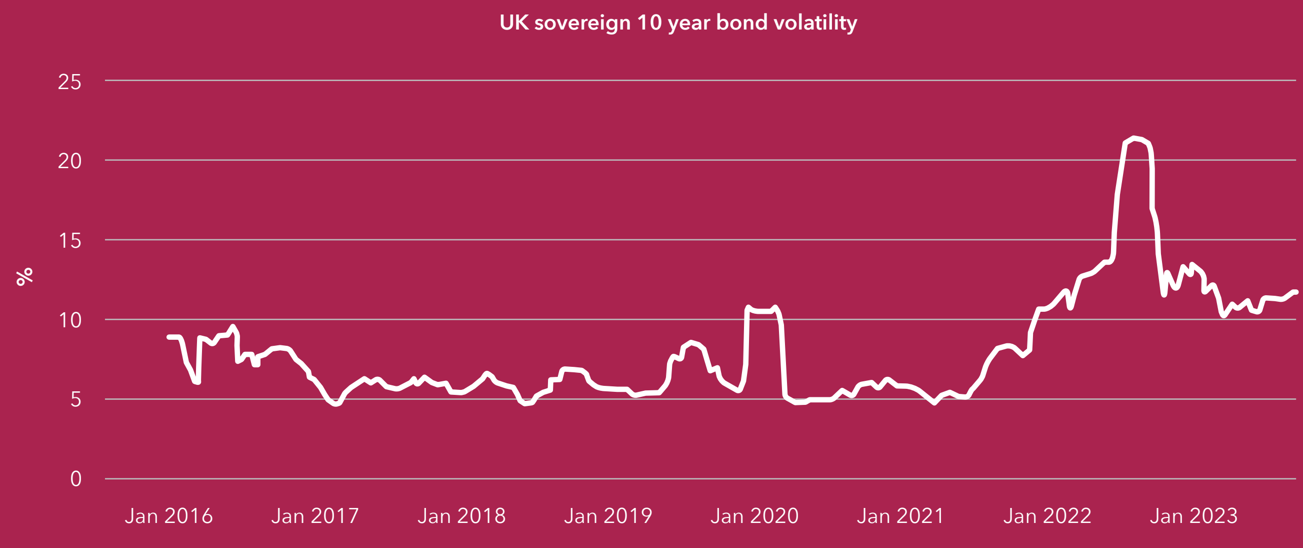
+ Bond market volatility refers to the degree of variation or fluctuation in the prices of fixed-income securities. This volatility is driven by multiple factors and can significantly impact investors, financial institutions and the broader economy. It would be wrong to assume that bond volatility inevitably leads to losses, such as those experienced in 2022. Volatility, whilst occasionally uncomfortable, often presents an opportunity to invest at unusually low prices. 2023 was one such example.

Factors influencing bond volatility vary but have historically been dominated by three factors:

1. Interest Rates: Changes in interest rates have a profound impact on bond prices. When interest rates rise bond prices typically fall and vice versa. This inverse relationship is fundamental to understanding bond market volatility. Central bank policy decisions, economic data releases, and inflation expectations all influence interest rates.

2. Economic Conditions: Economic indicators such as GDP growth, employment rates and inflation play a significant role in bond market volatility. Positive economic data might lead to expectations of higher interest rates, impacting bond prices.

3. Market Sentiment: Investor sentiment and market psychology also affect bond volatility. Fear or uncertainty in financial markets due to geopolitical tensions, unexpected events, or changes in outlook can lead to sudden shifts in bond prices.



Source: Bank of England.

And 2023 was another forceful demonstration of the power of bond market volatility. Investors in the Gilt market, or UK Government bonds, enjoyed a positive total return in 2023 but endured a year of huge swings in the price of bonds.

Typically, high volatility in investment portfolios can lead to investors seeking safer assets. These safer assets could well be Government bonds themselves, such as Gilts. This is often referred to as a 'flight to quality', but what do investors do when it is the safe asset itself that is exhibiting the extreme volatility?

Until mid-2021 bond volatility was unusually low, anchored by the Bank of England policy of keeping interest rates close to zero and very low global inflation. However, this regime ended when global inflation surged higher following the Russian invasion of Ukraine and continued supply chain disruption. For entities issuing bonds such as the UK Government (for example, to finance spending on public services), market volatility can impact borrowing costs. The increased volatility in 2022 made it materially more expensive for the UK Government to borrow through bond issuance.

In Figure 1 (above) we quantify the volatility of a ten-year Gilt over the recent past.

The extreme peak in this volatility is clear, coming during the brief tenure of Liz Truss as Prime Minister. Gilt volatility surged into October 2022, exacerbated by market perceptions of unfunded tax cuts announced by then-Chancellor Kwasi Kwarteng and the likelihood of significantly higher government borrowing required to finance them. With UK inflation already expected to rise above 10% in late-2022 this fiscal programme was regarded as reckless by the bond market. In the ten weeks to early October UK Government borrowing costs more than doubled. The Bank of England was subsequently forced to intervene and restore market confidence by offering to buy Gilts in an orderly and transparent fashion.

However, rising volatility was a broader theme for all global investors through 2022, affecting the performance of even well-diversified portfolios. Investors holding a mix of stocks and bonds experienced similar fluctuations in overall portfolio value in 2023, but this time largely due to bond market movements. A ten-year Gilt offered investors an income yield of 3.67% at the beginning of 2023. By the end of 2023 this Gilt yield had fallen modestly, the commensurate rise in price of the bond providing a positive total return to bond investors of over 5% for the year. However, this performance masks the volatility in the price of Gilts through 2023. By mid-August the investor in a ten-year Gilt was facing a price loss of 6% for the year. Yet, remarkably, Gilt prices rose 10% in the final ten weeks of 2023, resulting in a positive total return for the year. Staying invested proved rewarding.

In conclusion, bond market volatility is an inherent aspect of fixed income investing. The period of unusually low market volatility prior to the pandemic has been replaced by a return to normality: higher bond yields and greater volatility. Both represent investment opportunities for well diversified portfolios. Capital market volatility is the friend of patient, long-term capital.

Five year performance.

Portfolios	31 Dec 2018 to 31 Dec 2019	31 Dec 2019 to 31 Dec 2020	31 Dec 2020 to 31 Dec 2021	31 Dec 2021 to 31 Dec 2022	31 Dec 2022 to 31 Dec 2023	Since launch annualised (1 Oct 2015)
Defensive	+6.18%	+3.02%	+2.83%	-7.43%	+4.39%	**+2.24%**
Cautious	+9.90%	+3.69%	+6.28%	-8.75%	+6.02%	**+3.64%**
Cautious +	+11.32%	+2.80%	+7.77%	-9.99%	+6.95%	**+3.77%**
Cautious Income	+13.06%	+0.52%	+9.87%	-8.39%	+7.18%	**+4.39%**
Balanced	+13.66%	+3.53%	+9.81%	-10.50%	+7.97%	**+4.98%**
Balanced +	+14.86%	+3.57%	+10.76%	-10.49%	+8.07%	**+5.50%**
Balanced Income	+15.84%	-0.78%	+10.98%	-9.11%	+8.27%	**+4.88%**
Growth	+16.63%	+4.07%	+13.12%	-10.17%	+8.73%	**+6.60%**
Growth +	+17.80%	+2.47%	+14.25%	-11.01%	+9.77%	**+6.58%**
Aggressive	+17.63%	+3.81%	+15.59%	-9.22%	+9.64%	**+7.61%**

Source: True Potential Investments, data as of 31 December 2023.
Figures shown after Ongoing Charges Figure (OCF) has been deducted.

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