NORTH CAPITAL

Enable:

Weathering the Storm

Market Overview and Outlook

January 2023

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In this issue

Introduction

A very warm welcome to 2023 from us all at North Capital. It is fair to say that I think we would all welcome calmer waters in the year ahead than we witnessed in the preceding 12 months. The patchwork quilt illustration of market returns, otherwise known as a Callan Table, on page 4 provides a pictorial record of various asset class returns through the years. Out of the major asset classes we include in the sequence, oil and cash were the only positive contributors to a challenging year for all investors. The table serves to illustrate that no one asset class consistently outperforms another, which is why diversification is a cornerstone of our portfolio construction methodology. It also reaffirms that time in the market is more important than timing the market. Understanding your investment horizon is one of the most influential determinants of an investment strategy, with long term investors able to absorb soft market periods and benefit from the recovery phases that follow.

BRIAN O'CONNOR
CHIEF EXECUTIVE OFFICER

ANGUS JACK
HEAD OF CLIENTS

As mentioned in the last edition, we have amended the production cycle of this report to January and July. This allows the opportunity to present not only a review of investment markets since our last report but also include in the January edition(s) our outlook for the year ahead. In 2023, inflation remains under the spotlight and associated central bank policy decisions will in turn influence the direction of market returns. On page 11 we illustrate our discretionary portfolio positioning to reflect the current environment, where we remain moderately defensive.

We are very pleased to announce that Charlie Fletcher (pictured opposite) joined the team in January to help with office administration and operational support. We also look forward to introducing Jack Anderson to the team at North Capital in February. Jack will join as a finance and operations manager to help with some exciting change projects we have in the pipeline for 2023. This will include the introduction of a new e-platform to make the subscription process to Private Equity funds more efficient, but also lower the minimum investment amount to help democratise the investment asset class further. We expect to be able to roll this out to clients in the first half of the year. As a reminder of the potential beneficial characteristics of Private Equity, Paul Swan (pictured opposite) who joined in October from Coutts, has written a refreshed spotlight article on the asset class – see page 12.

At North Capital we have seen some notable individual successes over the past six months. Jennifer Hutchison was promoted to Client Adviser, after passing her Level 4 Investment Advice Diploma (IAD) and Connor Davidson passed his Level 1 Chartered Financial Analyst (CFA) exam, with an outstanding score that placed him in the top 10% of candidates globally.

We wish you all a happy new year and, whilst I am not an astrologist, we may be able to take some comfort from the Chinese zodiac, with 2023 becoming the year of the rabbit. This symbolises longevity, peace and prosperity – something I think we can all wish for after the turmoil of 2022.

Highlights

Paul Swan joins as an Investment Analyst and Charlie Fletcher also joins as Office Administrator and Executive Assistant

Major UK Equity Index ends the year up, driven by commodity stocks and defensive sectors

Interest rates at their highest in over a decade as central banks deal with inflation.

Global stocks down 16%; bonds down 17% in 2022.

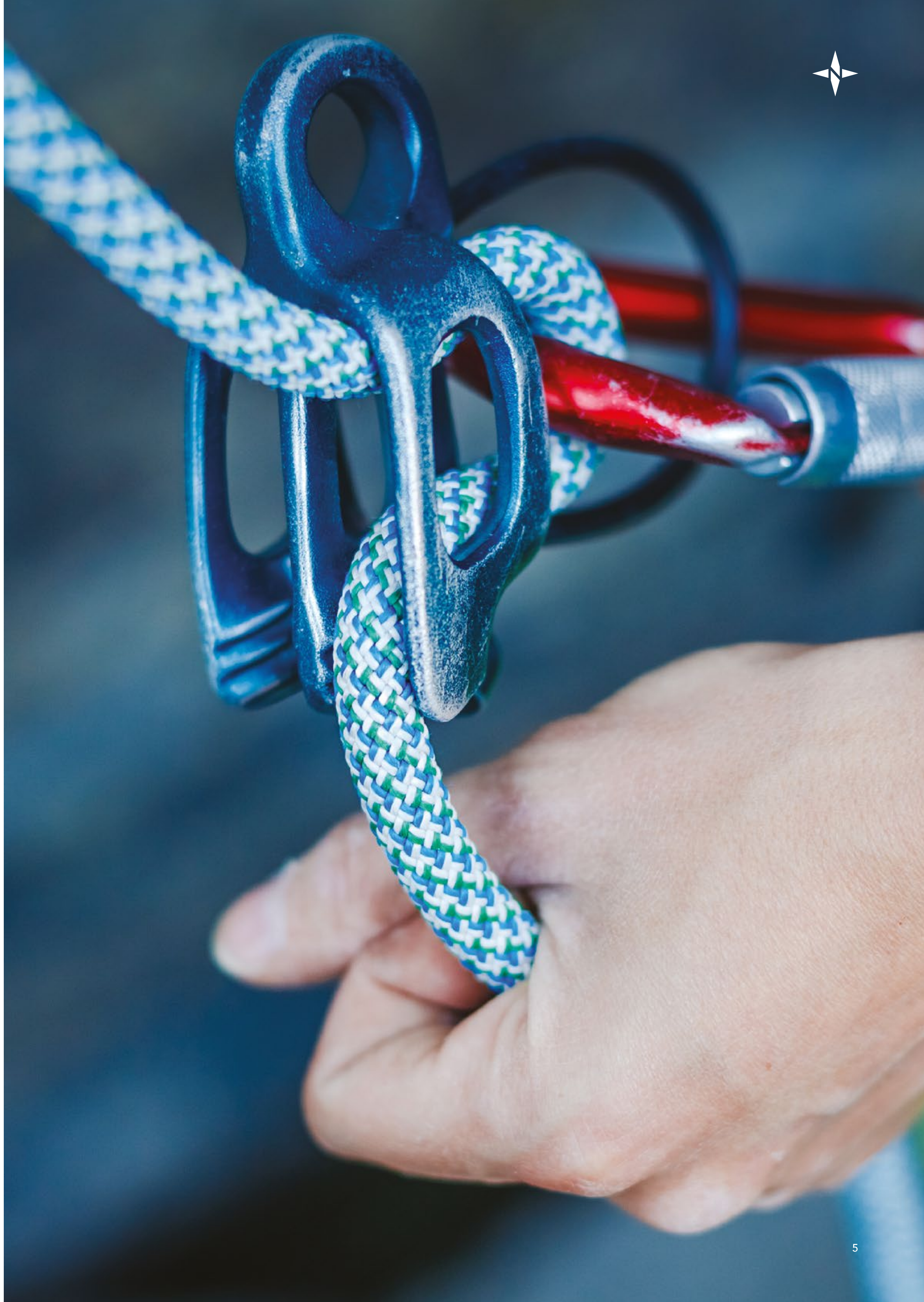
Multi-asset investors have few places to hide as bonds and equities fall in unison.

Alternative assets and commodities provide safe haven for investors.

This Callan table shows performance for various asset classes (colour coded) across multiple time frames.

10 YEARS	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Developed Equities 160.3%	Developed Equities 28.9%	Developed Equities 9.8%	UK Property 4.3%	Oil 52.4%	EM Equities 30.6%	UK Property 1.2%	Developed Equities 27.3%	Gold 20.9%	Oil 50.2%	Oil 8.8%
UK Property 61.4%	UK Property 8.1%	UK Property 7.2%	Hedge Funds 2.7%	EM Equities 9.7%	Oil 20.6%	GBP Cash 0.6%	Oil 18.0%	EM Equities 19.1%	Developed Equities 24.2%	UK Property 3.8%
EM Equities 56.5%	Hedge Funds 7.3%	EM Equities 5.2%	Developed Equities 2.1%	Developed Equities 9.0%	Developed Equities 18.5%	Government Bonds -0.4%	Gold 18.0%	Developed Equities 13.5%	UK Property 10.1%	GBP Cash 1.5%
Hedge Funds 25.3%	EM Equities 3.4%	Corporate Bonds 3.1%	GBP Cash 0.5%	Gold 7.7%	Gold 12.8%	Hedge Funds -2.7%	EM Equities 18.0%	Corporate Bonds 10.4%	Hedge Funds 3.8%	Gold -0.7%
Corporate Bonds 9.0%	GBP Cash 0.5%	Hedge Funds 2.7%	Government Bonds -3.3%	UK Property 4.4%	Corporate Bonds 9.1%	Gold -2.8%	Corporate Bonds 11.5%	Government Bonds 9.5%	GBP Cash 0.1%	Hedge Funds -2.3%
GBP Cash 5.4%	Corporate Bonds 0.3%	GBP Cash 0.5%	Corporate Bonds -3.6%	Corporate Bonds 4.3%	Government Bonds 7.3%	Corporate Bonds -3.6%	Government Bonds 5.6%	UK Property 7.0%	EM Equities -0.2%	EM Equities -15.5%
Gold 0.1%	Oil -1.2%	Government Bonds -0.8%	EM Equities -5.8%	Government Bonds 1.7%	Hedge Funds 3.2%	Developed Equities -7.4%	Hedge Funds 4.7%	Hedge Funds 2.9%	Corporate Bonds -2.9%	Developed Equities -16.0%
Government Bonds -11.1%	Government Bonds -4.3%	Gold -1.7%	Gold -10.9%	Hedge Funds 1.1%	UK Property 1.8%	EM Equities -10.1%	UK Property 1.4%	GBP Cash 0.2%	Gold -4.3%	Corporate Bonds -16.7%
Oil -23.4%	Gold -28.7%	Oil -46.3%	Oil -33.0%	GBP Cash 0.4%	GBP Cash 0.3%	Oil -20.7%	GBP Cash 0.8%	Oil -24.5%	Government Bonds -6.6%	Government Bonds -17.5%

Returns are reported in local currency, sorted in descending order for each column. Unless stated otherwise, each asset class is global in scope – see Disclaimer for full details. EM refers to Emerging Markets and UK property is residential property. Source: Lipper. Date: 30 Sep 2021. For index information, please contact your adviser.



Market Review and Outlook

Summary of the last six months

2022 has been a tale of two halves with the first six months of the year, witnessing a broad sell-off in almost all major asset classes. This was largely due to the significant pickup in inflation across most developed economies forcing central banks into aggressive action in raising interest rates. After dismissing the inflation threat as 'transitory' for much of 2021 and early 2022, there was a seismic shift in monetary policy stance, notably by the US Federal Reserve, to tackle what had become high and more entrenched inflation. In the second half of 2022, markets remained volatile but recovered some of their losses for the year with equity markets modestly positive in the second half, but global bonds still in negative territory. Throughout the six month period, investors continued to navigate the uncertainty of inflation, geopolitical risks caused by the war in Ukraine, a zero COVID policy in China, as well as the increased likelihood of a global recession.

CONNOR DAVIDSON
INVESTMENT ANALYST

Central banks and inflation continued to be the focal point of markets attention throughout the second half of 2022. The Bank of England base rate finished the year at 3.5%, a level which was almost unimaginable in January of 2022. This move has been mirrored by most countries with the notable exception of Japan. This has caused most of the previous decade's winners, such as technology stocks, speculative assets and long duration bonds – which all perform well in a low interest rate environment, to underperform. Inflation has forced the hand of central banks but there have been some modest signs of this easing off, with headline inflation in both the UK and US falling from peaks set earlier in the year. However, the path for inflation remains uncertain given the strength of the labour market and the self-fulfilling nature of some inflationary forces, such as wage growth and consumer habits.

UK investors have also had political risk to contend with. Government bond prices and the value of sterling fell sharply to historic lows as markets reacted to Kwasi Kwarteng's mini-budget. The unfunded tax cuts announced by Kwarteng caused the yield of government bonds – the cost at which governments borrow, which move inversely to the price of the bonds – to jump from 3% to 4.5% in a matter of days. This caused pension funds, who hold a large proportion of the government's debt, to sell the bonds aggressively, which in turn pushed the price of the bonds down in a self-fulfilling spiral. Ultimately this forced the Bank of England to step in as the buyer of last resort. This brought some order back to markets, but highlighted the sensitivity of a financial system that has become dependent on historically low debt financing.

Asset Class round up:

Equities

> Equities have rebounded modestly across the six month period returning over 2% after the sharp selloff in the first six months of the year, leaving 2022 losses at 16%.

> There was some differentiation across regions, with European equities performing the strongest (returning 6%), as the most extreme effects of the war in Ukraine and the forecasted energy shortages failed to fully materialise. Emerging markets lagged developed markets, falling 2%, as China continued to drag its feet on its zero COVID policy, and a strong dollar remained a headwind.

> The increase in equity markets has been driven, admittedly from a low base, by increased optimism around the path of inflation and the belief that central banks may stop hiking rates in 2023.

> Corporate earnings, on aggregate, remained strong, with earnings growth across the six month period beating expectations.

Bonds

> Fixed income finished a turbulent period with 10 year government debt yields in the UK yielding 3.6% and in the US 3.7%, both increasing roughly 1% over the six month period.

> Across the weeks surrounding the UK's mini-budget, fixed income markets in the UK saw their sharpest moves in decades, with prices of UK government bonds plummeting, and pushing yields – which move inversely to prices – above 4%, a level not seen since before the 2008 financial crisis.

> Default rates remain very low as company balance sheets continue to look healthy. However, given the uncertain economic outlook, yields on corporate debt have increased. This offers a good opportunity in investment grade debt, which is currently yielding around 6% and historically has a default rate of well below 1%, even in the most extreme market downturns.

> Debt with longer maturities is currently trading at a lower yield than shorter maturity debt, exhibiting what is called an inverted yield curve. This suggests the debt market expects yields to fall in the future, most likely caused by an economic slowdown.

Commodities

> Oil and gas prices have fallen from highs set at the start of the six month period. OPEC, a group of countries which control most of the supply of global oil, have been more accommodative to supply increases. The war in Ukraine has not changed considerably for the worse and a relatively mild European winter have also tempered fears of energy rationing.

> Fears around an impending recession, and the impact this will have on the consumers finances have also weighed on the outlook for oil prices.

> Gold prices have remained relatively flat over the six month period finishing 2022 at $1,820/oz.

Currency

> The pound had a volatile six months, with the mini-budget driving the pound as close to parity with the US dollar as it has ever been, briefly reaching 1.03 GBP/USD. However, as the UK's economic landscape became more certain at the end of the six month period, the pound regained most of its losses to finish at 1.21 GBP/USD.

> The US dollar has remained strong over the six month period as investors looked for safety in the US dollar, as well as the perception that the Federal Reserve will continue to hike rates at a faster pace than other major central banks.

> The yen has remained weak across this period, continuing its tumble against major currencies as the Bank of Japan continues its accommodative monetary policy – in stark contrast to most other central banks.

> The euro has remained largely where it was six months ago, as key political risks failed to fully materialise and the European Central Bank followed other central banks in tightening policy.

Cryptocurrency

> Cryptocurrencies failed to offer the inflation protection promised by many enthusiasts, with Bitcoin falling 13% over the six months, and the broader crypto index falling 11%.

> There have been some positive lights with the second largest coin, Ethereum, increasing 13%, although this brings the year to date loss to 65%.

> Innovation has continued in this space, with coins such as Tether, which are backed by physical assets, and the USD Coin, which tracks the USD, gaining popularity.

> Crypto markets have been rocked by the bankruptcy of the third largest crypto exchange FTX, whose owner has been charged with fraud. It is unlikely any FTX customers will see any of the money they put on to the platform.

Hedge Funds

> The volatility and wide variation of returns across major asset classes have provided fertile ground for hedge fund managers to deliver uncorrelated returns.

> Performance across the sector has been positive, however there has been considerable discrepancy across different hedge fund styles, with macro and currency strategies being afforded ample opportunity to outperform.

Private Equity

> Discounts in listed private equity (share prices relative to the net asset value of the underlying fund) have remained at historically wide levels over the six month period, as investors worry about the lag between private and public valuations.

> Activity in the private equity sector has faced challenges in the inflationary environment but remains above levels seen in 2020 as managers took advantage of attractive valuations.

Outlook for the year

At the start of 2022 we warned of inflation moving higher and becoming more entrenched than both markets and central banks were anticipating. This has indeed been the case; however, we too have been surprised by the level of inflation and the corresponding reaction by central banks around the globe. The response by central banks has brought the decade-long quantitative easing experiment to an end and forced them into introducing more restrictive policies. These policies, which are designed to bring down inflation, have brought monetary policy into restrictive territory – in other words at a level which is likely to cause some form of recession.

The major contributor to the actions of central banks is inflation. We have seen the path of inflation, in the short-term at least, to be trending down from decade-long highs. We would expect this to continue as we see the year-on-year figures fall, largely driven by gasoline and natural gas prices, which were elevated at the start of 2022 at the onset of the war in Ukraine. It is also likely that goods prices will put downward pressure on inflation as pandemic related supply chain disruptions continue to alleviate. However, it is the second order effects that we believe will keep inflation stubbornly above the central bank's target of 2%. These second order effects can be driven, in part, by increased wage demands in a labour market which, at the time of writing, is at historically tight levels with demand for workers far exceeding available recruits.

A global recession in 2023 is by no means a foregone conclusion but the signs are pointing to one. The US in fact entered a technical recession in 2022 with two consecutive quarters of negative GDP growth but was saved by the National Bureau of Economic Research, who failed to see enough evidence in other factors to declare a formal recession. If a recession does occur it is expected to be a moderate one, as savings rates remain high among consumers following the pandemic and there are no obvious private sector imbalances which caused much of the pain seen in 2008. However, it is important to be alert to the prospect of events which lead to contagion caused by a weaker economy. The UK's mini-budget is a recent reminder of the fragility of small pockets of financial markets which can have knock on effects to the wider market.

We begin the year with a more positive outlook, after our cautious stance during 2022. Valuations in both fixed income and equities enter 2023 at far more attractive levels than we have seen in many years. Inflation is likely to continue its downward trajectory, which could lead to a pivot by central banks. This would signal the end of a rate tightening cycle (at least in the short term) and would likely be viewed positively in both equity and fixed income markets. At present, markets are anticipating a mild recession. If any recession turns out to be worse than expected, this will no doubt have an impact on company earnings, which have so far been resilient. In this scenario, there could be further downward pressure on equities.

North Capital portfolio positioning

After being defensively positioned for much of 2022, we begin this year with an increase in equities back to our long-term neutral stance.

Within equities, we believe relative allocations will be rewarded this year – and so have tilted our exposure East – to emerging economies and Japan. Within Japan, we have added to more domestically focused Japanese companies. This has been introduced to benefit from movements in the yen which is very inexpensive while Japanese companies themselves are also on very reasonable valuations and are likely to benefit from the corporate governance revolution in the country.

We maintain our exposure to real assets – commodities, infrastructure, property, and gold – as we do expect inflation to remain above trend, albeit below the recent peak, over the medium term. These assets have historically acted as good inflation hedges while also giving us exposure to assets which tend to benefit from increased geopolitical tensions.

Within fixed income we continue to prefer shorter duration bonds which possess prices less sensitive to interest rate movements, as well as investment grade debt which is currently yielding more than enough to compensate for its limited default risk. We have also increased our allocation to inflation linked bonds, whose payments are linked to inflation which provide some further inflation protection to portfolios.

Although the outlook remains uncertain going in to 2023, we believe the regime shift that we have seen throughout 2022 now provides opportunities to deploy capital in a market which is far more fairly valued than it was 12 months ago.

	Asset Class	Tactical Conviction -2	-1	0	1	2	Rationale
	Overall Risk		○	●			**As we enter 2023, we become more positive on risk, having been underweight in 2022 – raising our allocation to equities back to neutral.**
Defensive Assets	**Cash**			●			**We remain neutral on cash.**
Defensive Assets	**Fixed Income**			●	○		**Throughout 2022, we built fixed income up from a maximum underweight to a slight overweight, as yields rose. At the beginning of 2023, we return to neutral.**
Defensive Assets	UK Sovereign Bonds		●				We remain biased to short duration bonds; due to the volatility we are seeing at the longer end (e.g. bonds with maturity beyond 10-years). Longer duration bond prices are much more sensitive to changes in interest rates. Due to the deep uncertainty over inflation and corresponding path of interest rates, we do not wish to run this risk. We have a preference towards investment grade bonds, as we are likely entering into a recession, with high yield bond credit spreads not wide enough to offer value. Holding a portion of sovereign bonds appears prudent in a recessionary environment.
Defensive Assets	UK Corporate Bonds				●		
Defensive Assets	Global Bonds			●			
Defensive Assets	Tactical Fixed Income			●			
Defensive Assets	**Real Return**			●			**Defensive real return assets offer good value in 2023, in the face of heightened inflation and rising rates.**
Defensive Assets	Inflation-Linked Bonds			●			After a significant sell off in inflation-linked bonds in 2022, notably at the long-end, we decided to bring exposure back to neutral. Real yields (nominal bond yield minus the expected inflation rate) are now positive, presenting value to investors.
Defensive Assets	Tactical Real Return			●			
Growth Assets	**Equities**		○	●			**Equities have become more attractive, with valuations closer to long-term averages and at a significant discount in some sectors/regions.**
Growth Assets	UK Equities			●			We believe 2023 will be a year where relative allocation within equity regions, styles and sectors will be rewarded. Regionally, we favour Emerging Markets and Japan, having recently increased exposure to both. We believe Emerging Markets offer attractive valuations and structural tailwinds, that are likely to persist in the medium term. There are signs that the US dollar may have peaked, which again supports the Emerging Market thesis. Japan offers investors useful diversification, notably with yen exposure (which remains undervalued). We think that US equity market dominance is over and that investors will look for better value options globally. Smaller companies offer an attractive entry point for long-term investors, at a steep discount to historic valuations. We retain our bias to quality stocks.
Growth Assets	Europe Ex UK Equities		●				
Growth Assets	US Equities		●				
Growth Assets	EM/Asia Equities			○	●		
Growth Assets	Japan Equities				●		
Growth Assets	Tactical Equities			●	○		
Growth Assets	**Real Assets**			●			**We retain exposure to real assets. The asset mix has tended to fare well during periods of heightened inflation.**
Growth Assets	Infrastructure/Clean Energy				●		We maintain our underweight to property, in favour of infrastructure. We are actively considering increasing exposure to commodities, which have historically been a very good inflation hedge. This is across the commodity complex, including gold, materials and energy.
Growth Assets	Property		●				
Growth Assets	Tactical Real Assets			●			

● = Current positioning ○ = Prior positioning

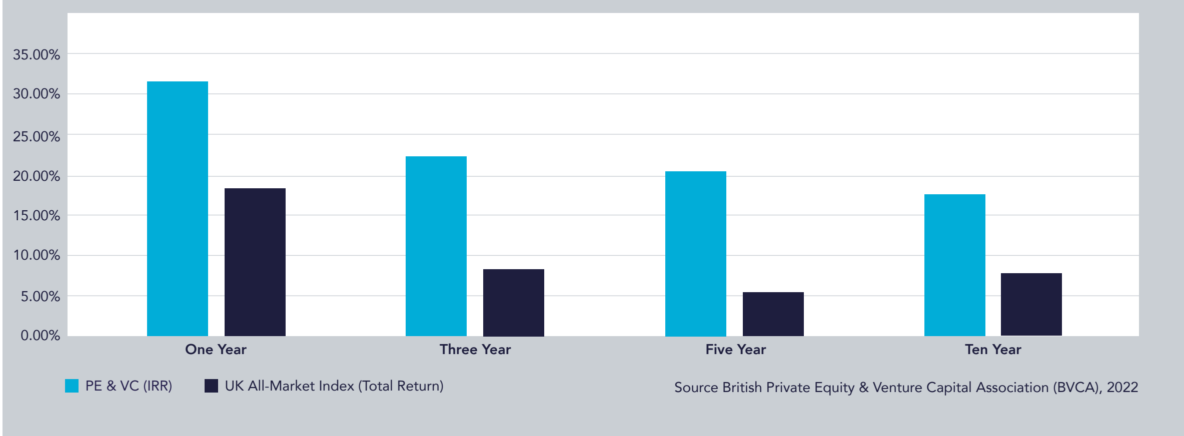
Spotlight: Private Equity

The Private Equity (PE) sector has attracted investors since its inception in the early 20th century, evolving significantly between the 1960s and 1980s with the emergence of PE funds. Renowned managers such as The Blackstone Group, Bain Capital, and KKR created means for investors to access the asset class through primary and secondary funds. Primary managers invest in companies directly, while secondary managers specialise in buying assets from other private managers requiring liquidity. PE funds now lead the way within the buyout, growth, and venture capital (VC) sector. We are cognisant of the fact that PE has its fair share of jargon, therefore we have enclosed a glossary at the end of this article.

PAUL SWAN
INVESTMENT ANALYST

At North Capital we are strong proponents of investing in private markets for those investors who can afford the illiquidity associated with the asset class. We first wrote about PE in our Q1 2018 Spotlight and introduced the favourable risk and return fundamentals. Five years on, the outperformance has been maintained as the asset class continued to provide a higher rate of return compared to its public market counterparts. In the UK, PE and VC have outperformed the public equity market over a one, three, five, and 10-year time horizon (to year end 2021). In 2021, the UK PE and VC industry returned 31.5% (BVCA, 2022). This outperformance is illustrated in figure 1. Similarly in the US, the primary PE index outperformed all major US public equity indices over the same time horizons. PE returned 41.3% in 2021, around 15% higher than US equity markets (American Investment Council, 2022).

Figure 1: UK PE Funds v UK All-Market Performance



Note: PE returns are calculated differently to public markets because of their illiquid nature and irregularly timed cash flows. The previously reported rates are Internal Rate of Return (IRR) which is an annualised growth rate that accounts for the timing of cash flows during the overall life of the investment.

2020 – 2021: A Recap

PE was not immune to the disruption caused by COVID – activity slowed abruptly in Q2 2020 before a V-shaped recovery eventually occurred. PE dealmakers stood strong, ending 2020 in line with their sturdy five year averages and backing up their reputation of providing enduring strength in uncertain times. The rapid bounce back can be explained by central bank policy, with trillions flushed into the economy to steady liquidity concerns for companies and markets. This resulted in a large amount of dry powder (cash committed for investment but unallocated). Private equity investors (known as General Partners (GPs) and Limited Partners (LPs)) needed to invest these funds, contributing to a strong Q3 and Q4 performance.

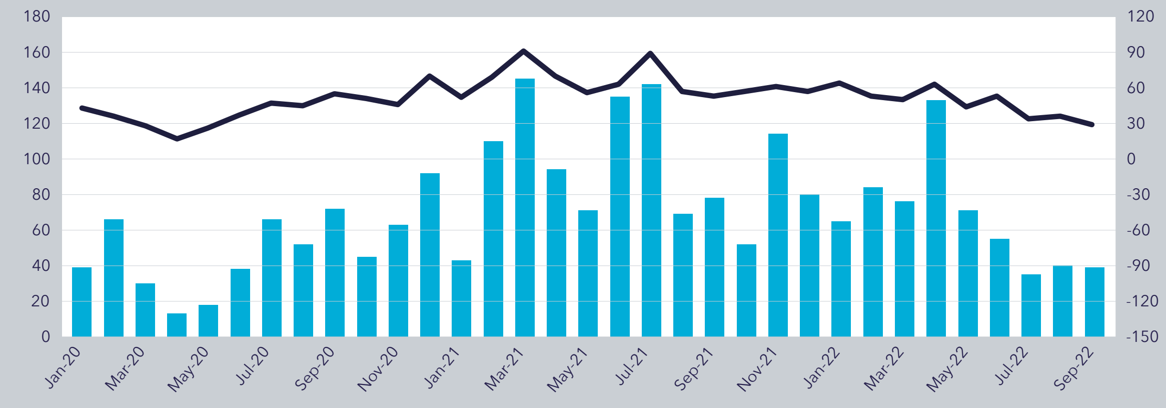
2021 became a record-breaking year in private markets with global assets under management (AUM) reaching $9.8 trillion. PE is responsible for nearly two-thirds of this after seeing 37.7% AUM growth over the year. Buyout deals alone were valued at $1.1 trillion, passing the 2006 record. Record figures are attributed to a jump of $2 trillion in net asset value, driven by higher valuations on unrealised assets. Also, PE's broad middle grew, with average deal size increasing 57%, raising it past the $1 billion mark for the first time. Even though deal values doubled from 2020's $569 billion, deals remained around the five-year average of 4,000, meaning the industry's $3.4 trillion in dry powder encouraged money to be put to work through larger deals.

Furthermore, 2021 proved to be an impressive year for exits. Soaring valuations, near zero cost of debt, and a large fiscal stimulus made it the perfect time to sell any asset. Therefore, exit valuations leapt to 131% against its five-year average. Money was also put to work through executing public to private (P2P) transactions, which rose 57% year on year. P2P provided a useful route for deploying capital, particularly in North America and Asia-Pacific, due to their magnitude and capacity to absorb large capital influxes. The shift to P2Ps mirrors activity right before the financial crisis. Back then, the performance was mixed with overpriced and directionless deals keeping internal rate of return (IRR) in single figures. However, this was not the case in 2021 due to stricter management, ensuring excess cash was used effectively and a focus on value creation for clients.

2022 and the Future

Following this success, 2022 proved considerably more challenging. Inflationary pressures tightened profit margins and decreased consumer spending, clear threats to PE investments as revenue and margin growth have slumped. Other macro issues have also come to the forefront: labour shortages put upward pressure on wages and the strong performance in 2021 stretched valuations to unsustainable levels. Lastly, geopolitical tensions and the war in Ukraine have created a universal retreat from globalisation, impeding the free flow of capital. Despite this, activity remains well above the levels seen in 2020 and at the largest PE firms, AUM has continued to climb.

Figure 2: Global PE Acquisitions by Month



Source EY, 2021

Year on year US inflation appears to have peaked and fell slightly in the second half of 2022. GPs and LPs will be assessing interest rates, inflation, recessionary scenarios, and analysing the effect on their portfolio companies or any acquisition targets. We believe the outlook for PE in the long run remains attractive – $3.6 trillion of dry powder leaves GPs in a strong position to anticipate any economic recovery.

PE firms continue to maintain a close eye on depressed public valuations, especially in newly listed firms. More than three quarters of US firms that became publicly listed in 2019-2021, are now priced below their initial public offering (IPO) share price, providing an attractive acquisition target for PE firms with ample dry powder. Indeed, there were 49 bids for London listed firms in 2022 and we have witnessed several funds complete a P2P strategy including the 'take private' of FTSE 250 firms Ted Baker plc, Euromoney plc and Stagecoach plc in 2022. Moreover, PE firms continue to innovate with new products and strategies. As leverage now looks set to remain expensive, PE firms will focus their exposure on quality companies and drive organic growth.

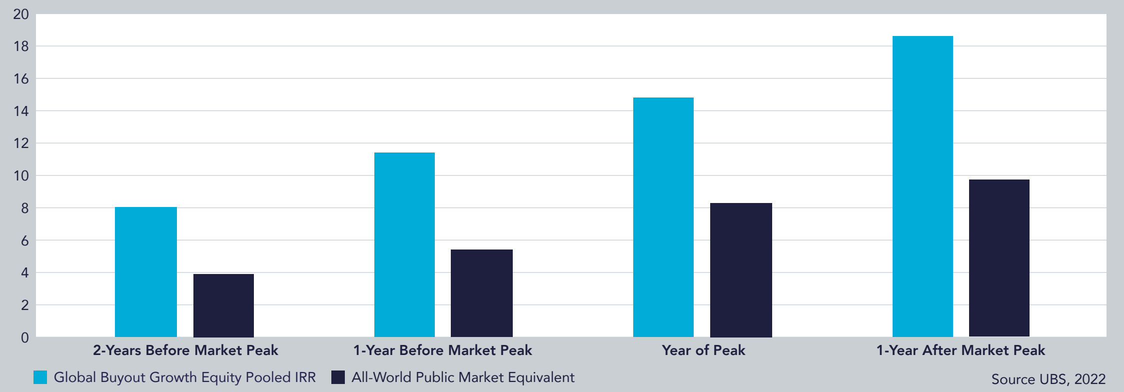
For the more established portfolios, PE funds are revising net asset values to reflect the current macro environment, but importantly as PE fund managers inherently have a long-term focus and are not forced sellers, we would expect holding periods to be extended and distributions become more muted in the short term.

It is important to note that whilst this may reflect in lower reported IRRs, it may not necessarily translate to lower exit multiples on investment. As David Baur, Head of Capital Equity Markets at KKR, commented "when you think about the amount of private equity capital that has been raised, then look at how much public equity valuations have re-rated, it feels like it's going to be a natural pairing up."

Analysis of PE vintage returns following public market peaks have delivered strong returns, consistently outperforming long-term averages for PE and the public market's own recovery.

Figure 3 shows the average vintage year IRR in % before and after the equity market peaks in 2000 and 2007.

Figure 3: Average Vintage Year IRR % Before and After Market Peaks



This can be partially attributed to the ability of GPs to take advantage of depressed valuations to acquire businesses during this time. Volatile markets can incentivise business owners to sell and/or force a re-evaluation of selling price expectations. Moreover, PE investment managers have control mechanisms and funding streams to support and help companies navigate through recessionary environments.

Neuberger Berman (2022) show that private equity portfolios have also experienced shallower peak-to-trough declines than the public equities. Indeed between 2007-2009 the buyout sector in the US experienced a peak-to-trough decline of 28%, this is roughly half the 55% drawdown for the major US All-Market public equity index. Furthermore, a PE portfolio diversified by vintage (the starting year of the fund) was able to recover much quicker than the public market despite a sharp bounce-back in public equities. A similar pattern exists between 2000-2003. These more modest drawdowns are attributed to insulation from public market sentiment and the control that private managers have over their companies.

Consequently, the current environment may well present a decent opportunity for investors to build an allocation to PE.

The North Capital Approach

The characteristics of the asset class has made the sector attractive to investors and forms part of our investment proposition at North Capital. To invest in PE funds, investors are committed to the investment for a minimum period, potentially a decade or longer, allowing the managers of the underlying companies time to transform and increase the value of their companies. This elevates the risk of the investment by removing the convenience of daily liquidity as seen in public equities. It is however a reasonable expectation for investors with the ability to tolerate this illiquidity to be compensated through higher returns, known as the 'illiquidity premium'. It is worth referring to the North Capital cash, lifestyle and endowment framework in the July 2022 Spotlight, where we discussed how investors may calculate a suitable allocation to illiquid investments. This is represented below in figure 4.

PE is most likely to sit within the endowment strategy, where clients typically can afford a higher risk profile, an extended time horizon and therefore the opportunity to access the illiquidity premium.

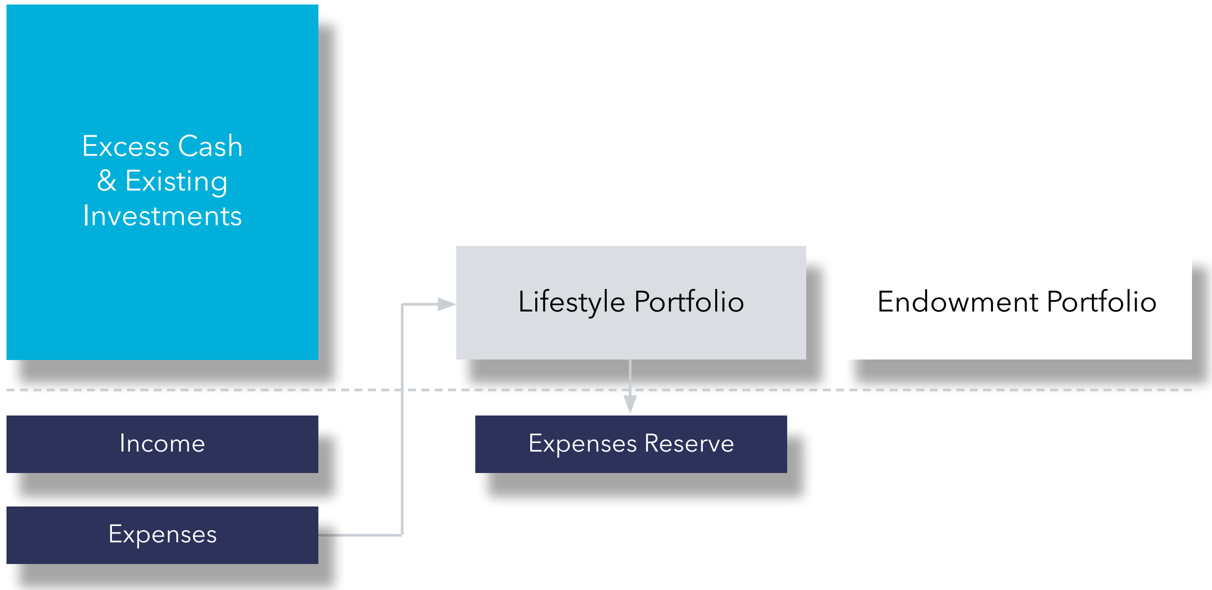


Figure 4: North Capital Management, 2022

Our approach to developing a strategy to invest in PE and private markets is one based on the principles of diversification. Firstly, as an asset class which can be held alongside a more traditional portfolio, primarily composed of public equities and fixed income. PE allows investors access to a broader investment universe, with 99% of all companies being private and a current trend of less companies choosing to become public. In the US, for example, the average number of IPOs fell from between 300 and 400 per annum between 1990 and 2000 to around 130 in the following two decades. Investors focussed purely on public markets are missing a broader opportunity set.

Secondly, diversification should be embedded in PE portfolio construction. Investors considering exposure to PE should allocate their capital across several PE funds, across geographies, managers, strategies, and vintage years. This approach limits over-exposure to any single factor or strategy. It reduces dependence on any single economy or region, whilst also ensuring less reliance on the behaviour or biases of any single fund manager. Investing across vintages helps investors access the whole opportunity set and should smooth performance differences between funds launched in different years.

An interesting benefit of illiquidity is that it helps investors avoid some behavioural biases. PE helps us invest systematically and without emotion in both times of market excess and market distress. PE investments are typically less impacted by day-to-day news, instead focusing on long-term value creation differentiating the asset class from public equities. The additional risk of the investment also provides the potential for exceptional return on investments.

Using our approach, PE has the potential to be suitable for clients as part of their endowment portfolios. The asset class may not appeal to those with spending commitments or liabilities, or to those with a preference for lower risk. However, the asset and its many potential benefits, combined with the previously discussed positive outlook, could be attractive for those able to tolerate the risk and illiquidity.

Glossary of Terms

Buyout Strategy	Buyout funds take controlling stakes in established companies with a view to create extra value.
Growth Strategy	Growth funds make minority investments into fast growing companies that need additional funding to expand.
Venture Capital (VC)	Venture capital funds acquire minority stakes in start-ups and early-stage companies.
Private Markets	Private Markets refer to assets not listed on a public market. It captures PE, private debt, infrastructure, and other real assets.
Public Equities	Companies with shares traded on a public market. For example, companies listed on the London Stock Exchange.
Dry Powder	Cash reserves retained by private market firms to cover future obligations, purchase assets, or make acquisitions.
General Partners (GPs)	Fund managers.
Limited Partners (LPs)	Investors into a private equity fund.
Public to Private (P2P)	The acquisition of the entire share capital of a publicly listed company by a PE manager.
Initial Public Offering (IPO)	An IPO is an offering in which the shares of a company are sold to investors for the first time via a stock exchange.
Exit Multiple	A measure of the total return from an investment in PE. It is the total cash received from the investment divided by the total cash invested. For example, if an investment of £100,000 yields a total cash return of £200,000, the exit multiple is 2X.
Vintage Year	The starting year of the fund when the first investments are made.

Spotlight:
Satellite Portfolios

Summary of the last six months

We have recently introduced a range of thematic discretionary managed portfolios, that act as a satellite allocation to a broader portfolio.

In the digital age, investors have a large volume of information to digest which brings many ways to gain exposure to markets, ranging from single stocks, to funds and ETFs (Exchange Traded Funds). There are thousands of investable options available – which can sometimes be overwhelming. Our role as investment managers is to distil the information and provide a curated list of best ideas for investors to access. Typically, this results in the formation of investment portfolios matching the risk tolerance and objectives of clients – this is what we would call a core portfolio, which is typically considered for the long-term. In order to provide investors with more focused exposures to specific themes, we have developed our range of satellite portfolios, that complement core portfolios. Whether it is capital preservation, inflation protection or growth potential, our satellite portfolios enable investors to tilt towards preferred themes.

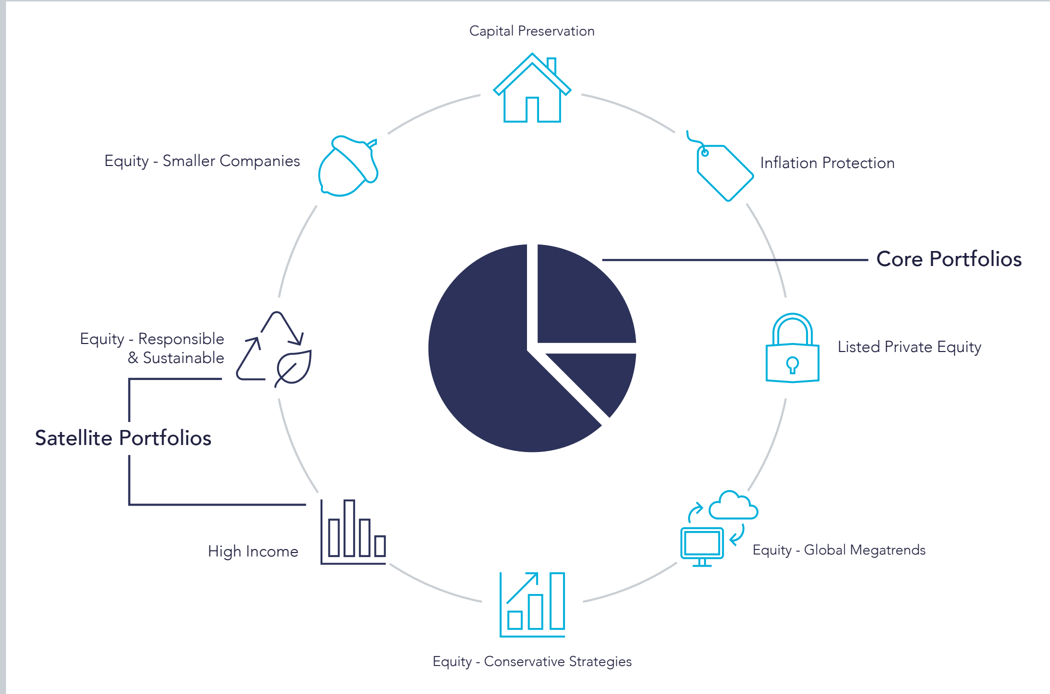
ANDREW SPENCE
CHIEF INVESTMENT OFFICER

Core/Satellite approach

Core portfolios typically consist of around 25-30 underlying funds, giving full diversification to meet the longer term objectives. We normally allocate 70% – 80% of an investor's capital to these portfolios.

Satellite portfolios typically consist of around 5-10 underlying funds, giving more focused exposure to a specific theme. This core/satellite approach to investing allows investors to create an overall portfolio more reflective to their investment preferences.

An illustration of the satellite portfolios we run



Our satellite portfolios

At present, we offer eight satellite portfolios, as described below:

Capital Preservation	This portfolio seeks to provide positive absolute returns, with low levels of volatility, from a diversified mix of fixed income, absolute return and multi-asset funds.
Real Return	This portfolio seeks to provide exposure to a diverse mix of inflation sensitive assets, across the risk spectrum, such as: property, infrastructure, commodities and inflation-linked bonds.
High Income	This portfolio seeks to provide an enhanced income yield from a portfolio of high income assets.
Defensive Equity	This portfolio seeks to provide equity like returns, but with lower levels of volatility than the overall market.
Responsible and Sustainable Equity	This portfolio seeks to provide equity exposure to the key structural themes as part of responsible investing. Principally that of climate change, social impact and health and wellbeing.
Global Megatrends	This portfolio seeks to provide equity exposure to long-term structural themes such as: climate change, aging population and technological innovation.
Smaller Companies	This portfolio seeks to provide equity exposure to companies lower down the size spectrum, with the opportunity to benefit from active management across geographies.
Listed Private Equity	This portfolio provides exposure to listed private equity companies in a diversified manner.

These satellite portfolios have been specifically designed to offer investors, in discussion with their adviser, more flexibility when constructing their overall portfolio. For example, a client may hold a core balanced portfolio, but would like more exposure to inflation sensitive assets. Here, they could consider our Real Return portfolio – which is a diversified mix of inflation sensitive assets, as described opposite.

Example Satellite Portfolio – Real Return

Aim

The Real Return portfolio seeks to provide exposure to a diverse mix of inflation sensitive assets, across the risk spectrum, such as: property, infrastructure, commodities and inflation-linked bonds. The portfolio targets a positive real (inflation adjusted) return (net of fees) over the long term*.

Investor Profile

Typical investors in this portfolio are likely to be those looking for broad, diversified exposure to inflation sensitive assets; or those looking to enhance the inflation characteristics of a wider portfolio strategy. They are willing and able to accept moderate levels of volatility in order to achieve this.

Portfolio Characteristics

The asset mix is constructed using a range of asset classes, across equities, bonds and alternative investments. As such, it is likely to exhibit moderate levels of volatility. The beta (change in portfolio, relative to change in equities) is also expected to be moderate, with the potential for it to be close to one (equivalent beta) in extreme market conditions.

Holdings*

> Sanlam Global Inflation-linked Bond fund (25%)
> TwentyFour Monument Bond Fund (10%)
> M&G Global Listed Infrastructure Fund (15%)
> Waverton Real Assets Fund (15%)
> RM Alternative Income Fund (7.5%)
> Foresight Sustainable Global Real Estate Fund (12.5%)
> JPMorgan Natural Resources Fund (15%)

For illustrative purposes only. Actual holdings may vary according to manager discretion.

Noteworthy

HAMISH MACPHERSON
ASSOCIATE ADVISER

Campeones del Mundo!

Despite the uproar and controversy leading up to the 2022 World Cup, there is no denying that the Qataris hosted a tournament that will go down in the history books as one of the most thrilling, with countless records having been broken.

Lionel Messi played in a record 26th FIFA World Cup match, whilst also matching Geoff Hurst's record for the most goals scored in a World Cup final. Morocco became the first African nation to advance to a World Cup semi-final. Stephanie Frappart became the first woman in history to referee a men's World Cup match. The 2022 tournament also saw eight teams drawing the opening game 0-0 for the first time ever. Cristiano Ronaldo became the first man to score at five World Cups. Almost 20 million people in the UK tuned in to watch the final. The tournament had a total attendance of 3,404,252 spectators, the third highest attendance to date.

Beyond the pitch, there were several mind-boggling statistics. Mark Zuckerburg had reason to gloat after WhatsApp reached a record 25 million messages per second during the final, as well as Messi's celebratory Instagram post amassing a record 72 million likes. Elon Musk jumped on the bandwagon by tweeting that there had been 24,400 tweets per second after France's equaliser, the highest ever for a World Cup.

But perhaps the most impressive feat of them all is that not a single British national was arrested during the tournament. A Christmas miracle for the foreign secretary!

Traditional caviar on death roe?

Beyond Meat's posh, upper-class cousin, Caviar Biotech, claims to have cracked the code in terms of the production of sustainable caviar, by growing sturgeon eggs out of a laboratory in 'biochemical soup' in just 40 days. For reference, it normally takes around 14 years for a sturgeon to reach maturity and lay the eggs from which caviar is derived.

Kenneth Benning, who founded Caviar Biotec in 2013, opened England's first caviar farm in Exmoor before developing the 'franken-sturgeon' technology with biochemical engineers from UCL. They claim this technology could produce more caviar than the entire global production in a room less than 300m2. This is sure to disrupt the £640m sturgeon farming industry.

Sam Bankman-Fraud

This year saw one of the biggest falls from grace the world of finance has seen when Sam Bankman-Fried's cryptocurrency exchange platform, FTX, a company worth $32 billion, collapsed into bankruptcy.

The reason why isn't yet fully understood, but a lethal concoction of greed, nonchalance and stupidity surely played a part. US prosecutors are investigating how FTX may have manipulated the price of the cryptocurrencies Terra and Luma, after speculators began to have doubts and their prices started to fall. It turns out that majority of the sell orders came from Bankman-Fried's own trading company, Almeda Research, which held billions of dollars' worth of FTX's own cryptocurrency, FTT. It was able to use this as collateral for loans that were being spent on real estate and huge political contributions. When investors caught wind of this, they pulled a $6 Billion rug from beneath FTX. Their main rival, Binance, sold $580m worth of FTT before pulling out of a deal to save them. 72 hours later, Sam's fortune had evaporated and FTX filed for bankruptcy, leaving an $8bn hole in customer deposits.

At one point the world's 32nd richest person, he was now proverbially at the helm of the biggest sinking ship the crypto world had ever seen. 'Sorry' wouldn't cut it, and the world would make sure to see him go down with it. He was arrested in the Bahamas and extradited to the US, where the was tried and released on bail for $250 Million, an impressive sum to pay for a bankrupt man who owed literally billions to those he'd failed.

We think this highly speculative 'asset class' is probably here to stay, but this is yet another example of how it still operates as the 'Wild West' of the investment universe.

Bluetooth

Fresh new clues have been unearthed in the search for the burial ground of the Viking whose name was used for the wireless Bluetooth technology, developed by Ericsson.

The Norse king is credited with helping to spread Christianity across much of Scandinavia, and until recently, it had been widely accepted that King Harald Gormsson of Denmark, who died in 986 AD, was buried in the small Danish city of Roskilde.

However, Swedish archaeologist, Sven Rosborn, and Polish researcher, Marek Kryda, may have had a breakthrough following the discovery of old parish archives and an inscribed golden disc.

The Sielski family came into possession of the above artefacts after they were discovered in a tomb beneath the Wiejkowo church, in western Poland, where a medieval chapel once stood. The reason for Rosborn and Kryda's excitement? Both refer to Bluetooth, the name the King was given due to a tooth of his that had gone bad. On top of this, recent geological surveys of the site show strong indicators of a Viking burial ground. However, there are no plans just yet to excavate the site.

The logo for Ericsson Mobile's Bluetooth technology symbolises the way Harald Bluetooth united the tribes of Denmark into a single kingdom, represented by the initials H and B in Scandinavian runes.

Disclaimer

All data as at 31/12/2022

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