CREDO

Fund Commentary

In the final quarter of 2023, the Credo Dynamic Fund (Dynamic) demonstrated robust performance, delivering a return of 7.6%, surpassing both the benchmark and peer group (the IA Mixed Investment 40-85% Shares Sector), which returned 5.8% over the same period[1]. This marked a notable achievement in a prosperous year as the Fund outperformed its peers by 2.9%. The consistent outperformance has contributed to the Fund's impressive long-term track record, surpassing peers by 12.7% over the last three years and a notable 22.1% since inception, establishing Dynamic as one of the best-performing and highest-rated funds in the sector.

Reflecting on the challenging backdrop of 2023, which followed a difficult 2022 for all assets, investors began the year with concerns surrounding both inflation and a recession. Whilst there was strong consensus on a recession from research analysts as well as CEOs, this never materialised. The ensuing optimism grew throughout the year culminating in the US Federal Reserve Bank (the Fed) completing a U-turn. Having raised rates four times in 2023, the Fed surprised the market late in the year by signalling several rate cuts could be expected in 2024. As a result, all investments were back in play, as investors scrambled to tie in long-term interest rates or increase their exposure to equities. This led to the Fund having a very good breadth of returns in the last quarter with third-party funds, individual equities and corporate bonds all delivering strong returns.

As of year-end, the strategic asset allocation comprised 43.4% in equities, 43.0% in fixed income and 12.5% in alternatives. While this allocation may appear cautious compared to a traditional 60/40 portfolio (i.e., 60% stocks and 40% bonds), it is important to emphasize the distinctive characteristics of the portfolio constituents. We remind investors that the fixed income allocation is not merely for diversification, but is positioned to deliver an attractive outright return, maintaining an exciting yield of 8.7% as we entered the quarter. Furthermore, despite the appearance of stability in recent quarters, the asset allocation conceals three significant changes that were made in the period. These changes share a common theme of introducing more beta, enhancing the Fund's sensitivity to market swings, and all contributed to the outperformance in the quarter.

1) When the Facts Change our Opinion Changes

In recent updates, we have referred to the high-quality laddered portfolio of corporate bonds. This provided an attractive return relative to cash as well as downside protection. This approach appeared prudent amid the heightened uncertainty in markets until the fourth quarter presented a shift in the global inflation landscape. Inflation data from the UK and US trended towards a more reasonable 3-4% range, with forecasts indicating a continued cooling in 2024. This shift has effectively dispelled concerns over rampant inflation, marking a significant departure from the earlier environment.

[1] *Performance of the Credo Dynamic Fund Class A Retail Shares over the period 30/09/2023 to 29/12/2023.*

The undeniable link between inflation and interest rates has been the key source of economic concerns and market uncertainty. If inflation is truly plateauing and the Fed doesn't have to fight the inflation war, given the Fed's dual mandate of keeping prices stable and achieving maximum employment, one assumes a neutral rate will be lower than today's interest rates. This could be a fortuitous turn of events, as until only recently the Fed Chair hammered home the view that rates had to stay higher for longer and there was a big reticence to cut too soon. However, as previously mentioned, the U-turn was complete in December when the Fed Committee, through the infamous dot plots, indicated there would be several rate cuts in 2024.

Throughout 2023, Dynamic has made a gradual shift towards acquiring longer-dated bonds, which accelerated in the final quarter. This marked a departure from the initial focus on downside protection and signalled a strategic shift towards anticipating potential capital gains. Longer-dated corporates, with a maturity of greater than 10 years, typically offer higher yields due to greater uncertainty until maturity. Crucially, these bonds exhibit a higher potential for capital gains, particularly in anticipation of moderating interest rates. Over the year, Dynamic increased the duration by approximately 50%, progressing from around 3 to 4.5 years at the start and end respectively. This resulted in notable performance on the longer dated bonds. Standout performers were a 30-year British American Tobacco bond and a Nationwide Perpetual bond, both delivering mid-double-digit returns primarily driven by capital appreciation.

2) Beautiful Things Come in Small Packages

Dynamic has consistently maintained exposure to small and mid-sized companies, recognizing the evidence suggesting their long-term potential for substantial growth and outperformance, albeit with higher volatility. However, when inflation re-emerged in late 2021, we took a prudent approach by significantly reducing the exposure to such assets due to concerns about a potential economic downturn. Smaller companies typically have fewer resources to combat higher interest rates, prompting us to prioritize the stability of larger companies with more predictable business models and stronger balance sheets.

The seven largest US technology companies, which have become universally known as the Magnificent Seven, were responsible for the lion's share of gains over the year. After such incredible returns, bouncing back from a dismal 2022, the Magnificent Seven stocks are now roughly equal to the combined value of the Canadian, UK and Japanese stock markets. Although it is undeniable these are great companies, after such a strong run, we were left wondering if there were better opportunities in the stocks that had been left behind.

The graph below illustrates an example of the discount in smaller companies. Quite simply, the gap was too large to ignore. Cognisant of the potential recession risks in smaller companies but believing to a degree that this may be priced in, we increased the exposure to small and mid-cap stocks and the other 493 companies in the S&P 500 that fall outside of the Magnificent Seven.

Relative Forward P/E of US Larger Companies (Russell 1000) as a Ratio of Smaller Companies (Russell 2000).

Source: BofA, Factset, November 2023

Furthermore, the UK market, our local hunting ground, trades at a discount to global markets. As a result, UK smaller companies are at very attractive long term valuation and have a history of doubling in value over 5 years from valuations seen at the beginning of the quarter, thereby further encouraging Dynamic to add to this asset class.

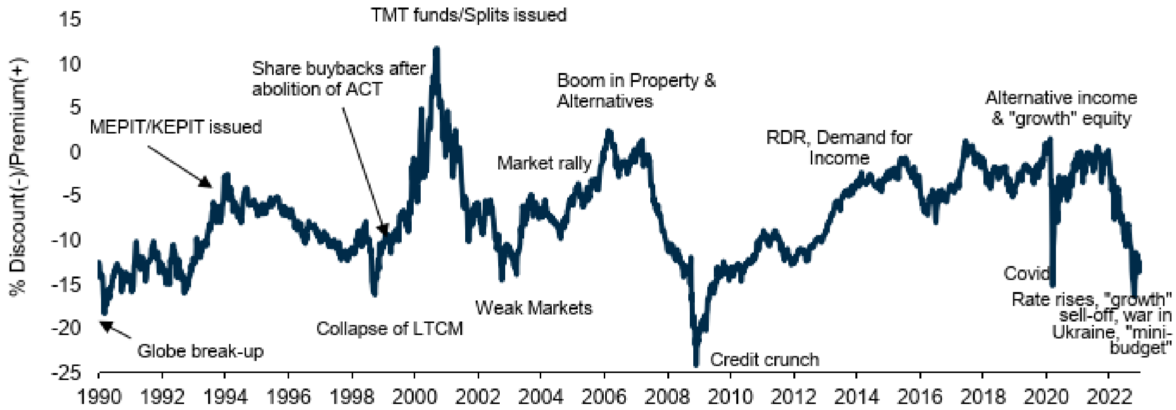
In terms of individual equities, a standout performer was FRP Advisory Group, a top ten holding specializing in restructuring, administration and corporate advisory services. The company responded positively to a trading update, delivering a substantial 15% increase in value during the period. Notable gains were also made in the Investment Trust arena, which we outline in more detail next.

3) Investment Trusts add Alpha

In the long-term landscape of investments, historic evidence suggests that Investment Trusts have outperformed Unit Trusts. Unlike Unit Trusts, where investors purchase new units, Investment Trusts operate as closed vehicles with permanent capital. One contributing factor to this outperformance could be that managers are not distracted by the constant inflows and outflows of funds, allowing for a more focused and strategic approach. Additionally, the ability of Investment Trusts to utilize leverage can potentially enhance returns when used judiciously. Whatever the precise rationale, the attractiveness of Investment Trusts became evident in 2023, fuelled by a valuation anomaly.

In contrast to Unit Trusts, which trade at the Net Asset Value (NAV), Investment Trusts are subject to the influence of supply and demand causing them to trade at either a premium or a discount to their assets based on market sentiment. In 2023, Investment Trusts experienced their widest discount since 2008 as shown by the graph below. This presented a rare opportunity, as Investment Trusts could potentially deliver a leveraged return on the market, benefiting from both the narrowing of discounts and the appreciation of asset values.

Discount/Premium of Investment Trusts



Source: Numis, October 2023

Throughout the year, we doubled the exposure to Investment Trusts, to constitute approximately a third of the Fund, with a particular focus on equity Investment Trusts. This expansion involved a variety of names including Montanaro in the smaller company arena, Smithson in the mid-cap space and Pershing Square Holdings with its focus on larger companies. In the last quarter of the year, the equities within these investments exhibited strong underlying performance, accompanied by a narrowing of discounts, resulting in half of the top ten performers of Dynamic being Investment Trusts.

While most positions thrived, the Hipgnosis Songs Fund was one of the few that detracted from overall performance over the period. Recognizing some uncertainty and governance issues, coupled with potentially more promising opportunities elsewhere, we reduced the position size. Despite this decision costing Dynamic approximately 0.25% over the period, we retain a holding in the belief that the fund's assets are relatively unique, and its trading at a notable discount to realizable value could present an opportunity for acquisition.

Looking Forward

Our long-term view remains bullish. The last quarter is a perfect illustration of how gains can come quickly, which few predicted at the start of the year.

Looking at a shorter-term horizon, there are grounds for optimism as risks related to the economy, namely inflation and interest rate expectations, have notably diminished, though it remains premature to declare unequivocal victory on any front. Markets have experienced a significant rally, with a number of interest rate cuts now priced in. Consequently, it would not be unreasonable for markets to pause, reassess and take a breath.

In navigating this interim period, we advocate for a relatively balanced approach that encompasses both risk assets and more defensive plays. Please find more detail on the larger holdings shown in the table below.

We wish all our investors and readers a happy, healthy, and prosperous New Year.

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Rupert Silver – Lead Manager

Portfolio Top Holdings[2]

UK Equities	%
Entain plc	2.1
BP plc	1.7
FRP Advisory Group Limited	1.3
Aberforth Smaller Companies Trust plc	1.2
Ecora Resources plc	1.0
Total UK Equities	11.8

Alternatives	%
Gresham House Energy Storage Fund plc	2.1
BH Macro Ltd	2.1
Literacy Capital plc	1.8
Taylor Maritime Investments Limited	1.5
Assura plc REIT	1.3
Total Alternatives	12.5

International Equity Funds	%
Polar Capital Technology Trust	6.8
DBX S&P 500 Equal Weighted	6.6
GQG Global Equity Fund UCITS	3.3
Smithson Investment Trust plc	3.2
SPDR S&P 500	1.8
Total International Equity Funds	30.8

Fixed Income	%
BP plc Perpetual	2.7
Investec plc 9.125% 06/03/2033	2.5
IG Group plc 3.125% 18/11/2028	2.5
Nationwide10.25% Perpetual	2.0
British American Tobacco 4% 23/11/2055	2.0
Total Fixed Income	43.0

Overseas Equity	%
Tonies SE	0.8
Total Overseas Equity	0.8

Cash	%
GBP	1.2
Total Cash	1.2

[2] *Portfolio positions of the Credo Dynamic Fund as at 29/12/2023.*