



Brewin  
Dolphin

# Sustainable Managed Portfolio Service

Quarterly report – Q3 2022

# Introduction

**Welcome to the RBC Brewin Dolphin Sustainable Managed Portfolio Service (SMPS) investment review. In this report we will be covering information and events that influenced performance during the third quarter of 2022.**

Equities and bonds were highly volatile in the third quarter as high inflation led to interest rate hikes by central banks around the world.

In the US, the S&P 500 registered its third consecutive quarter of declines for the first time since 2009. Signs of slowing economic growth led to hopes of interest rate cuts in 2023, but these were quashed when the Federal Reserve reaffirmed its commitment to fighting inflation at the Jackson Hole summit in August.

UK chancellor Kwasi Kwarteng's mini-budget sparked widespread market turmoil towards the end of the quarter. The raft of tax-cutting measures raised concerns about a surge in UK government borrowing and more aggressive interest rate hikes. The pound hit a record level against the dollar, yields on ten-year gilts surged and mortgage lenders pulled deals from the market. The Bank of England subsequently launched a temporary bond-buying programme in an attempt to restore orderly market conditions.

The ongoing energy crisis and rising inflation weighed on shares in the eurozone. The annual rate of inflation hit a record 10% in September, with price rises in Germany reaching a 71-year high of 10.9%. The downturn in business activity deepened and European Central Bank president Christine Lagarde warned the eurozone's economic outlook was darkening.

The quarter also saw geopolitical tensions escalate – both between Russia and Ukraine, and China and Taiwan – which added to the overall risk-off sentiment.

Long-term investors may take some comfort from the fact that a lot of the bad news is already priced in to valuations. Inflation should begin to drop significantly and there probably isn't much room for central banks to increase rates by much more than markets expect. While the outlook remains uncertain, this probably isn't the time to become more bearish.

# The big picture in Q3 2022

- The quarter started with the news that the Financial Conduct Authority is delaying further consultations on the Sustainability Disclosure Requirements (SDR) – the UK's answer to the EU's Sustainable Finance Disclosures Regulation (SFDR). Implementation is now unlikely to happen at the beginning of the new year, and the financial industry is still waiting to gain clarity on what it means for an investment to be 'green'.

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  - Another regulatory flashpoint emerged in Europe as both gas and nuclear power were included in the EU's green taxonomy. This was understandably controversial for climate campaigners and four groups have started legal action against the European Commission to prevent the adoption of natural gas.

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  - Sticking with the theme, the US also saw a major breakthrough with the Inflation Reduction Act surprisingly gaining the support of senator Joe Manchin and passing into law in August. It is the largest federal legislation to ever address climate change, with billions of dollars of investment and significant tax credit boosts for renewables, energy efficient technologies and decarbonisation of transport.

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  - Towards the end of the quarter, former Bank of England governor Mark Carney's \$130trn Glasgow Financial Alliance for Net Zero (GFANZ) ran into difficulties. Some of the members feel blindsided by tougher UN climate criteria and are worried about the legal risks of participation. So far, two pension funds have left but tensions remain high while internal conversations are ongoing.
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# Market overview Q3 2022

- Equities slipped by -0.3% over the third quarter, according to the RBC Brewin Dolphin benchmark, as central banks reaffirmed their commitment to fighting inflation.
- The UK was among the worst performing equity regions, declining by -3.4% as fears of an imminent recession grew. In contrast, the emerging market equities benchmark outperformed with a gain of +7.2% (in GBP terms) on the prospect of Brazilian president Jair Bolsonaro's term coming to an end. North America equities gained +3.3% in GBP terms, with returns boosted by the strong US dollar, while Japan equities rose +0.93%.
- Bonds tumbled -7.7% following the mini-budget induced sell-off and interest rate increases by several of the world's major central banks. The biggest negative contributors were gilts (-12.8%), UK corporates (-12.5%) and global inflation-linked bonds (-6.5%).
- The ten-year US Treasury yield rose to 3.83% following the Federal Reserve's fifth interest rate hike in the year so far.
- Alternative assets recorded a small gain of +0.4%. Gold and absolute return increased by 2.1% and 1.6%, respectively, while global real estate investment trusts (REITs) fell by -3.9%.
- High inflation and a tight labour market in both the UK and US resulted in central banks continuing to raise interest rates, which resulted in ongoing stress in bond markets.
- In the latter part of the quarter, UK sovereign bonds sold off heavily after the newly elected prime minister Liz Truss proposed new fiscal measures. The ensuing volatility in the UK government bond market saw the BoE intervene with a commitment to purchase bonds for a limited time. Sterling touched a multi-decade low against the US dollar, before recouping its losses following the BoE's intervention.
- One of the spill-over effects of high and volatile interest rates in the UK has been in the mortgage market, where selected providers have withdrawn a number of products. Generally, the higher cost of borrowing has led to a slowdown in the number of mortgage inquiries. House prices are showing signs of stalling after a period of record highs.
- Europe is preparing itself for a difficult winter. In September, the Nord Stream pipelines that transport gas from Russia to Europe were sabotaged in a move which nobody has claimed credit for, but which seems most likely to be a Russian act. European countries have filled gas storage facilities and implemented measures to reduce consumption.

The value of investments, and any income from them, can fall and you may get back less than you invested.

# Sustainable MPS highlights Q3 2022



## Asset Allocation

### What worked and why?

Our equity positioning was a notable positive contributor to performance in the third quarter. We cut equity exposure at the right time in August, to become underweight before the sell-off in late August and September. The overweight to cash and the underweight to bonds were also positive contributors to performance.

### What didn't work and why?

There were no notable detractors from asset allocation in the third quarter.

## Fund Selection

### What worked and why?

Stewart Asia Pacific Leaders was the most significant contributor this quarter with its defensive positioning helping in a volatile month for equities. Evenlode Income also outperformed during the third quarter.

### What didn't work and why?

BNY Mellon Sustainable Global Dynamic Bond was the most significant detractor as bonds sold off heavily during the quarter. Muzinich Global Tactical Credit also detracted from returns.

# Sustainable MPS Portfolio changes Q3 2022

## Asset Allocation

In July, the Asset Allocation Committee agreed to have a neutral position on equities, by reducing the weight of UK and European equities by 0.5% each and increasing cash by 1%.

In August, the committee voted for a further reduction to the equity weight, moving to an underweight position, while increasing the weighting to absolute return. In September, no changes were made, as the overall underweight to both equities and bonds, and the overweight to cash and absolute return, were considered appropriate.

## Fund Selection

We increased the weightings in BlackRock ICS Sterling Liquidity, Muzinch Global Tactical Credit and BNY Sustainable Global Dynamic Bond. These were funded through reductions in TB Evenlode Income, Royal London Sustainable Leaders, Brown Advisory US Growth and Stewart Investors Asia Pacific.

## SMPS performance

SMPS PERFORMANCE (%)			
	Q3	2022 YTD	1yr
Income Portfolio	-1.4	-13.4	-11.2
Income Higher Equity Portfolio	-0.4	-13.5	-10.8
Balanced Portfolio	0.4	-13.3	-10.1
Growth Portfolio	1.7	-13.5	-9.7
Global Equity Portfolio	2.9	-13.7	-9.3

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All figures shown above are calculated to 30 September 2022.

Performance Calculation: All income is reinvested. Performance is shown inclusive of underlying fund charges but gross of RBC Brewin Dolphin's investment management charge. Deduction of this charge will have the result of reducing the illustrated performance. Neither simulated nor actual past performance are reliable indicators of future performance.

# Funds in focus Q3 2022

## Pictet Global Environmental Opportunities

Pictet's core belief is that the true value of natural capital is not properly reflected in market prices, leading to overconsumption of natural resources and excessive pollution. Over the long term, companies with the strongest environmental credentials, that also provide solutions to help reverse ecological damage and increase resource efficiency, will be most in demand. Resource-intensive and/or highly polluting business models will have to adapt or disappear. The team believes that the environmental universe is still early stage and poorly understood. In addition to the market's short-termism, this should allow them to achieve persistent superior returns.

The Pictet Environmental Opportunities fund invests in companies whose products and services have a positive environmental impact but also operate within the Planetary Boundaries, a science-based environmental framework created by the Stockholm Resilience Centre. This model is used to determine if companies are operating within the safe operating space and also the environmental footprint at sub-industry and company levels, taking a cradle-to-

grave lifecycle approach. It considers a number of key environmental phenomena including climate change, ocean acidification, chemical pollution, freshwater, and land-usage change.

The fund's investible universe spans renewable energy, energy efficiency, dematerialised economy, sustainable agriculture & forestry, water supply technology, waste management & recycling, and pollution control. The fund's largest exposures are currently energy efficiency, waste management & recycling, and pollution control.

The Pictet team says that the outlook for the environmental theme continues to remain strong. They believe that the current dislocations in the energy markets will continue to stimulate corporate investments in energy saving technologies while 'Green Capex' will be a multi-year secular theme driving the next wave of infrastructure investments across areas such as electrification, electricity grids, renewables, green buildings, battery storage, and electric vehicles, amongst others.

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## Schroder Global Cities

The Schroder Global Cities aims to identify real estate companies with majority of assets in global cities, large urban centres with strong economic activity, good transport connections with access to educated labour force. At the heart of their approach is a strong focus on data collection, processing and analysing. Their Data Insights team use Python scripts which every month scrapes hundreds of websites around the world to effectively extract the geospatial coordinates of their entire portfolios. The team also built environmental database which highlights environmental risks like seismic hazard, flood risk and other climate related risk factors.

The ESG analysis element of investment process is explicitly embedded in both phase one and phase two due diligence analysis. They score each company: weak score will result in exclusions of those companies and medium scores help them to identify companies to engage with and it will affect the weight of the company in the fund. Each year there are 5-10% of companies

scores are changed, some deteriorate but most improve. In the sector overall every company now understands sustainability and trying to do better, so the threshold i.e. cut off points gradually increases as quality of the ESG factors improve across the fund's universe.

The team carries out numerous engagements with each of the companies in the portfolio. In the third quarter alone the team have engaged with 14 companies across a broad range of subsectors and geographies. In Europe the managers engaged with Segro (European Logistics), Vonovia (German Residential) and Derwent London (London's creative office specialist) on varied topics such as Pathway to Net Zero, environmental impact and executive compensation.

# ESG reporting for SMPS Income

(as at 30 September 2022)

## MSCI ESG Ratings

ESG Quality Score **8.1**

**MSCI**  
ESG RATINGS



CCC B BB BBB A AA AAA

## Carbon Intensity

Carbon Intensity measures a portfolio's exposure to carbon intensive businesses and is a recommended metric for assessing carbon risk by the Task Force on Climate Related Financial Disclosures (TCFD). It is calculated as a weighted average of each portfolio company's total Scope 1(1) and Scope 2(2) carbon emissions divided by their annual sales, with a lower score representing less (better) Carbon Intensity.

Comparisons of Carbon Intensity figures should be made with caution, as generally companies in the sectors with the highest carbon emissions (such as utilities) also have the highest potential for reducing their carbon emissions. We believe it is important to encourage these reductions in carbon emissions where they have the potential for highest impact.

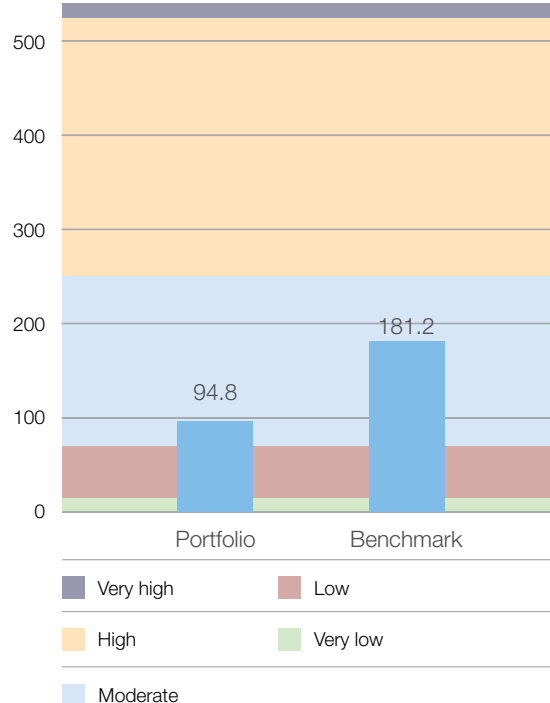
### References:

(1) Scope 1: All direct GHG emissions from sources owned or controlled by the company (e.g. emissions from combustion in owned boilers, furnaces).

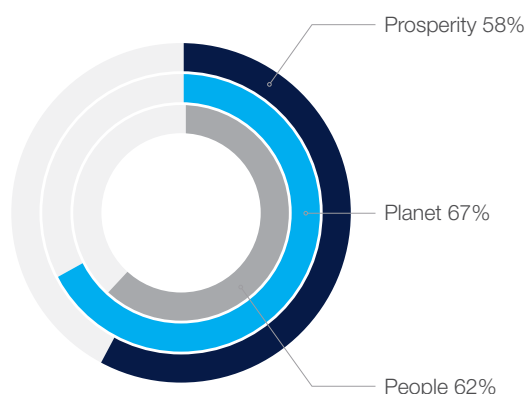
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 45% Global equity, 55% Global aggregate bonds

## Carbon Intensity vs Benchmark (TCO2e / \$m sales)



## SDG Alignment



The UN SDG Alignment provides a framework for considering a broad set of 17 sustainability issues. Although not intended for investment purposes, it provides a useful context for measuring a portfolio's alignment with these goals.

We select 12 of these SDGs and place them into three sustainability themes: People, Planet, and Prosperity, with each sustainability theme consisting of four SDG goals. We use fund alignment data from MSCI to measure the alignment of the portfolio to each of our three sustainability themes. To calculate this, we take a weighted average of each fund's alignment to each of the three sustainability themes.

For instance, if Fund A is a 10% holding in the portfolio, and within the People theme is aligned with both "Zero Hunger" and "Gender Equality" but not the other two SDGs, then the fund will contribute 5% to the overall score of the People theme: 2.5% through Gender Equality and 2.5% through "Zero Hunger".

### Prosperity



### Planet



### People



# ESG reporting for SMPS

## Income Higher Equity

(as at 30 September 2022)

### MSCI ESG Ratings

ESG Quality Score **8.4**

**MSCI**  
ESG RATINGS



CCC B BB BBB A AA AAA

### Carbon Intensity

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Comparisons of Carbon Intensity figures should be made with caution, as generally companies in the sectors with the highest Carbon Emissions (such as Utilities) also have the highest potential for reducing their Carbon Emissions. We believe it is important to encourage these reductions in carbon emissions where they have the potential for highest impact.

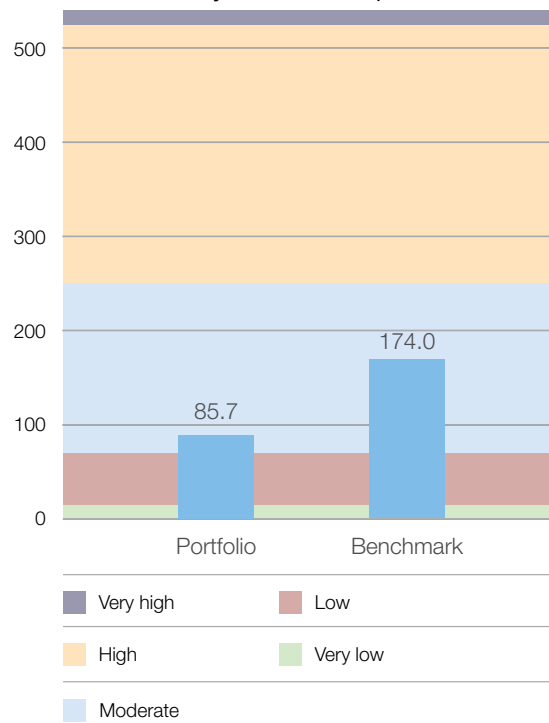
#### References:

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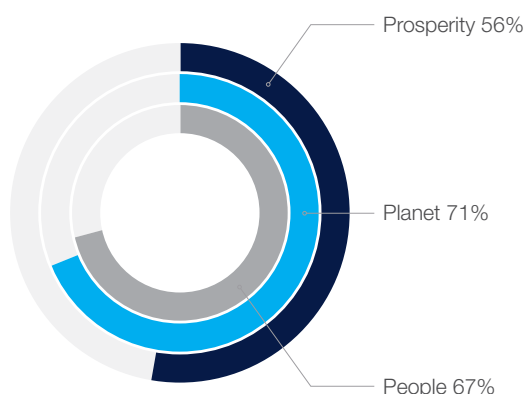
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 55% Global equity, 45% Global aggregate bonds

Carbon Intensity vs Benchmark (TCO2e / \$m sales)



### SDG Alignment



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#### Prosperity



#### Planet



#### People



# ESG reporting for SMPS Balanced

(as at 30 September 2022)

## MSCI ESG Ratings

ESG Quality Score **8.5**

**MSCI**  
ESG RATINGS



CCC B BB BBB A AA AAA

## Carbon Intensity

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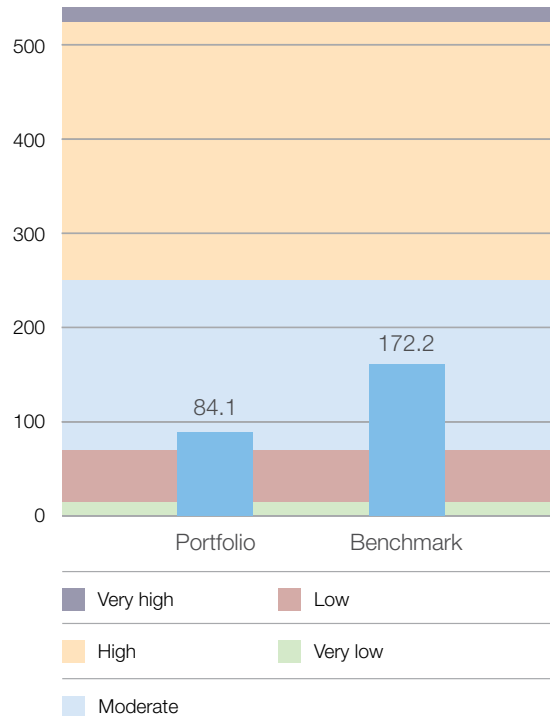
### References:

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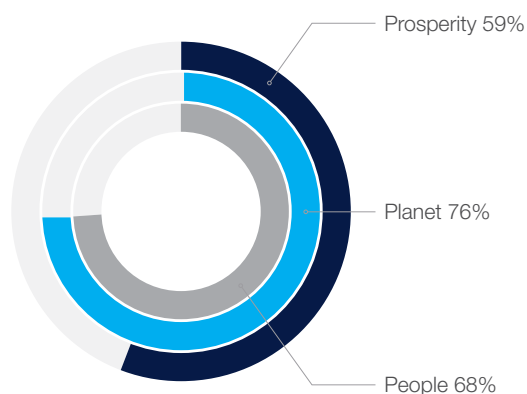
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 70% Global equity, 30% Global aggregate bonds

Carbon Intensity vs Benchmark (TCO2e / \$m sales)



## SDG Alignment



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### Prosperity



### Planet



### People



# ESG reporting for SMPS Growth

(as at 30 September 2022)

## MSCI ESG Ratings

ESG Quality Score **8.8**

**MSCI**  
ESG RATINGS



CCC B BB BBB A AA AAA

## Carbon Intensity

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Comparisons of Carbon Intensity figures should be made with caution, as generally companies in the sectors with the highest carbon emissions (such as utilities) also have the highest potential for reducing their carbon emissions. We believe it is important to encourage these reductions in carbon emissions where they have the potential for highest impact.

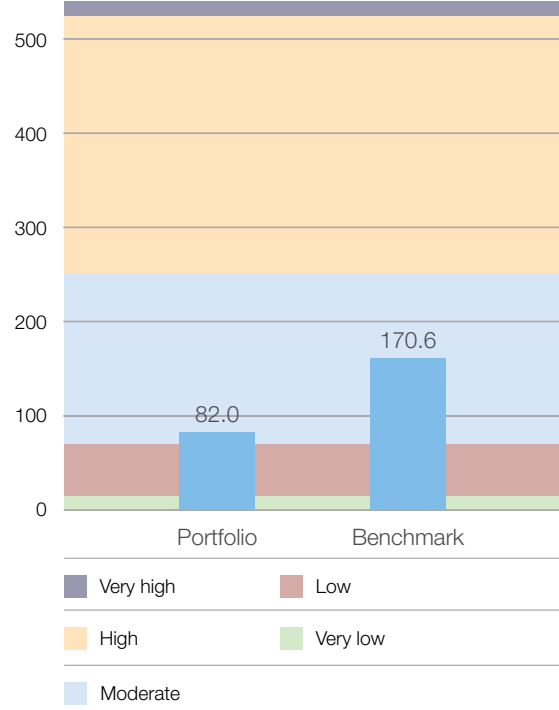
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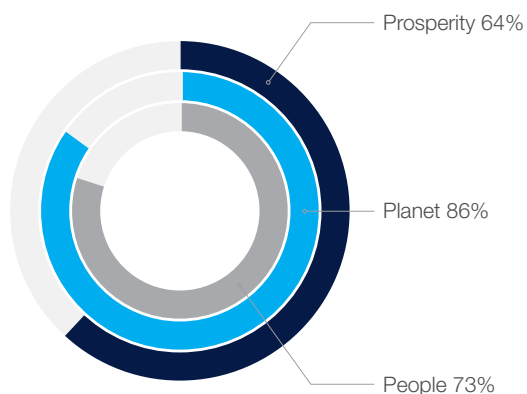
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 85% Global equity, 15% Global aggregate bonds

Carbon Intensity vs Benchmark (TCO2e / \$m sales)



## SDG Alignment



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### Prosperity



### Planet



### People



# ESG reporting for SMPS Global Equity (as at 30 September 2022)

## MSCI ESG Ratings

ESG Quality Score **9.1**

**MSCI**  
ESG RATINGS



CCC B BB BBB A AA AAA

## Carbon Intensity

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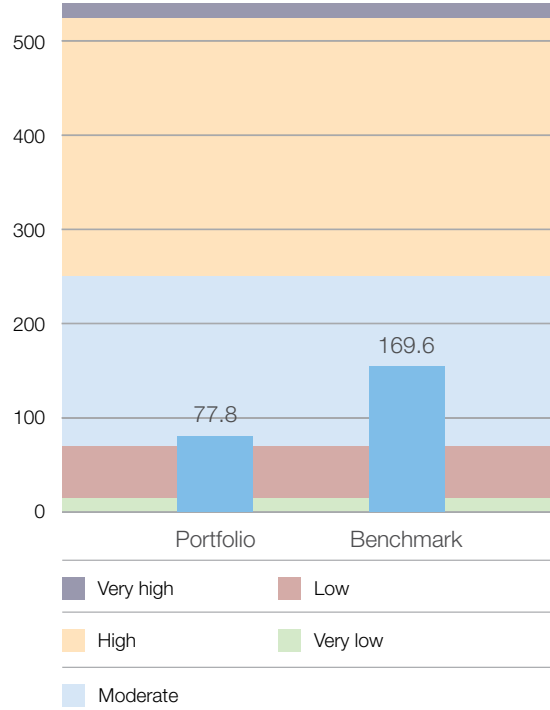
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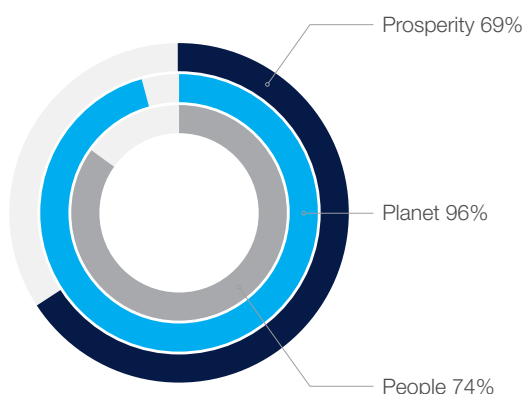
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 100% Global equity

## Carbon Intensity vs Benchmark (TCO<sub>2</sub>e / \$m sales)



## SDG Alignment



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### Prosperity



### Planet



### People



# Asset Allocation Committee investment outlook

These views are implemented across our portfolios but there may be deviations where asset classes or suitable investments are unavailable or excluded.



## Cash

We remain overweight cash. Cash is a relatively attractive asset class at a time when global growth momentum is slowing and bond yields are rising. Moreover, the Bank of England (BoE) base rate continues to move higher.



## Bonds

We increased our allocation to gilts in October. However, we only increased gilts to neutral, as we believe it is too early to expect a sustained rally. One reason is that the peak in yields typically happens much closer to the point when the BoE stops hiking rates. Historically, the furthest the gilt yield peaked ahead of the last BoE hike of the cycle was five months. Currently, the market is pricing in BoE rate hikes until next June. Even if the BoE finishes its hiking cycle a few months earlier than traders expect, it would be unusual for gilts to start a sustainable rally so far ahead of that. Another reason is that there is a lot of gilt supply coming to the market that the private sector will need to absorb. This is due to the government ramping up net issuance to pay for both the energy bailout and tax cuts at a time when the BoE is shrinking its balance sheet. On that point, the recent market ructions only caused the BoE to delay its programme of active sales – those will now begin at the end of this month. We remain underweight corporate bonds as there is scope for further spread widening if economic growth continues to deteriorate, as we expect.



## Global Equities

We remain underweight global equities, largely because of our view that we are on the cusp of a meaningful slowdown in global economic growth that will see the US economy suffer a recession at some point next year. Historically, the S&P 500 reaches a bottom a median of four-and-a-half months before the associated recession ends. Importantly, if we exclude the dot-com and Covid bear markets, which were atypical, the range around which the S&P bottoms ahead of a recession ending has been tight at between three and six months. There is no reason to think that won't hold again this cycle. Given a US recession has not even started, it is probably too early to think that global equities have hit a bottom.



## Alternatives

We hold a neutral position in gold. The potential for real bond yields to rise further (a headwind for gold) is offset by the potential for a further rise in geopolitical risk. We remain underweight property. Real bond yields are rising, inflationary pressures in the US are close to peaking and valuations are unattractive. Finally, we are overweight absolute return. This is a relatively attractive asset class at a time when the risk/reward backdrop for equities has deteriorated and when it appears too early to raise bond exposure.



## UK Equities

Interest rate hikes will likely impact growth in the UK faster than in the US, partly because mortgage terms in the UK are much shorter. Rising UK mortgage rates should put a dampener on UK house prices, and that historically has coincided with weaker consumer spending. Relatively weak UK economic growth tends to weigh on the relative performance of UK equities. That said, if global bond yields continue rising, that should help to offset a weak UK economy. Within equities, rising bond yields tend to boost the relative performance of the global value style versus its growth style counterpart. The UK equity market is very value style exposed.



## **US Equities**

The relatively richly valued US market is particularly vulnerable to rising interest rates and bond yields. That said, a slowing in global economic momentum is a performance tailwind for the US, given that its sector composition and currency are both relatively defensive. Against this mixed backdrop, we maintain modest exposure to US equities.



## **Europe ex-UK Equities**

On the one hand, Europe ex UK stocks are cheap and unloved. In addition, tech/digital stocks, which Europe has very little of, are vulnerable to further underperformance if bond yields keep moving higher. That said, most other non-US markets are out of favour, and there probably isn't massive upside from where bond yields are now. Meanwhile, it is probably too early to bet on a sustainable rally in the euro. If European FX continues to slide, that has negative implications for relative performance in common currency terms. At a time when the key macro drivers of Europe ex UK equity relative performance look set to move in competing directions, and given the uncertainty around the natural gas backdrop in Europe heading into the winter, we believe it is prudent to stay modestly negatively positioned.



## **Japan**

Given Japan's plunging population and birth rate, Japanese equities are confronting major demographic headwinds. This acts as a strong disincentive for Japanese businesses to invest and is a structural roadblock to equity market outperformance. More immediately, Japanese equity relative performance in common currency terms has been hindered by the very weak yen. Looking ahead, we do not expect a catalyst to arrive that could spark a meaningful turnaround in Japanese equity relative performance. That said, Japanese equities are relatively defensive in the current environment of tightening monetary policy in the Western world. Meanwhile, the Japanese economy should benefit from its delayed pandemic re-opening in the next few quarters, which should come at a time when US/European economic growth is slowing. Against this backdrop, the relative performance outlook is balanced in our view.



## **Asia ex-Japan Equities**

The Chinese economy is facing strong headwinds and it is right to be cautious on the outlook. But there are several reasons to believe it makes sense to take a contrarian stance and position for Asia ex Japan outperformance on a 12 to 18-month view. Valuations are undemanding, China should begin to ease up on its zero-Covid policy, there is very little inflation, and there has been a shift on the part of the Chinese authorities to stimulate the economy and impose regulation in a more market friendly way. Importantly, Asia ex Japan equity correlation with the global equity market is fairly low. If US and European markets remain weak, the region stands to hold up relatively well.



## **Emerging markets ex-Asia**

Brazil, Saudi Arabia, South Africa, Mexico and the United Arab Emirates are the countries with the highest market cap weightings in EM ex Asia, making it a very commodity exposed index. The Brazilian presidential election was held recently and with no candidate getting 50% of the vote, it is heading to a second round later this month. Odds are good that Lula wins, but Brazil's strong performance under his previous leadership (from 2003 to 2010) is unlikely to repeat, as commodity prices are unlikely to rise like they did back then. Lacklustre commodity prices are a relative performance roadblock for this region. That is somewhat offset by the fact that valuation multiples are very undemanding.

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The Sustainable MPS model portfolios promote investment into firms with positive environmental, social and good governance characteristics, but they do not have sustainable investing targets. Due to the sustainable focus of this portfolio, there are companies and sectors in which we are unable to invest, meaning the portfolio's performance may be lower than that of an unconstrained investment portfolio with the same benchmark.

The value of investments, and any income from them, can fall and you may get back less than you invested.

Neither simulated nor actual past performance are reliable indicators of future performance

Performance is quoted before charges which will reduce illustrated performance.

Investment values may increase or decrease as a result of currency fluctuations.

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