



Brewin  
Dolphin

# Sustainable Managed Portfolio Service

Quarterly report – Q1 2023



# Introduction

**Welcome to the RBC Brewin Dolphin Sustainable Managed Portfolio Service (MPS) investment review. In this report, we cover information and events that influenced performance during the first quarter of 2023.**

The first quarter of 2023 began with gains for equity markets. Technology shares performed particularly well, partly because sentiment towards the sector had become extremely depressed after a year of poor returns.

At the start of the new year, forecasts were very downbeat for growth around the world, and particularly in the UK. But as the quarter progressed, it became clear that economies are more resilient than most people thought.

A decline in energy prices helped to engender a sense of inflation having passed its peak. The oil price fell around 10% over the quarter, while European wholesale gas prices halved. Prices have not been definitively tamed though. In the US, core inflation, which strips out the effect of falling energy prices, accelerated during the first few months of the year.

The evidential improvement in the economy saw interest rate expectations begin to really pick up during February, with growing concerns that the labour market remained tight despite the extremely steep increases in interest rates suffered during 2022. However, the outlook for interest rates changed quite dramatically in March after the collapse of Silicon Valley Bank sparked concerns about the banking sector. Central banks in the US, UK and Europe pressed ahead with interest rate hikes in March, but there was widespread speculation that further hikes will be limited.

Central banks are still fighting an inflation problem, and so it is unlikely that interest rate cuts are imminent. It is also unlikely that banking sector volatility will bring on a recession faster than we previously anticipated. The headwinds from tighter credit conditions are being offset by lower bond yields. Most banks are well capitalised, and regulators have acted quickly and decisively to stem the fallout. It probably remains a reasonable base case to expect a mild US recession to begin at the end of this year.

# The big picture in Q1

- In January, we saw world and business leaders gather for the World Economic Forum at Davos. Several NGOs, including Oxfam and Earth4All, used the event to highlight inequality and call for higher taxes on society's wealthiest, which was well covered as the cost-of-living crisis bites. Another highlight was European Commission president Ursula von der Leyen detailing new subsidies to rival the US's Inflation Reduction Act as energy investment, supply security and technology have become increasingly important on the political agenda.

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- There is a strong sense of division within Europe after Germany formed an alliance with Italy and several Eastern European countries opposing the planned phase-out of internal combustion engines from 2035, unless cars running on e-fuels are exempted from the ban.

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- Abortion rights became a topic of conversation in corporate boardrooms. At least 22 companies, including Alphabet, Meta and Coca-Cola, received shareholder proposals concerning how much information they are disclosing about abortion policies. Negotiations about disclosures are going on with other companies behind the scenes.

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- In the UK, we saw the Department for Business, Energy and Industrial Strategy being split into three new units — including the new Department for Energy Security and Net Zero. This was perhaps a reaction to MP Chris Skidmore's Net-Zero Review, which concluded that the government's current approach is not sufficient to deliver steep enough emissions cuts. In March, the government updated the UK Net Zero strategy, although even with its new policies, the UK will meet only 92% of the emissions cuts required under the Paris agreement.

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- Finally, the most headline grabbing event of the quarter was down to poorly managed 'governance' risks within the banking sector. Mismanaged interest rate risks at Silicon Valley Bank, inadequate financial controls at Signature Bank, and the discovery by Credit Suisse of "material weaknesses" in its financial reporting controls triggered a run on all three banks. The two US banks fell into receivership with the Federal Deposit Insurance Corporation, while Swiss regulators arranged a UBS buyout of Credit Suisse, wiping out the contingent capital in the process. Swift action by regulators and tighter regulatory standards have appeared to limit further contagion, but there has been some discomfort on both sides of the Atlantic at how the failures played out.

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# Market overview Q1 2023

- At the broader market level, asset classes gave a mixed performance in the first quarter of the year. Equities gained overall, driven by strong performance in technology shares and receding recession concerns. Lower interest rate expectations positively influenced bonds, which had suffered due to the steep trajectory of interest rate increases during 2022.

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- Among equities, developed Europe ex UK led the way with a +8.4% return, despite volatility in the banking sector. North America followed at +4.5%, and Japan and UK equities both reported returns above +3%. However, emerging market equities experienced a decline of -2.1% as US-China tensions escalated.

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- Bonds were boosted by lower interest rate expectations, with global corporate bonds returning +2.7%, global inflation-linked bonds +3.3%, global sovereign bonds +2.8%, UK sovereign bonds +2.1%, and UK corporate bonds +2.5%. Cash reported a +1% return.

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- Among alternatives, precious metals performed well with a +6.1% return, but other alternatives showed a slight decline at -0.2%. Property fell by -1.2%.

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- Resilient economies and increased consumer spending, supported by savings accumulated during Covid-19 lockdowns, contributed to a positive economic outlook. Falling oil prices played a role in reduced household and business expenses, lowering the cost of fuel for transport and goods production.

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- However, inflation has not been completely tamed, and concerns remain around wage inflation and high job vacancies. The shift in the interest rate outlook in March had a significant impact on the banking sector. The fallout has led to a reappraisal of the risks associated with the banking sector and limited the extent to which interest rates can now rise.

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- Although recent events may echo the financial crisis of 2008, measures have been taken to safeguard depositors and ensure a resilient banking system. The decrease in interest rate expectations has led to reduced mortgage costs, contributing to a potential resurgence in residential property markets. Wage increases, a decline in mortgage rates, and a return to the workplace are all driving the demand for housing.

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

# Sustainable MPS highlights Q1 2023



## Asset Allocation

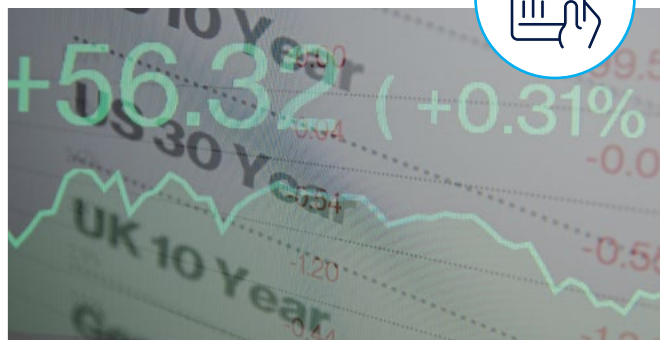
### What worked and why?

The underweight to bonds (particularly credit) and the modest underweight to property supported the portfolio over the quarter.

## Fund Selection

### What worked and why?

Brown Advisory was the standout fund in the first quarter, delivering strong performance ahead of its benchmark. This was down to a combination of strong stock picking and style tailwinds, as quality growth stocks benefitted from the shift in narrative from accelerating cyclical growth to one of a potential slowdown.



### What didn't work and why?

The modest underweight to equities was a small detractor to returns over the quarter.

### What didn't work and why?

Columbia Threadneedle Responsible Global Equity was the most significant detractor from returns as its US banking exposure was hit by recent events.

# Sustainable MPS Portfolio changes Q1 2023

## Asset Allocation

In January, the Asset Allocation Committee felt that recent weakness in bond prices was an opportunity to increase the allocation to UK gilts and global inflation-linked bonds by 0.5% each. While portfolios remain underweight bonds, they are neutral on global inflation-linked bonds and overweight UK gilts. The change was funded by a reduction in cash and absolute return.

In March, the Asset Allocation Committee felt that a small underweight to equities remained appropriate in the current environment. However, the committee recommended neutralising our regional tilts given the lack of clarity on how individual regions will perform through 2023.

## Fund Selection

There were no new fund additions or removals in the first quarter.

We increased weightings in Brown Advisory US Sustainable Growth, Robeco Global Credits SDG, and ASI Global Government Bond Tracker. These were funded through reductions in TB Evenlode Income, Royal London Sustainable Leaders, Royal London Ethical Bond, and BNY Mellon Sustainable Global Dynamic Bond.

## SMPS performance

| SMPS PERFORMANCE (%)           |     |          |      |       |
|--------------------------------|-----|----------|------|-------|
|                                | Q1  | 2023 YTD | 1yr  | 2022  |
| Income Portfolio               | 2.8 | 2.8      | -4.1 | -11.7 |
| Income Higher Equity Portfolio | 3.3 | 3.3      | -3.1 | -11.7 |
| Balanced Portfolio             | 3.5 | 3.5      | -2.3 | -11.5 |
| Growth Portfolio               | 3.9 | 3.9      | -1.4 | -11.6 |
| Global Equity Portfolio        | 4.5 | 4.5      | -0.3 | -11.7 |

All figures shown above are calculated to 31 March 2023.

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 Q1 2023

## Royal London Sustainable Leaders Trust

The Royal London Sustainable Leaders Trust is our primary UK large cap growth offering on our SRI buy list. Fund manager Mike Fox and his team believe that capital can be used for good as well as to generate further financial wealth and we think that they have a particular strength and niche in ESG analysis and sustainable investing. This view is supported by the manager having one of the longest track records (since 2003) in sustainable investing.

The fund sets out to support improvements in society, the environment and corporate behaviour whilst generating alpha versus the broader UK market. It invests in companies that are ESG leaders in their field and have sustainable products or services, and the team engages with management on areas for improvement.

The very first stage of their process involves identifying companies that deal well with ESG issues and whose products and services are cleaner, safer, more inclusive or healthier than pre-existing alternatives and are therefore part of solutions in the transition to a more sustainable world. Only after this do they move on to financial assessments, which focus on returns on capital, stable growth, and valuations, to ensure they are paying a fair price.

Using a scorecard comprising measures of sustainability and financial factors, they construct the portfolio allocating 10% to those rare companies that score highly across all measures, with higher weights to each of these companies. 30% of the portfolio is invested in mid-tier scoring companies with 1-3% invested in each, and the remaining 60% is allocated to lower-tier companies with weights of 0-1% each to compensate for the higher risk of lower financial or sustainability scores.

The resulting portfolio has around 40-50 companies with 10-15% in overseas names, and 40% in mid-sized companies. The fund is naturally overweight tech, healthcare and innovative industrials, has no mining or oil and gas, and is underweight financials. However, the team recently introduced some exposure to banks and payment processors such as Visa.



**Amy Kennedy**  
Senior Analyst

# ESG reporting for SMPS Income (as at 31 March 2023)

## MSCI ESG Ratings

ESG Quality Score **7.8**

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.

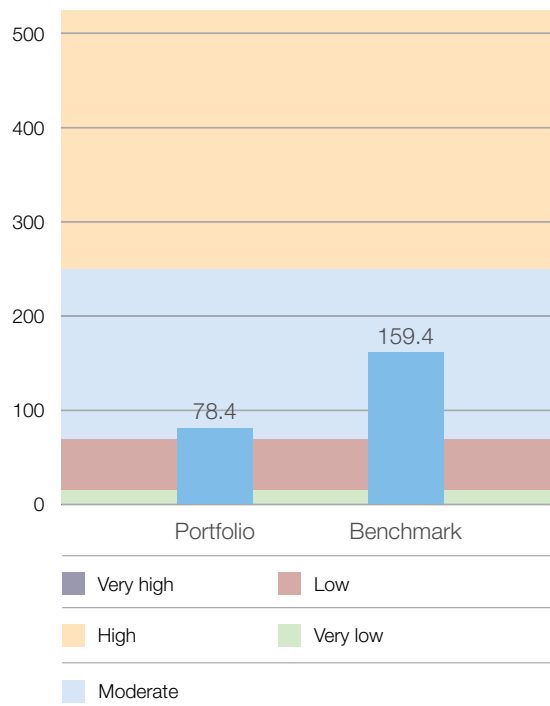
#### References:

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

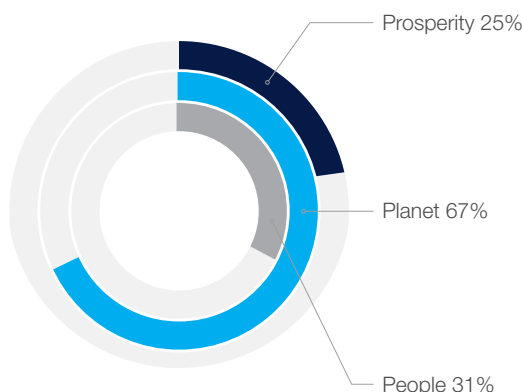
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 45% MSCI ACWI, 55% Bloomberg Barclays Global Aggregate

### 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 31 March 2023)

### MSCI ESG Ratings

ESG Quality Score **8.0**

**MSCI**  
ESG RATINGS



CCC B BB BBB A AA AAA

### Carbon Intensity

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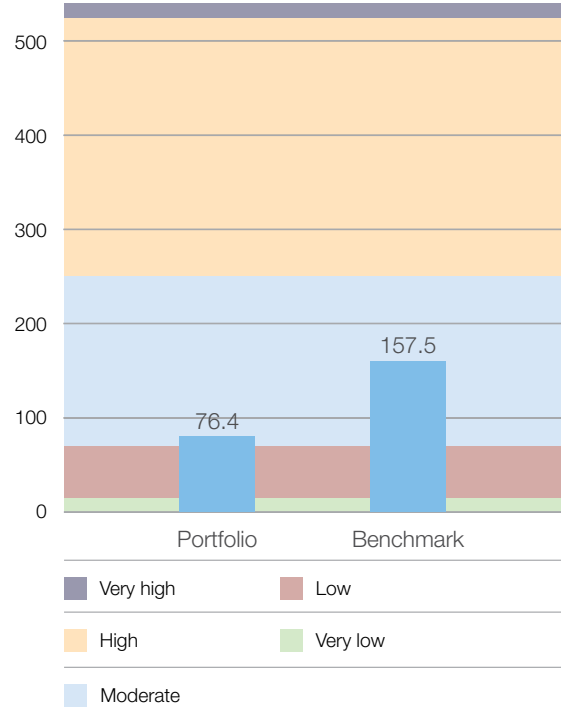
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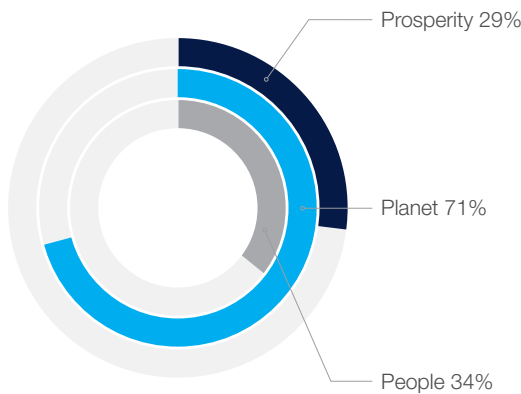
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 55% MSCI ACWI, 45% Bloomberg Barclays Global Aggregate

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



### SDG Alignment



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#### Prosperity



#### Planet



#### People



# ESG reporting for SMPS Balanced

(as at 31 March 2023)

## MSCI ESG Ratings

ESG Quality Score **8.2**

MSCI  
ESG RATINGS



CCC | B | BB | BBB | A | AA | AAA

### Carbon Intensity

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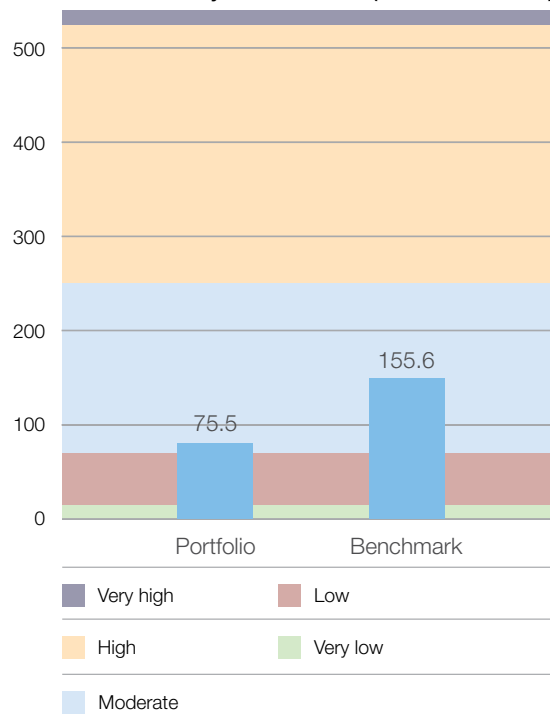
#### References:

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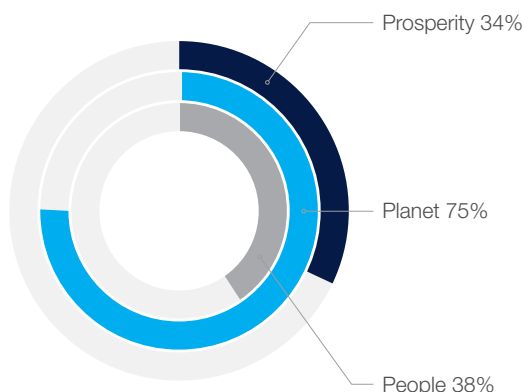
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 70% MSCI ACWI, 30% Bloomberg Barclays Global Aggregate

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



### SDG Alignment



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#### Prosperity



#### Planet



#### People



# ESG reporting for SMPS Growth

(as at 31 March 2023)

## MSCI ESG Ratings

ESG Quality Score **8.5**

MSCI  
ESG RATINGS



CCC B BB BBB A AA AAA

### Carbon Intensity

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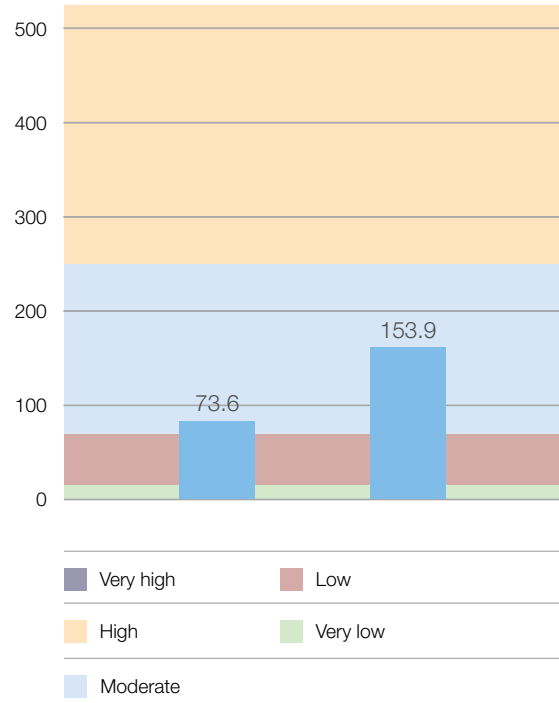
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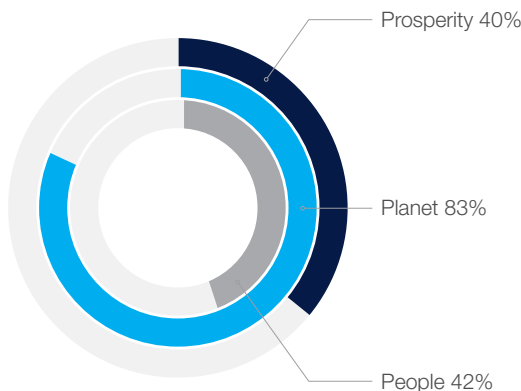
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 85% MSCI ACWI, 15% Bloomberg Barclays Global Aggregate

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



### SDG Alignment



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#### Prosperity



#### Planet



#### People



# ESG reporting for SMPS Global Equity

(as at 31 March 2023)

## MSCI ESG Ratings

ESG Quality Score **8.9**



CCC | B | BB | BBB | A | AA | AAA

### Carbon Intensity

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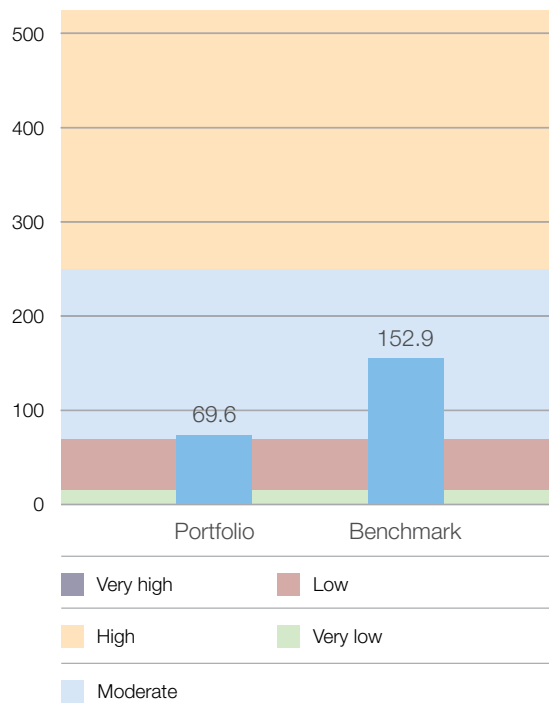
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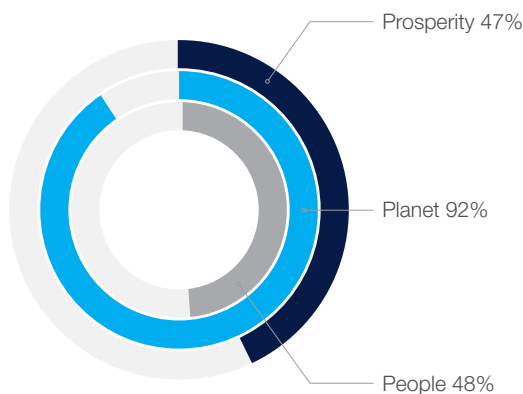
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 100% MSCI ACWI

Carbon Intensity vs Benchmark (TCO2e / \$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, which is a relatively attractive asset class at a time when global growth momentum is slowing and there is scope for bond yields to keep rising. Moreover, with the UK yield curve inverted, cash now offers a more attractive return than longer-dated bonds.



## Bonds

We retain a neutral position towards government bonds. Within this category, we favour gilts, given the UK's interest rate sensitivity and more challenging economic outlook. With central banks nearing the end of their tightening cycles, our bias is to look for attractive entry points to go overweight. Corporate bonds have rallied since October on the back of a decline in risk-free bond yields and credit spread compression. With yield curves deeply inverted and central banks unlikely to start cutting rates any time soon, we are not likely to see the risk-free component support corporate bond performance over the next couple of months. With regards to the credit component, spreads have tightened significantly since October. Credit spreads typically move inversely with economic momentum. Although there may be a temporary pick up in growth, it will likely be modest. Our base case is that a mild US recession begins at the end of this year, so we do not believe the economic outlook is one that justifies credit spreads tightening much further. Against this backdrop, we retain an underweight position in corporate bonds.



## Global Equities

Global equities have rallied sharply since October. Chinese growth, global energy prices, US inflation and labour force participation have been moving in a clear 'soft landing friendly' direction. Nevertheless, we suspect the US will ultimately suffer a recession (albeit a mild one), with it stemming largely from monetary tightening. A US recession would pull corporate profits lower, and the global equity market along with it. Against that backdrop, we retain a mild global equity underweight.



## Alternatives

The gold price has historically been inversely correlated with real (inflation-adjusted) bond yields. The recent rally in gold has been significantly stronger than one would have expected based on the much more modest recent drop in real yields. Dollar weakness has explained part of the divergence, as has the reportedly strong buying from foreign official sector purchasers (China, Russia) looking to diversify their reserve holdings. Against this backdrop, we retain a neutral position to gold, despite the fact that it looks expensive relative to real bond yields. We remain underweight property. Real bond yields should remain elevated (for now), and inflationary pressures are weakening. Finally, we are overweight absolute return. This is a relatively attractive asset class at a time when the risk/reward backdrop for equities and bonds is not great.



### **UK Equities**

Rate hikes should have a more immediate detrimental impact on growth in the UK, partly because mortgage terms in the UK are much shorter. Higher mortgage rates are pushing UK house prices lower, and that historically has coincided with weaker consumer spending. Relatively weak UK economic growth tends to weigh on UK equity relative performance. The UK market is heavily weighted in value style-oriented stocks, which have mostly outperformed since late 2021. Looking ahead, the outlook for value versus growth stock relative performance is more balanced.



### **US Equities**

We are close to a cyclical top in sovereign bond yields, in our view. Rising bond yields have been good for the relative performance of the global equity value style over the global growth style. If it is correct that bond yields aren't far from a peak, that removes a headwind for the relative performance of growth stocks. That would be supportive of US equity relative performance given that this market is heavily overweight the growth style. Nevertheless, with the US equity market relatively expensive, the dollar outlook uncertain over the next year and the interest rate backdrop likely to be higher for longer, we suspect US equities do not offer much in the way of relative performance upside.



### **Europe ex-UK Equities**

Europe ex-UK equities have strongly rebounded versus the global equity benchmark (in common currency terms). Helping to drive the turnaround has been the strength in continental European FX, which has received a boost thanks to the decline in natural gas prices, increased hawkishness at the European Central Bank, and the shift to a more risk-on environment. Looking ahead, in order to believe the pro-cyclical euro will continue to appreciate, risk assets will likely need to continue to rally. We are sceptical. Without continued upside in European FX, it will be difficult for Europe ex UK to sustain its recent outperformance in common currency terms.



### **Japan Equities**

In our view, the best way to assess the outlook for Japanese equities is to gauge Japan's relative economic growth prospects. Looking ahead, Japanese GDP is likely to outperform US GDP in common currency terms over the near term. First, there appears to be scope for the yen to continue to appreciate versus the dollar. Second, Japan's economy should expand at a reasonable pace at a time when we expect US GDP to be sluggish. Against that backdrop, there's probably a window for Japanese equities to outperform. That said, in the long term, with both the population and birth rate in freefall and given Japan's lack of enthusiasm for immigration, Japan's demographics should act as a roadblock to any sustained economic and equity outperformance.



### **Asia ex-Japan Equities**

With the region heavily oversold, Asia ex Japan equities outperformed the global equity benchmark from the end of last October through mid-January this year. Announcements from the Chinese authorities, such as its 16-point plan to support the property sector and 20-point plan to optimise Covid restrictions (before outright dropping them), helped to catalyse the gains. In addition, like all regions outside the US, Asia ex Japan received a relative performance boost (in common currency terms) from the decline in the dollar. Since then, relative performance has flagged. Looking ahead, the outlook appears balanced. On the one hand, China should be the main global growth bright spot this year. On the other hand, at last month's annual National People's Congress meeting, a conservative GDP growth target of 5% for this year was announced. This does not send a strong signal that the authorities are set to be aggressive with regards to stimulus. Finally, geopolitics and the opaque political backdrop in China remain concerning.



### **Emerging markets ex-Asia Equities**

Brazil, Saudi Arabia, South Africa, Mexico, and the UAE are the countries with the highest market cap weightings in the EM ex Asia equity index, making it very commodity exposed. There are crosscurrents confronting the region. On the one hand, EM ex Asia remains very cheaply valued. On the other hand, EM FX should depreciate versus the dollar as global economic growth slows. With the Chinese economy accelerating but most of the rest of the world slowing, the outlook for commodity prices appears to be neither hot nor cold.

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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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