Managed Portfolio Service

Quarterly report – Q2 2022

BREWIN DOLPHIN

Introduction

Welcome to the Brewin Dolphin Managed Portfolio Service investment review. In this report we will be covering information and events that influenced performance during the second quarter of 2022.

Equities and bonds came under pressure in the second quarter as interest rate hikes by major central banks led to fears of a recession.

In the US, the S&P 500 entered bear market territory as the Federal Reserve raised interest rates in May and then June, its largest rate hike since 1994, in an effort to rein in inflation. The US economy remained robust in the second quarter, although signs of a slowdown emerged with services and manufacturing output easing in June.

European markets struggled as the war in Ukraine added to inflationary pressures and sparked concerns about potential gas shortgages. The rising cost of living and fears of a recession saw consumer confidence fall to its lowest level since April 2020. The European Central Bank is expected to raise interest rates at its meeting on 21 July and again in September.

Inflation was also in focus at the Bank of England, which voted to increase the base interest rate three times during the quarter to 1.25%. Inflation is expected to top 11% in October, when the energy price cap is increased.

As we head into the third quarter, more interest rate increases are expected, but the debate has begun about whether those that have been announced so far may already be dousing the inflationary flames. If that were true, then it would reduce the headwind posed by central bank interest rate policy, turning a headwind into a tailwind for investments. There is considerable uncertainty in the interest rate trajectory, but the outlook for the market is far brighter when it is already anticipating bad news.

The big picture in Q2 2022

- Inflation in the US hit a 40-year high in the second quarter, although a strong dollar and a tighter fiscal policy should prevent it from rising further. Given the persistence of price increases in housing, together with a very tight labour market, the Federal Reserve will likely continue to restrict monetary policy to bring inflation back down towards 2%.
- In the UK, surging inflation was primarily driven by April's rise in the energy price cap, which had previously shielded households from rising wholesale energy prices.
- US government bond prices declined for most of the quarter, although they partially recovered during the second half of June. Looking ahead, it wouldn't be surprising to see prices increase, as economic growth fears mount and inflationary pressures start to ease. In the past, bond prices have usually bottomed when the Federal Reserve has stopped hiking interest rates.
- In Europe, the European Central Bank (ECB) signalled it will start raising interest rates to tackle inflationary pressures. This led to a sell off in government bonds of weaker countries like Italy, which has a huge debt pile and lower potential for growth, compared to bonds of other more fiscally stable eurozone countries. This prompted the ECB to reassure on the effectiveness of its measures and to announce the implementation of new tools to reduce the risk of financial fragmentation.
- Higher oil prices helped the energy sector move higher over the quarter, although some industrial metals prices fell. The resilient US economy and the potential continued growth from the post-Covid reopening are reasons why global growth should continue a little longer.
- China, the world's second-largest economy, continued to enforce its Covid-19 restrictions while minimising disruptions underpinning any supply-side bottlenecks. A recent business survey pointed at signs of improvement in both delivery times and the backlog of work. China is expected to grow its gross domestic product by 7.5% in real terms over the third quarter, according to economists at JP Morgan.

Market overview Q2 2022

- Equities fell -7.4% over the second quarter as investors feared interest rate hikes could tip the economy into a recession.
- Emerging market equities saw the biggest decline at -12.4%, followed by North America with a fall of -9.6%. UK equities dropped by -5.0% and Asia equities slipped -3.2%.
- Bonds extended their downward trajectory, falling -7% over the quarter as central banks' adopted an increasingly hawkish policy stance. The biggest negative contributors were inflation-linked bonds (-9.8%), UK corporates (-7.8%) and UK sovereigns (-7.4%).
- The ten-year US Treasury yield rose to almost 3% as the Federal Reserve enacted a series of interest rate hikes and lowered its growth forecasts for 2022.
- Alternative assets gave a mixed performance. The gold benchmark was up 0.9% over the quarter, whereas global real estate investment trusts (REITs) fell by -8.5% and absolute return slipped -0.8%.

The value of investments can fall and you may get back less than you invested.

MPS performance

MPS PERFORMANCE (%)												
	Q2	2022 YTD	1yr	2yr	3yr	4yr	5yr	2021	2020	2019	2018	2017
Cautious Portfolio	-5.4	-9.5	-8.1	-0.2	2.6	7.7	11.5	3.7	6.7	11.2	-2.7	5.9
Cautious Higher Equity Portfolio	-5.8	-10.0	-8.3	1.5	3.9	8.8	12.7	5.5	6.6	11.2	-2.7	5.9
Income Portfolio	-6.1	-10.1	-8.1	4.2	5.9	11.3	16.6	6.8	6.8	14.5	-4.2	8.1
Income Higher Equity Portfolio	-6.3	-10.2	-7.9	6.4	7.7	12.9	18.3	8.4	6.9	14.5	-4.2	8.1
Balanced Portfolio	-6.8	-11.0	-8.5	9.3	10.4	16.3	23.5	10.6	7.8	16.6	-3.9	8.8
Growth Portfolio	-7.6	-12.0	-8.9	13.8	15.1	20.7	33.0	13.5	10.3	18.4	-4.0	11.8
Global Equity Portfolio	-8.4	-12.8	-9.2	17.4	17.2	23.0	37.1	16.0	10.0	22.1	-4.8	12.8

All figures shown above are calculated to 30 June 2022.

Performance Calculation: All income is reinvested. Performance is shown inclusive of underlying fund charges but gross of 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.

MPS performance highlights Q2 2022

Asset Allocation

What worked and why?

The overweight to cash and absolute return and the underweight to bonds and property were the key positive contributors in the second quarter. As central banks tightened policy in the face of rising inflation bonds, which generally pay fixed amounts to investors, lost value. Being underweight global property REITs helped as they fell alongside broader equity markets. Being overweight cash was helpful over a period when most asset classes fell.

What didn't work and why?

The overweight to North America detracted slightly from relative performance. All equity regions fell but the US fell a little more than the average.

Fund Selection

What worked and why?

A number of value-exposed funds (JPM US Equity Income, BNY US Equity Income, Invesco Asian and Man GLG Japan Core Alpha funds) all contributed positively to relative performance. The Colchester Global Bond and the Allianz Strategic Bond strategies also provided a positive contribution.

What didn't work and why?

Growth strategies such as Jupiter UK Mid Cap, Lindsell Train in UK, Baillie Gifford European and Baillie Gifford American all detracted from relative performance. The property exposed Schroder Global Cities strategy was a drag.

MPS portfolio changes Q2 2022

Asset Allocation

There were no changes to the strategic asset allocations this quarter.

On a tactical basis, the Asset Allocation Committee agreed in May to reduce the equities overweight by 0.5%, allocating the proceeds to global property. Within the equity regions, Asia was moved to an overweight position. Among fixed income, inflation-linked bonds were reduced by 1%, while global sovereign and UK gilts were increased by 0.5% each.

In June, the Asset Allocation Committee voted to reduce the equities overweight by a further 0.5%, retaining a 1% overweight across the majority of risk categories. Within the equity regions, Europe was trimmed by 0.3%, while the US was trimmed by 0.2%, leaving overweight positions in the US, UK and Asia, with Europe the only underweight. The committee also agreed a 0.5% increase to absolute return, thereby increasing the overweight to alternatives to 1.5%.

Fund Selection

The transition to the MI Select Managers Alternatives fund was completed over April and May. The fund gives investors exposure to alternative assets such as infrastructure, property and physical gold.

BlackRock ICS Sterling Liquidity, which invests in high quality and short-term money market instruments, was introduced in June following the Asset Allocation Committee's decision in April to increase the allocation to cash.

MI Select Manager fund weights

MISM FUND WEIGHTS AS AT 30/06/2022		
MISM Fund	**Mandate**	**Weight (%)**
MI Select Managers Bond Instl Inc	Robeco Global Credits	29
	PIMCO UK Corporate Bond	23
	Insight UK Government Bond	16
	Colchester Global Bond	20
	Allianz Strategic bond	4
	DWS US TIPS 10yr+	8
MI Select Managers NA Equity Instl Inc	JPM US Equity Income	32
	Baillie Gifford American	11
	BNY Mellon US Equity Income	28
	Artemis US Select	29
MI Select Managers UK Eq Inc Instl Inc	Ninety One UK Equity Income	33
	Man GLG UK Equity Income	33
	Threadneedle UK Equity Income	34
MI Select Managers UK Equity Instl Inc	JPM UK Equity Core	31
	RWC UK Equity Income	29
	Lindsell Train UK Equity	25
	Jupiter UK Mid & Large Cap Crossover	7
	Teviot UK Smaller Companies	8
MI Select Managers Alternatives Fund	Schroder Global Cities	14
	Muzinich and Co	24
	Commodities and other alternatives	37
	Absolute Return Funds	15
	NN Investment Partners	10

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. Investment values may increase or decrease as a result of currency fluctuations. Information is provided only as an example and is not a recommendation to pursue a particular strategy.

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 has become a relatively attractive asset class at a time when the global growth momentum is slowing, and bond yields are rising. Moreover, the Bank of England base rate continues to move higher.

Bonds

We remain underweight bonds. After hitting an intraday high of 3.50% last month, the ten-year Treasury yield is now at 2.97%. Looking ahead, it wouldn't be surprising to see continued consolidation in the bond market. Economic growth fears are mounting, inflationary pressures are likely to cool, and bonds are still somewhat oversold. But the Federal Reserve is likely going to keep raising rates into early next year. If the past is a good guide, the bond yield should peak close to the point at which the Fed stops hiking rates.

Global Equities

Most equity markets are oversold and sentiment is bearish. Nevertheless, the headwinds confronting equities are growing and so we have further cut our exposure. There is limited room for economies to grow, and the economic data has recently deteriorated. High oil prices are a worry, but the bigger concern is natural gas. The risk is that Russia will continue to weaponise its supply to Europe, which seems to be in its best interests given Europe's plans to diversify away over the longer term. The risk of a recession beginning over the next 12 months has increased. High inflation means central banks are much less likely to come to the rescue than they were in downturns over the past 25 years.

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

We have cut our UK equity exposure. The UK's high weighting towards the financial and metals & mining sectors at a time when global growth is slowing is a concern. In addition, the pound tends to drop during global growth deceleration phases. UK domestic economic growth prospects are lacklustre. Rate hikes will likely impact growth in the UK faster than in the US, given that 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 UK equity relative performance.

US Equities

The relatively richly valued US market is particularly vulnerable to rising interest rates / bond yields. It is also vulnerable to a continued shift in the backdrop that is less beneficial for the 'stay at home' stocks that the US market is heavily weighted in. That said, a slowdown in global economic growth is a relative performance tailwind for the US, given that its sector composition and currency are both relatively defensive. Against this mixed backdrop, we maintain a modest exposure to US equities.

Europe ex-UK Equities

This region is facing two big risks. The first is the potential for a forced rationing of natural gas over winter, which would drag down economic activity. The second risk is linked to the periphery of the eurozone. ECB monetary policy is currently much too loose given the inflation backdrop. Despite slower growth, the ECB must tighten policy or risk severely damaging its credibility. But this process risks bringing pain to the periphery of Europe. Heavily indebted, slow growing Italy is the biggest concern. An increase in risk aversion toward Europe would likely push the euro even lower. A weak euro is a major headwind for the relative performance of Europe ex UK equities.

Japan

With the plunging population and birth rate, Japanese equities are confronting major demographic headwinds. This backdrop acts as a strong disincentive for Japanese businesses to invest and is a structural roadblock to equity market outperformance. More immediately, Japanese equities have underperformed sharply in common currency terms given the very weak yen. Although there is a lack of catalysts on the horizon that would support Japanese equity outperformance, Japan looks medium-term oversold. As such, we hold a weighting in-line with our benchmark.

Asia ex-Japan Equities

With valuations undemanding, very little inflation and the shift by the Chinese authorities to emphasise stimulus and impose regulation in a more market-friendly way, it seems like a good risk/reward bet to position for Asia ex Japan outperformance on a 12 to 18-month view. As such, we remain overweight and positioned for moderate outperformance.

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. Looking ahead, there are crosscurrents confronting the region. On the one hand, EM ex Asia remains very cheaply valued, and there is scope for the economies in this index to bounce back as Covid subsides. On the other hand, our base case expectation is that the oil price moderates somewhat in the second half of this year. Against this mixed backdrop, we hold exposure that is in-line with our benchmark to this pro-cyclical region.

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.

Information is provided only as an example and is not a recommendation to pursue a particular strategy.

Information contained in this document is believed to be reliable and accurate, but without further investigation cannot be warranted as to accuracy or completeness.

We or a connected person may have positions in or options on the securities mentioned herein or may buy, sell or offer to make a purchase or sale of such securities from time to time. In addition we reserve the right to act as principal or agent with regard to the sale or purchase of any security mentioned in this document. For further information, please refer to our conflicts policy which is available on request or can be accessed via our website at www.brewin.co.uk

The opinions expressed are not necessarily those of Brewin Dolphin Ltd.

Brewin Dolphin Limited is a member of the London Stock Exchange, and is authorised and regulated by the Financial Conduct Authority (Financial Services Register reference number: 124444). Registered office: 12 Smithfield Street, London, EC1A 9BD.
Registered in England and Wales – company number: 2135876. VAT number: GB 690 8994 69

BDM3407_2207_0.3
Issue date: July 2022