Managed Portfolio Service

Quarterly report – Q1 2024

Introduction

Welcome to the RBC Brewin Dolphin Managed Portfolio Service (MPS) investment review. In this report, we cover information and events that influenced performance during the first quarter of 2024.

The first quarter of 2024 ended with a strong performance by equities but a mixed performance from bonds. In that sense, it bore resemblances to the year that had gone before but, as ever, there were distinctions which marked out 2024.

While the debate over the outlook for inflation remains in investors' minds, their attention has been drawn to the extraordinary change in the global economy and what opportunities that might provide.

The UK Spring Budget contained few surprises from an investment perspective. The most substantial measure was a 2% cut to employees' National Insurance contributions, which followed a similar reduction that took effect in January. This provides a welcome boost for UK employees and comes on top of the slowdown in inflation.

Germany slipped into recession during 2023 and is only expected to grow very slowly during 2024. German unemployment was very high following unification, and the gradual process of normalising provided a period of impressive growth. There is less scope for German employment to rise from here without a big increase in immigration, which seems unwelcome based upon the shifting political landscape evident in German opinion polls.

The UK also slipped into recession during 2023. The generally accepted definition of a recession is two consecutive quarters of negative growth, and the UK met this test in the second half of last year – although many would consider that a real recession results from a substantial increase in unemployment. Thankfully, this has been absent, but the economy has been weak.

With the run up to elections in the UK, U.S. and several European countries, and with some semblance of recovery in most Western countries' manufacturing sectors, the outlook for interest rates is hotly debated. A succession of better-than-expected data have led investors to expect a fairly modest two or three quarter of a percentage point cuts in the UK, U.S. and Europe. Falling interest rates should be good news for equity markets, all else being equal.

Oil prices rose during the first quarter of the year, in part due to the determination of the Organisation of Petroleum Exporting Countries (OPEC) to keep supply tight (and support prices). A further driver of energy prices is the threat of energy disruption. This rises with geopolitical strife in the oil exporting regions, most notably the Middle East. As the quarter went on, a steady flow of acts of terrorism and insurgency afflicted various parties, including the continued harassment of shipping through the Red Sea, a vital trade corridor leading to the Suez Canal.

The big picture in Q1 2024

- The upcoming U.S. presidential candidates both offer experience, if not youthful vigour. The first quarter saw them secure nominations smoothly, setting the stage for a tough campaign. Historically, incumbents win unless a recession occurs. This bodes well for President Biden, as the economy shows strength with a robust consumer base, a stable housing market, and a reaccelerating manufacturing sector.

- Despite a global manufacturing downturn, the U.S. has shown a stronger and earlier recovery than Europe. The UK, initially thought to be the slowest G7 economy to recover from Covid-19, has passed that title to Germany, which has been losing momentum since 2017 due to a slowdown in job growth.

- As Western countries experience economic recovery, anticipated interest rate cuts in the UK, U.S., and Europe are expected to be less severe and later in 2024 than initially predicted. Meanwhile, Japan has raised interest rates for the first time in 17 years, albeit modestly.

- The stock market performed well in Q1, largely due to excitement over the potential roll-out of artificial intelligence (AI) technologies. This will require significant investment in semiconductors, promising efficiency gains for successful AI implementers. Despite some wariness, the reliance on data and hardware should boost semiconductor demand, making the future of the sector optimistic.

- The first quarter of the year saw a rise in oil prices due to a stronger economic outlook and the Organization of the Petroleum Exporting Countries (OPEC)'s commitment to maintaining tight supply. Meanwhile, cocoa prices also soared due to supply shortages caused by severe drought and record-breaking temperatures in major cocoa-producing regions.

- Despite these challenges, the market's reflection of digital potential alongside physical commodity limitations highlights the need for vigilance towards emerging threats and opportunities.

Market overview Q1 2024

- Asset class performance for Q1 2024 reveals a strong quarter for equities. The standout performers were North America and Japan, both posting impressive returns of around 11%. Developed Europe ex UK also performed well, returning 6.7% while the UK and Developed Asia ex Japan were modestly positive, with returns of 3.6% and 2.9% respectively. Emerging markets lagged but were fairly flat with a return of -0.2%.

- In the bonds asset class, performance was generally flat or negative. UK Sovereign Bonds underperformed, with a return of -1.7%, while Global Sovereign Bonds and Global Inflation Linked Bonds were also in negative territory, both returning -0.4%. Global Corporate Bonds and UK Corporate Bonds were flat.

- The alternatives asset class had a mixed performance. Gold was the standout performer, returning 7.7%, while Absolute Return posted a modest return of 1.8%. Global Property, however, underperformed with a return of -0.8%.

- Cash continued to deliver positive returns in the higher interest rate environment.

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

MPS performance

MPS PERFORMANCE	Q1	2024 YTD	1yr	2yr	3yr	4yr	5yr	2023	2022	2021	2020	2019
Cautious Portfolio	2.1	2.1	7.1	2.2	2.6	17.1	14.2	6.8	-10.1	3.7	6.7	11.2
Cautious Higher Equity Portfolio	2.7	2.7	8.3	3.7	5.1	22.2	18.1	7.4	-9.9	5.5	6.5	11.2
Income Portfolio	3.3	3.3	9.2	4.9	7.1	29.2	22.9	7.7	-9.5	6.8	6.8	14.5
Income Higher Equity Portfolio	4.1	4.1	10.6	7.0	10.2	36.1	28.0	8.3	-8.8	8.4	6.8	14.5
Balanced Portfolio	4.8	4.8	11.7	8.3	12.2	43.9	33.6	8.8	-9.0	10.8	7.6	16.4
Growth Portfolio	5.9	5.9	13.0	10.0	14.9	56.9	43.0	9.1	-9.2	13.8	9.9	18.4
Global Equity Portfolio	7.2	7.2	15.1	12.5	18.9	70.3	51.3	9.8	-8.9	16.3	9.7	22.1

All figures shown above are calculated to 31 March 2024.

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.

MPS performance highlights Q1 2024

Asset Allocation

What worked and why?

The overweight to U.S. equities, which was increased over the quarter, was a positive contributor. The U.S. technology sector continues to power ahead on the back of the latest positive developments in artificial intelligence. The underweight position to global corporate bonds, due to concerns over their valuations, was beneficial as returns were broadly flat.

What didn't work and why?

The overweight position to sovereign bonds was unhelpful over the first quarter. These are principally held in the portfolios as a foil against economic weakness. If central banks cut interest rates as expected later this year, we would expect them to support portfolios.

Fund Selection

What worked and why?

The Fidelity Emerging Markets fund returned almost 7% at a time when broader Asia and Emerging markets have not been strong. The Man GLG Sterling Corporate strategy strongly outperformed its benchmark for the third quarter in row. The strategy has performed very well since its introduction almost a year ago. Brown Advisory US Sustainable Growth has also performed well, benefitting from extremely positive earnings results from a number of companies exposed to artificial intelligence.

What didn't work and why?

Value investments in U.S. funds rose but have struggled on a relative basis. We have replaced the JPM US Equity Income strategy with a broader value strategy we believe will complement portfolios better over the long term. The Ninety One Global Macro Alternatives strategy had a difficult first quarter following a positive one at the end of last year. The fund is held as a diversifying position and its defensiveness should provide resilience in the event of a sell-off.

MPS portfolio changes Q1 2024

Asset Allocation

There was an adjustment to the Strategic Asset Allocation benchmarks at the beginning of the year within the bond component. There was an increase in the weighting to UK government bonds and a reduction in the allocation to global government bonds. This reflects the fact that the UK economic outlook remains challenging compared to most regions, which should support the price of gilts.

In February, in light of a brighter economic outlook, the Asset Allocation Committee raised its tactical guidance on U.S. equity and global property by 0.5% each. This was funded by reductions in cash and Absolute Return.

The Asset Allocation Committee increased the guided weight to equities again in March, raising the non-U.S. equity regions to neutral against the benchmark, while maintaining a positive stance on U.S. equities. This change was supported by a reduction in Absolute Return exposure, which diversifies portfolios but can struggle to keep up against strong equity markets.

Fund Selection

In January, JPM US Equity income was replaced with the DWS US Value 200 strategy as part of a wider restructuring of the MI Select Managers North American fund and follows the introduction of Brown Advisory US Sustainable Growth in December. Man GLG Japan Core Alpha was replaced by M&G Japan, which has less of a pronounced value exposure. The Man GLG fund has performed very well over recent years, but the market environment has changed as inflation has finally started to take hold. The new M&G Japan strategy should work well in the new regime.

In February, the BlackRock Sterling Liquidity fund was decreased and US funds were increased following the changes in guidance. In alternatives, Schroder Global Cities was increased and Absolute Return strategies were reduced. Global property has had a difficult few years as interest rates have risen, but we believe the bad news is now reflected in prices. A low-cost exposure to large cap quality growth stocks was introduced in the MI Select Managers North American fund.

In March, The Blackrock Continental European, the Fidelity Asian and the M&G Japan Fund were increased, while the MI Select Managers Alternatives fund was decreased. The Vanguard US Index fund was lowered and the exposure to large cap tech was extended. In the high risk portfolios, the Baillie Gifford European fund was replaced with the Blackrock European Dynamic, a fund in which our analysts now have higher conviction.

MI Select Manager fund weights

MISM FUND WEIGHTS			
Date	**MISM Fund**	**Mandate**	**Weight (%)**
31/03/2024	MI Select Managers Bond Instl Inc	Robeco Global Credits	22
		Man GLG Sterling Corporate Bond	14
		Insight UK Government Bond	24
		Colchester Global Bond	20
		DWS US TIPS	16
		Other fixed income funds	4
31/03/2024	MI Select Managers NA Equity Instl Inc	Brown Advisory US Sust Growth	29
		Baillie Gifford American	7
		BNY Mellon US Equity Income	23
		DWS US Value	23
		Mandate: DWS US Tech Weight	18
31/03/2024	MI Select Managers UK Eq Inc Instl Inc	Ninety One UK Equity Income	40
		Man GLG UK Equity Income	42
		CT UK Equity Income	18
31/03/2024	MI Select Managers UK Equity Instl Inc	JPM UK Equity Core	33
		Redwheel UK Equity Income	31
		Lindsell Train UK Equity	28
		Teviot UK Smaller Companies	8
31/03/2024	MI Select Managers Alternatives	Commodities and other alternatives	42
		Muzinich Global Tactical Credit	13
		Ninety One Global Macro Alternatives	10
		Schroder Global Cities	22
		Absolute Return funds	13

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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 hold a neutral position in cash. Cash currently offers a relatively attractive return and acts as dry powder that can be deployed when conditions for the riskier asset classes improve.

Bonds

With central banks now looking ahead to rate cuts, we maintain an overweight to government bonds. We remain underweight corporate bonds. Credit spreads are not sufficiently large to compensate for global economic growth risks, in our view. This leaves us with a small overweight position in bonds as an asset class.

Global Equities

The resilience of the U.S. economy is supportive of the global equity market. Indeed, the probability of a soft landing appears to have risen. Meanwhile, there is the potential for AI-related themes to push equity prices higher. Technically, market momentum is very strong. Tempering our optimism are sentiment and positioning (on balance already bullish), the stage of the economic cycle (late), U.S. valuation metrics (high), and the risk of political turmoil following the November U.S. presidential and congressional elections.

Alternatives

The gold price has been supported by strong buying among central banks and, more recently, by expectations of rate cuts. However, gold appears stretched considering how much real bond yields have risen over the last couple of years. Meanwhile, sentiment and positioning is bullish, which implies less scope for greater optimism required to push prices higher. The outlook for the gold price appears broadly balanced, and we retain a neutral position. We hold a neutral position in property. Encouragingly, global developed world REIT (real estate investment trust) macro fundamentals appear to be stabilizing (commercial mortgage-backed security (CMBS) spreads, underlying property prices). While fundamentals are challenging in the office space, the market cap weighting of this sector is small. The backdrop is notably stronger in other REIT subsectors.

UK Equities

The UK market is undeniably cheap and unloved. With that in mind, it might not need a lot of good fundamental news to outperform. However, the most important determinant of UK equity relative performance is global sector and style performance. Given its high weightings in value-oriented sectors like energy and financials, and low weightings in growth sectors such as technology, UK equity market relative performance benefits strongly during periods when global value stocks outperform. The bad news is that the outlook for the relative performance of value stocks appears uninspired. The composition of the UK market also probably makes it a good hedge against unexpectedly strong global inflation. Cyclically, inflation pressures have moderated.

US Equities

The big risk to U.S. relative performance involves valuation, including the valuation of the dollar. Nevertheless, we are more optimistic about U.S. equities than other regions, for two main reasons. The first relates to the secular outlook, which appears relatively bright for tech stocks. The main upside risk for the global equity market over the next few years is if an 'AI boom' scenario unfolds. With the Federal Reserve now on hold, and likely to begin cutting rates this year, a weaker version of the cycle that played out during the second half of the 1990s is a possibility today. Back then, excitement linked to the growth of the internet drove gains. This cycle, AI could be the driver. The U.S. has much greater exposure to the 'pick and shovel' plays positioned to benefit from an AI investment spending boom than any other region. The second reason for favouring the U.S. relates to the cyclical outlook. Even though the odds of a soft landing have gone up, economic growth risks are still significantly higher than in any given year. The U.S. is the most defensive of our six equity regions, which is an attractive characteristic at a time when growth risks are elevated.

Europe ex-UK Equities

If we can predict where the relative performance of global teach and continental European FX are going, we stand a good chance of successfully predicting whether Europe ex UK Equities will outperform. We are optimistic on the secular outlook for the global tech sector, which bodes poorly for Europe ex UK Equities as it has low weightings in this sector. With regards to continental European FX, over the longer term, there appears to be room for appreciation, which would support regional equity relative performance in common currency terms. Importantly, the euro is cheaply valued (based on purchasing power parity conversion rates), and regional existential risks have declined. However, over the medium term, sluggish economic growth in Europe vis-à-vis the U.S. should limit the upside in continental European FX.

Japan Equities

Shareholder-friendly reform momentum has picked up in Japan, which could help spark a further expansion in relatively depressed price-to-book multiples. However, demographics amount to a major structural headwind to Japanese equity relative performance. From a cyclical perspective, with the unemployment rate low and labour force participation high, Japan does not have much scope to put idle economic resources to work. Despite low price-to-book multiples, Japan does not stand out as cheap, in our view. Indeed, it trades at a premium to the World ex U.S. market on 12-month forward P/E (price-to-earnings).

Asia ex-Japan Equities

Chinese economic growth has been lacklustre, with property a key area of weakness. House prices continue to contract, and residential floor space sold remains deep in negative territory on a year-on-year basis. Nevertheless, the Chinese authorities have become increasingly preoccupied with stabilising the stock market. Meanwhile, many investors remain extremely pessimistic on China, suggesting the bar for positive surprises is low. Despite this seemingly attractive combination, we are not optimistic with regards to Asia ex Japan relative performance. China has become structurally less shareholder friendly, and geopolitics is likely to continue to hinder performance. High indebtedness and challenging demographics should act as longer-run economic headwinds in China.

Emerging markets ex-Asia Equities

Emerging Markets ex Asia is very cheap, but there does not appear to be a catalyst on the horizon to unlock that value. Brazil, Saudi Arabia, South Africa, Mexico, and the United Arab Emirates are the countries with the highest market cap weightings in the EM ex Asia equity index, making it very commodity exposed. We do not expect much upside to commodity prices in an environment where global growth is slowing and China refrains from large-scale stimulus.

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