RBC Brewin Dolphin

Sustainable Managed Portfolio Service

Quarterly report – Q1 2024

Introduction

Welcome to the RBC Brewin Dolphin Sustainable Managed Portfolio Service (SMPS) 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 Q4

- With the next UK general election confirmed for 2024, campaigning has begun with stark differences on green issues; Prime Minister Rishi Sunak's government has pledged to "max out" oil and gas production. The opposition Labour party initially put clean energy at the centre of its economic strategy, but later dropped its £28bn-a-year spending pledge.

- Nature and biodiversity have been taking increasing prominence in sustainability circles. China made a step forward in its National Biodiversity Strategy and Action Plan, which requires companies to identify the impact of their relevant operations on biodiversity, and regularly monitor, assess and disclose their biodiversity risks, dependencies and impacts.

- Europe also saw further regulation in the form of the Corporate Sustainability Due Diligence Directive (CSDDD), which will require disclosures beyond climate impact. This will include human rights issues such as child labour and forced labour. Importantly, it is the first major regulation of its kind to introduce a legally mandated standard for how companies conduct supply chain due diligence. This step change will require companies affected to overhaul existing third-party risk management and supply chain due diligence processes.

- Several large asset managers including JPMorgan, State Street and Blackrock have either left or scaled back participation in Climate Action 100+. This highlights a growing split between the largest U.S.-based asset managers, which are under intense pressure from Republicans over climate issues, and those elsewhere. Smaller competitors and European firms have largely stuck with various climate coalitions and Climate Action 100+ continues grow in terms of the number of signatories.

- A Delaware judge controversially overruled Elon Musk's compensation package, which had been agreed with the board in 2021. She stated that most board members had close relationships with Musk or "compromising conflicts", rendering them unable to fairly represent shareholder interests. Subsequently, Musk has announced he is considering moving the company to Texas.

- The U.S. Securities and Exchange Commission (SEC) completed a historic rulemaking on March 6 by adopting new rules requiring public companies to disclose certain climate-related information in registration statements, and annual reports including scope 1 and 2 emissions (those from a company's own operations and from its energy use). U.S. Republicans had pre-drafted a legal challenge and filed a lawsuit in court on the same day the regulation was released.

Market overview Q1 2024

- The first quarter was strong for equities. 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.
- 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 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.
- 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 these challenges, the market's reflection of digital potential alongside physical commodity limitations highlights the need for vigilance towards emerging threats and opportunities.

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

Sustainable MPS 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?

Royal London Ethical Bond and Robeco Sustainable Bond both did well through careful asset selection. 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?

Schroder Global Sustainable Value and Schroder Global Energy Transition struggled over the quarter. The period has been a difficult one for the solar energy industry in particular, but the technology remains key to a carbon free future and we continue to believe that the long-term prospects are positive.

Sustainable 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, following the changes to the strategic asset allocation benchmark, the allocation to overseas sovereign bonds was reduced and the allocation to UK gilts was increased, reflecting our increased preference for domestic bonds.

In February, the BNY Mellon Sustainable Global Dynamic Bond fund and Muzinich Global Tactical Credit were decreased in Alternatives, and Stewart Asia Pacific Leaders and Evenlode Global Income were increased in equities.

In March, the Evenlode Global Income and the FSSA Asia Pacific Sustainable Leaders were increased, while the Muzinich Global Tactical Credit and the BNY Mellon Global Dynamic Bond were reduced.

SMPS performance

SMPS PERFORMANCE (%)						
	Q1	2024 YTD	1yr	2yr	2022	2023
Income Portfolio	2.2	2.2	6.9	2.5	-11.7	7.5
Income Higher Equity Portfolio	2.9	2.9	7.8	4.5	-11.7	8.3
Balanced Portfolio	3.3	3.3	8.3	5.9	-11.5	8.5
Growth Portfolio	4.1	4.1	9.7	8.1	-11.6	9.4
Global Equity Portfolio	5.3	5.3	11.5	11.1	-11.7	10.7

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.

Funds in focus Q1 2024

TB Evenlode and TB Evenlode Global Income

Evenlode Investment is a boutique fund management house known for its long investment time horizon and sole focus on identifying the highest quality companies to own in portfolios. We believe that this combination will be very rewarding to clients. In addition to strong economic moats, reliable cash flows, and healthy balance sheets, an assessment of environmental, social and governance factors that may impact its businesses over time is integral to its holistic analysis of quality.

ESG considerations are considered throughout the investment process at Evenlode, from idea generation, the construction of its investible universe, its deep fundamental analysis to its position sizing decisions. For example, it has constructed an ESG checklist of questions it asks about each potential investment, with the score having a direct impact on the maximum position size for that company. Example questions include, “Does the company provide positive social impact to society through its business activities?” and “Is there board-level oversight and management of climate-related risks?”

In addition to this deep integration of ESG considerations, Evenlode considers stewardship to be a core responsibility as stewards of client capital, and an opportunity to deepen its insight into company management. Topics it engages on include long-term strategy, remuneration policies, attitude to capital structure, labour relations, climate change risk, shareholder rights, succession planning, and company culture.

We admire the strong investment culture at Evenlode and its genuine integration of ESG considerations. From this, it has built a strong investment team and a repeatable investment process, and delivered robust investment returns, and we are happy to utilise both the Evenlode Income and Evenlode Global Income funds in our sustainable MPS range.

Funds in focus Q1 2024 continued

Schroder Global Energy Transition

The fund provides exposure to companies actively engaged in the energy transition as the world shifts to a low-carbon economy. One of the reasons we selected this particular clean energy fund is that lead portfolio manager Mark Lacey and his team are dedicated energy sector specialists who have extensive experience within the entire industry, spanning environmental technology and conventional energy.

The fund provides a focused thematic exposure to the best-performing companies involved in new clean energy systems. It targets strategic industries and emerging technologies integral to the global shift to cleaner energy, seeking opportunities across key value chains, including renewable energy, transmission and distribution, energy storage, and energy services and equipment. The fund's mandate is very well-defined, such that it will not invest in companies involved in fossil fuels or nuclear energy, nor those who have large indirect exposure to these industries via end markets.

Crucially, the focus will be kept on the energy system and the associated technologies needed to enable its change. This means the fund will only invest in companies involved in the production and distribution of clean energy, the management of energy consumption, or the production of materials and technologies required to facilitate these activities. Therefore, it does not invest in companies with more generic end uses, such as semiconductors.

Examples of the types of business operations that fall within the investment universe includes wind and solar equipment, residential solar, energy storage and battery solutions, grid operators, electrical cable makers, electrical vehicle infrastructure including charging points, and smart metering.

Anna Haugaard
Senior Analyst

ESG reporting for SMPS Income

(as at 31 March 2024)

MSCI ESG Ratings

ESG Quality Score 7.1

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.

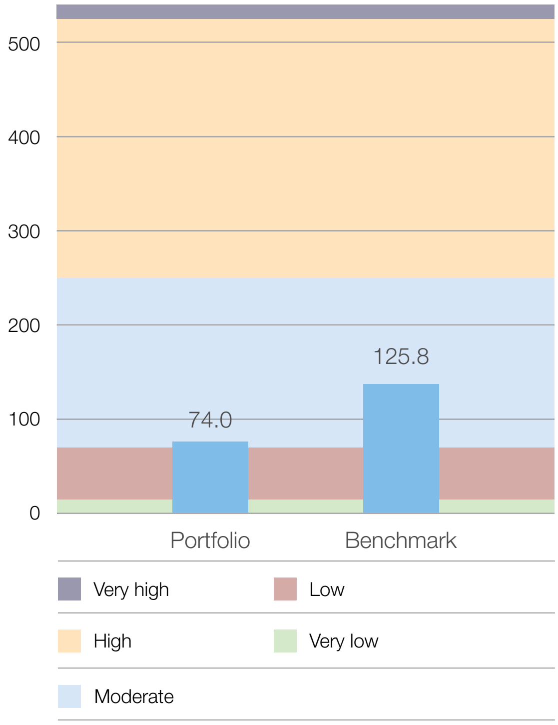
References:

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

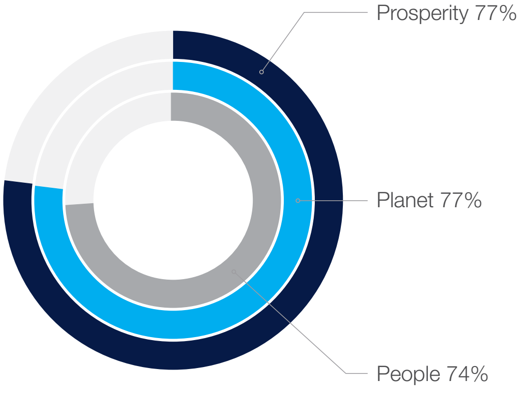
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

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

1 NO POVERTY

8 DECENT WORK AND ECONOMIC GROWTH

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

11 SUSTAINABLE CITIES AND COMMUNITIES

Planet

6 CLEAN WATER AND SANITATION

7 AFFORDABLE AND CLEAN ENERGY

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

13 CLIMATE ACTION

People

2 ZERO HUNGER

3 GOOD HEALTH AND WELL-BEING

5 GENDER EQUALITY

10 REDUCED INEQUALITIES

ESG reporting for SMPS Income Higher Equity

(as at 31 March 2024)

MSCI ESG Ratings

ESG Quality Score 7.2

MSCI ESG RATINGS AA

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

Carbon Intensity

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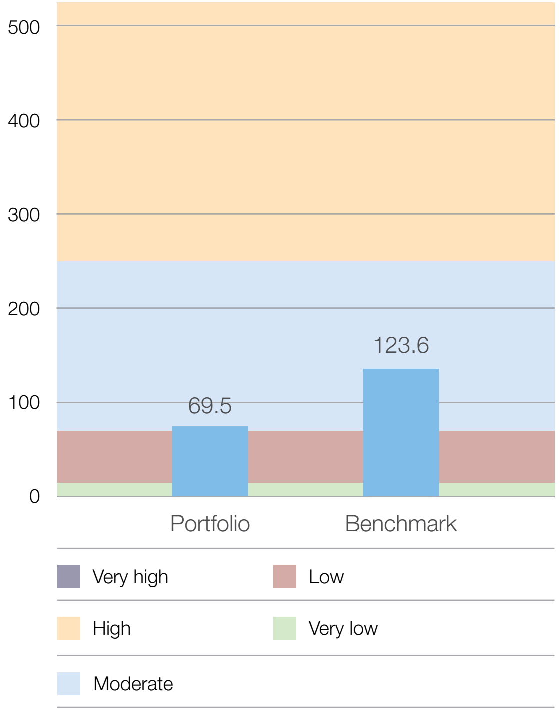
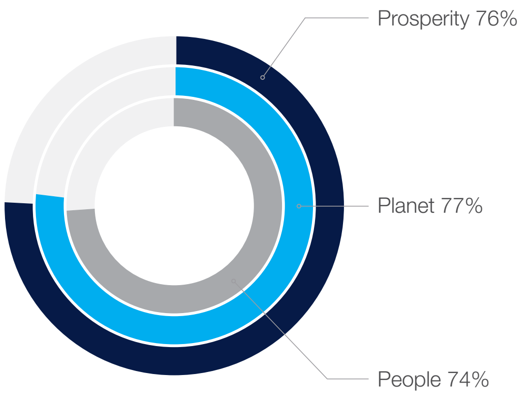
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

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

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



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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 Balanced

(as at 31 March 2024)

MSCI ESG Ratings

ESG Quality Score 7.3

MSCI ESG RATINGS AA

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

Carbon Intensity

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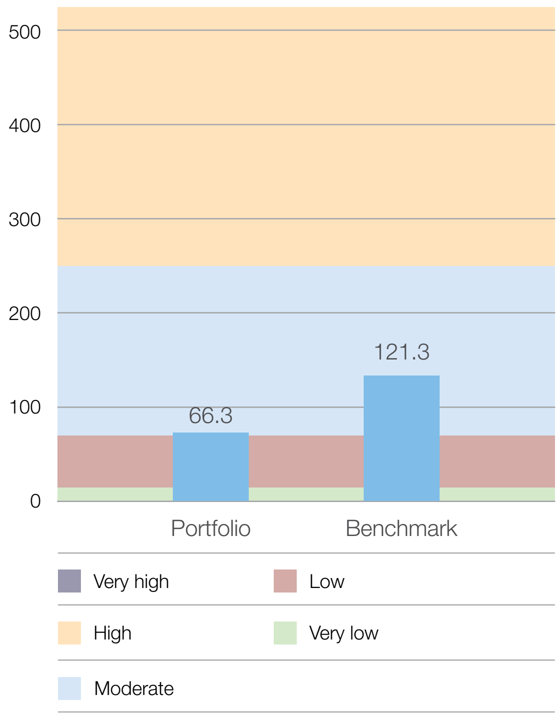
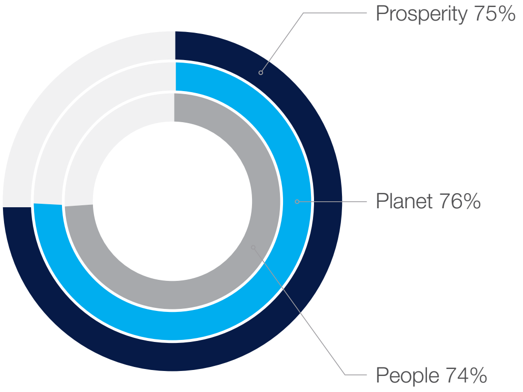
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

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

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



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Prosperity

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Planet

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7 AFFORDABLE AND CLEAN ENERGY

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

13 CLIMATE ACTION

People

2 ZERO HUNGER

3 GOOD HEALTH AND WELL-BEING

5 GENDER EQUALITY

10 REDUCED INEQUALITIES

ESG reporting for SMPS Growth

(as at 31 March 2024)

MSCI ESG Ratings

ESG Quality Score 7.5

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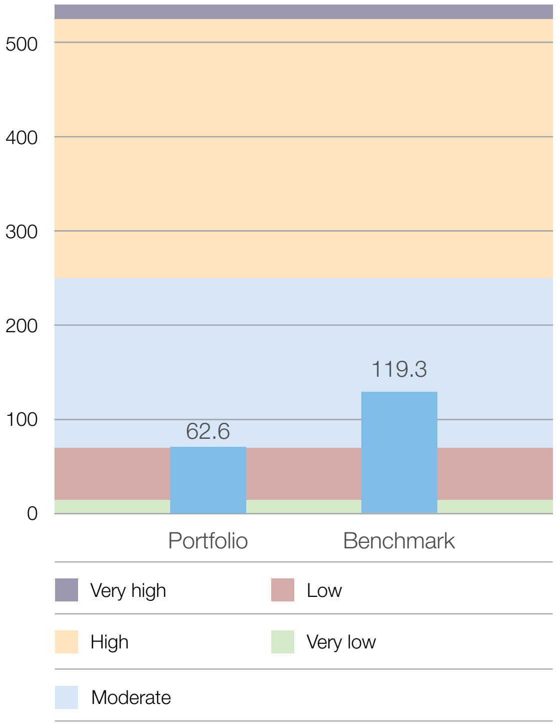
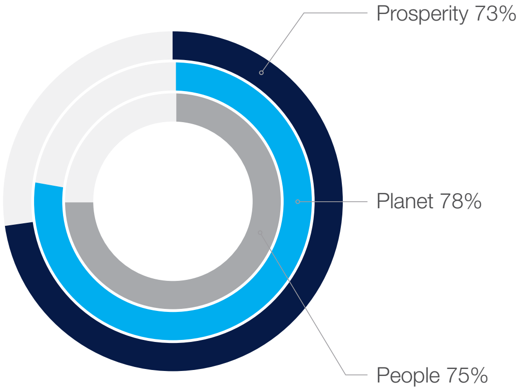
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

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 31 March 2024)

MSCI ESG Ratings

ESG Quality Score 7.7

MSCI ESG RATINGS AA

CCC	B	BB	BBB	A	AA	AAA

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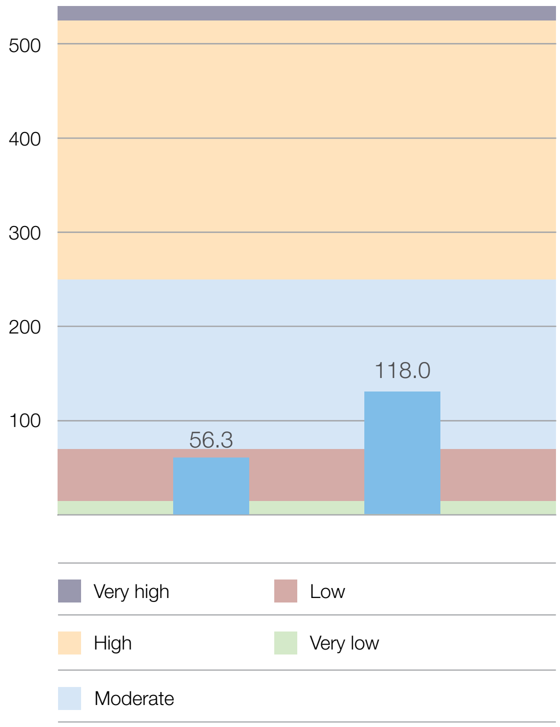
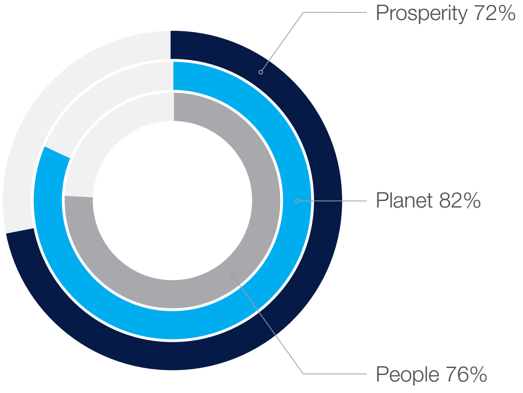
(2) Scope 2: Indirect GHG emissions that occur from the generation of purchased electricity, steam or heat consumed by the company.

Benchmark for comparison: 100% Global equity

Carbon Intensity vs Benchmark (TCO2e / $m sales)



SDG Alignment



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10 REDUCED INEQUALITIES

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

he 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).

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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

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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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