Canaccord Genuity Wealth Management

MPS investment update

February 2025 (written 7 February 2025)

Portfolio asset allocation

	Risk profile 3	Risk profile 4	Risk profile 5	Risk profile 6	Risk profile 7
Debt and fixed interest	**59.01**	**46.19**	**31.47**	**16.82**	**0.00**
Emerging Markets	2.93	2.88	1.93	0.00	0.00
International	10.73	11.54	8.51	4.84	0.00
Government	21.65	13.07	8.30	3.90	0.00
Corporate	23.7	18.7	12.73	8.07	0.00
Equities	**21.09**	**41.42**	**61.19**	**80.74**	**97.16**
Emerging Markets	1.03	2.00	1.97	2.65	2.86
Far East	1.01	2.00	2.17	3.76	4.65
Japan	1.05	1.11	1.93	2.50	3.01
North America	3.39	8.07	11.67	16.77	20.66
Thematic	2.27	4.12	6.87	8.22	8.44
United Kingdom	5.60	11.19	17.52	23.41	28.04
International	6.74	12.92	19.07	23.44	29.49
Alternative investments	**14.82**	**10.01**	**4.95**	**0.00**	**0.00**
UCITS funds	12.78	8.02	2.89	0.00	0.00
Commodities	2.04	1.99	2.06	0.00	0.00
Cash	**5.08**	**2.38**	**2.39**	**2.44**	**2.84**

Data as at 31 January 2025

Core inputs to our asset allocation framework

The economy

Inflation-driven, asynchronous and volatile: three terms that define the current economic cycle. While we have all felt the impact of inflation, the other two factors are just as crucial. Asynchronous? The US has been the standout performer in growth and productivity. Southern Europe has its bright spots, but core European countries have stagnated, with the UK facing increasing pessimism as its growth outlook weakens. Meanwhile, with fiscal sustainability concerns rising across major economies, bond investors are reacting to government policy triggering bouts of volatility. While this mix may make for a bumpy ride, there's still plenty to be excited about from an investment perspective.

Inflation

Inflationary pressures continue to gradually subside, though, as we long anticipated, the final stretch from 3% to 2% is proving more challenging. In both the UK and the US, remaining inflation is driven entirely by services – a sector less sensitive to monetary cycles. Excessive government spending is keeping services inflation stubbornly high and with fiscal consolidation (governments reducing debt and deficits) unlikely anytime soon, the path for inflation remains uncertain. While US growth remains resilient, 'stagflation' (stagnant growth and high inflation) is increasingly on the lips of UK economists.

Interest rates

The US Federal Reserve (Fed), Bank of England (BoE), and European Central Bank (ECB) have all begun cutting rates and they now face the same question of where next? Policy expectations have shifted almost as frequently as the rates themselves, but long-term policy expectations shouldn't be this volatile. Expectations for the three regions are now diverging. With inflationary pressures

largely receding in the eurozone and growth stagnating, the ECB is expected to cut to 1.8% by year-end. Meanwhile, the BoE and the Fed are expected to move more cautiously leaving policy rates around 3.75–4% at the end of the year. In the US, real rates will likely remain more restrictive, reflecting the economy's relative strength.

Corporate earnings

As peak earnings season unfolds, a robust corporate landscape is taking shape, with strength expanding beyond the US megacap stocks. Profit margins are improving in the broader market suggesting a wider earnings recovery, which could accelerate as productivity-boosting technologies filter through the economy. Financials have delivered strong Q4 results, with positive revisions outpacing other sectors. Meanwhile, European equities are enjoying their best relative performance in a decade, attracting record inflows as investors bet on recovery amid easing financial conditions. While challenges remain, the broadening of market leadership - both within the US and globally – signals a durable earnings cycle ahead.

Valuation and positioning

US equities remain historically overvalued, but strong corporate performance and robust earnings growth continue to offer support. Still, it's worth asking: has optimism gone too far? In contrast, valuations in Europe, Asia, and the UK are modest – or even outright cheap – leaving room for significant recovery if positive surprises emerge. Bond market valuations appear fair given the outlook for growth, inflation, and interest rates. Meanwhile, corporate credit spreads – the difference in yield between corporate and government bonds of similar maturity – remain tight. This reflects both the resilience of the corporate sector and strong demand for fixed income, as investors look past narrow spreads and focus on attractive all-in yields.

Key subject of the month: 'A song of ice and fire'

While we remain optimistic about the road ahead, we recognise the potential for both supply-side (fire) and demand-side (ice) shocks.

- Ice (economic slowdown): When economic activity slows, central banks lower interest rates to stimulate growth. This environment favours traditional fixed income, such as government and high-quality corporate bonds, which currently offer compelling yields and downside protection during recessionary phases
- We have increased the 'quality' of our fixed income allocation and have constructed our bond allocation to complement equities with targeted and precise allocations
- Fire (inflation & supply shocks): Periods of inflation or supply-driven price shocks require exposure to inflation-sensitive assets; and so we incorporate floating-rate asset-backed securities (ABS), short-dated US TIPS (inflation-protected government bonds), infrastructure equities, commodities, commodity-related equities and liquid alternative strategies to hedge against inflation surprises.

The return of equity-bond diversification with a twist: Traditional equity-bond diversification has reasserted itself, but the relationship could be more dynamic going forward – we expect inflation to be higher on average and more volatile, with periods where stocks and bonds fall together, demanding a more adaptive and flexible approach.

Risk management remains at the core of our philosophy and our approach is designed to withstand uncertainty, not predict it, ensuring resilience through both 'ice' and 'fire'.

Key asset allocation positioning

- We remain neutral across all asset classes at a 'headline level', reflecting our view that most asset classes offer a fair balance between risk and reward
- This stance has remained consistent over the past 16 months and while we believe it remains appropriate for early 2025, we stay open-minded given the potential unpredictability of the year ahead
- We maintain a moderate underweight stance towards the US, large cap tech and growth themes in equity markets, although we have moderated that stance
- We continue to see value opportunities in regions like Asia, Europe and the UK, although we do not have an extreme positional skew
- While our equity allocation is neutral, we are well positioned for a potential economic slowdown, as we have increased focus on those companies that should have dependable business models and profit streams in a slower economic environment
- We remain underweight UK gilts and interest rate duration in fixed interest investments but have moderated our previous positioning and are expecting to increase interest rate sensitivity further
- Alternatives can add value in volatile markets, as 'relative value' trades help, but we can now find better opportunities in fixed interest and equity markets
- As in recent years, our strategy is clear: balance, diversification, and flexibility.

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