MPS investment update

June 2024 (written 4 June 2024)

Portfolio asset allocation

	Risk profile 3	Risk profile 4	Risk profile 5	Risk profile 6	Risk profile 7
Debt and fixed interest	**59.06**	**46.70**	**31.90**	**17.17**	**–**
International	16.01	16.92	12.91	4.96	–
Government	21.29	13.02	8.18	3.88	–
Corporate	21.76	16.76	10.81	8.33	–
Equities	**20.29**	**40.17**	**60.26**	**80.04**	**97.91**
Emerging Markets	1.00	1.98	1.96	2.67	2.89
Far East	1.00	1.99	2.19	3.84	4.78
Japan	1.13	1.09	1.92	2.50	3.03
North America	3.73	8.64	13.18	17.94	20.89
Thematic	5.43	7.63	10.58	15.21	18.51
United Kingdom	5.38	12.25	20.28	25.70	31.22
International	2.62	6.58	10.16	12.18	16.60
Alternative investments	**14.68**	**9.77**	**4.89**	**–**	**–**
UCITS funds	12.60	7.72	2.86	–	–
Commodities	2.08	2.05	2.02	–	–
Cash	**5.97**	**3.36**	**2.95**	**2.80**	**2.09**

As at 31 May 2024

Core inputs to our asset allocation framework

The economy

The economy continues to follow the path we outlined as our 'base case' at the start of the year. There are increasingly obvious signs that the US is slowing, while Europe and China improve slightly. This should lead to a year in which overall economic activity grows in comparison to last year, but not by a huge amount. We see the share of growth distributed less towards the US and more in favour of Europe and China. Even if some minor cracks are appearing in parts of the US economy, there's no real sign of an impending recession.

Inflation

'Same old story' as last month. Inflation continues to moderate, but not as fast as anyone hoped. Not least the central banks. The persistency of inflation remains the greatest risk to investors, even if most markets have been unperturbed by that risk so far. Has our view changed? Not really. We still expect recent disinflationary tendencies to continue, but we're not expecting overall inflation rates to reach central banks' targets of around 2% anytime soon. Our core view remains that it's likely that the ceiling on inflation in the last decade, roughly 2%, will be the floor in the coming years.

Interest rates

We are starting to see a divergence in interest rate expectations across the developed world, even if the next moves are still expected to be cuts in the US, Europe, and the UK. Traditionally it's the US Federal Reserve (Fed) that cuts rates first with others following, but this time around it's the European Central Bank (ECB) and Bank of England (BoE), which seem likely to lower rates in June and August, respectively. This makes sense, as while the economies on both sides of the English Channel are improving, they could still do with some help as interest rates are too high. The US is a different case and there is very little justification for cutting rates currently. It appears the Fed agrees with this view and while there will probably still be one or two adjustments lower this year, any motivation to reduce rates has fallen markedly amongst their committee members.

Corporate earnings

Although the most recent reporting season demonstrated once again that corporate earnings growth is heavily concentrated in a few behemoth US technology companies, the overall results were reassuring for investors. It appears the corporate sector is doing 'just fine', even if the best results are skewed towards tech companies, and even if large companies are doing considerably better than small ones. Perhaps the most supportive part of the concluded results season was that earnings estimates for the rest of the year have increased - which is a rare and positive phenomenon at this time of the year.

Valuation and positioning

We would describe investor optimism as being 'a bit hot', but not worryingly so. Investors are understandably calmer after a period of strong returns, as well as satisfactory earnings releases and positive economic news flow. Interestingly, the stock market has started to broaden out as the rally has progressed, which should be considered a positive. While asset markets are unlikely to make further headway in the short term, as investors are a little complacent and valuations have expanded, there doesn't seem a case to be made for a major market pullback. Even a correction or period of consolidation is possible - as it always is.

Key subject of the month: 'does the UK election matter for global markets?'

- The short answer is not really. Whilst in the UK we might look upon the recently announced general election of early July with keen interest, we think global investors simply don't care
- There are three reasons why the UK election is unlikely to move markets in a major way, aside from the fact that the UK is shrinking in global influence
- First is that the result is already deeply discounted. Investors and markets are expecting the incumbent Conservative Party to suffer a crushing defeat
- Next is the fact that there are no signs that any future Labour Party administration is planning on pursuing any maverick policies. We might all be able to find something that we disagree with in their manifesto, but the reality is that it's likely to be unexciting
- Finally, any new government might think they are in charge, but the reality is that the bond market is in charge. Because of the teetering and ever-growing debt pile that has been amassed by our governments over the last 20 years, we don't have the ability for 'out of the box' policies. The ill-fated administration of Liz Truss was a clear reminder of the practicalities of overseeing the country in our parlous financial position
- There could, of course, be some reaction, but we view this as unlikely
- More likely is that the UK markets continue to perform based upon corporate fundamentals.
- UK equities have started to perform better, and we think this will continue. UK company's shares are cheap, and profits are expected to grow
- International investors could breathe a sigh of relief at the changing of the political guard, but it is more likely that they 'buy British' because our equity and corporate bond markets are cheap
- UK gilts will likely be mostly dominated by global inflation and interest rate trends, even if some domestic factors could have a bit of an influence. The currency market is likely to be relatively rangebound, with the exchange rate continuing to oscillate between US$1.20 and US$1.30
- This election could be a non-event in market terms, but that doesn't mean that the outlook for UK assets is boring. We remain positive on UK equities and UK corporate bonds.

Key asset allocation positioning

We are neutral in all asset classes at a 'headline level', reflecting our view that most asset classes are offering a fair balance between risk and reward. This is also influenced by our view that we need to 'wait and see' how certain key factors progress this year.

In equity markets, we are underweight the US, large-cap tech and growth themes, although we have moderated that underweight stance. Our favoured region is Asia (inc. Japan) and top sectors include healthcare and renewables.

We remain underweight UK gilts and interest rate duration in fixed interest investments but have moderated our extreme positioning and are expecting to increase interest rate sensitivity further. We remain comfortable taking corporate credit risk and believe 'compensation' through yields is fair.

We think alternatives can add value in volatile markets, as 'relative value' trades help, but we can now find better opportunities elsewhere in fixed interest and equity markets. As stated repeatedly through the last few years, our key stance is to remain balanced, diversified and operating with a 'flexible mindset'.

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