MPS investment update

May 2024 (written 8 May 2024)

Portfolio asset allocation

	Risk profile 3	Risk profile 4	Risk profile 5	Risk profile 6	Risk profile 7
Debt and fixed interest	**59.82**	**47.25**	**32.27**	**17.33**	**–**
International	16.01	16.95	12.94	4.07	–
Government	21.87	13.39	8.41	3.95	–
Corporate	21.94	16.91	10.92	8.42	–
Equities	**20.31**	**40.22**	**60.25**	**80.11**	**97.85**
Emerging Markets	1.01	2.00	1.99	2.70	2.92
Far East	1.00	2.00	2.20	3.89	4.82
Japan	1.20	1.09	1.91	2.49	3.01
North America	3.73	8.66	13.17	17.94	20.85
Thematic	5.41	7.62	10.58	15.36	18.67
United Kingdom	5.37	12.17	20.08	25.34	30.75
International	2.66	6.68	10.32	12.38	16.82
Alternative investments	**14.76**	**9.84**	**4.93**	**–**	**–**
UCITS funds	12.66	7.75	2.88	–	–
Commodities	2.10	2.08	2.05	–	–
Cash	**5.12**	**2.70**	**2.55**	**2.56**	**2.16**

As at 30 April 2024

Core inputs to our asset allocation framework

The economy

The global economy now appears to be following the track that we suggested at the start of 2024. The US is slowing - but to satisfactory rates of growth - whilst the rest of the world is improving. In the US, we have seen various data points hint at a moderate slowdown, but there is still no obvious cause for concern. In China, we have seen some signs of economic hope - following a period of disappointment - suggesting that various measures announced by the Chinese government, and a degree of policy loosening by the People's Bank of China is working. In Europe and the UK, a recovery from a stagnant winter is underway and this will be a relief to governments across the region. In short, the global economy remains on a solid yet unspectacular path.

Inflation

The pressure of rising prices is once again dominating investors' thoughts. We are currently less concerned, as most indicators we focus on are moving in the right direction (i. e. gradually lower). We must recognise that the easiest part of the inflation journey was going to be from circa 10% down to circa 3%. The 'last mile' towards the central banks' targets of around 2% was always going to be the toughest part. We must also admit that it might be a forlorn hope to get back to those sorts of levels that were symptomatic of the 2010s. The world has changed so much in the last few years, with a higher degree of uncertainty across all macroeconomic and geopolitical factors. However, we do not expect a further surge in inflation, even if the regime ahead follows the 'inflation uncertainty' pattern that we suggested was likely at the start of this turbulent decade.

Interest rates

As we will discuss later, we have been forced to change our view on central banks' monetary policy this year. We expect an interest rate cut in the US, but we anticipate it will come much later than previously expected. We also expect there will be fewer cuts overall. We anticipate the European Central Bank (ECB) will cut rates at its next meeting, as inflationary pressures have cooled significantly and economic activity could do with a boost, even if overall growth rates should improve anyway. The Bank of England (BoE) will follow suit shortly after the ECB, as we are somewhere between Europe and the US in terms of inflationary data and economic experience. We would expect the rate cuts in both Europe and the UK to be the first of many this year, and for that policy to persist into 2025.

Corporate earnings

We are currently approaching the end of the first reporting season of the year. 'So far, so solid' would be our simple estimation. The overall rate of growth in profits is perfectly satisfactory, even if the overall profitability levels remain skewed towards the US and the behemoth technology companies, in particular. However, across the world we have seen that corporate profits are growing. This has been sufficient to keep equity markets supported and, in some cases, boosted in those markets in which expectations and valuations were low. The UK would be a classic example of this after a relatively excellent April.

Valuation and positioning

After five strong months for markets in late 2023 and the first quarter of 2024, the pendulum had swung fully from the 'fear of losing money' to the 'fear of missing out'. We started the second quarter of 2024 a little wary of the path ahead for markets, based upon rampantly positive sentiment and growing complacency from investors, which was clear in various investor surveys conducted around the end of the first quarter of 2024. April saw a period of volatility in markets, as inflation and interest rate fears resurfaced, quickly eradicating much of the excess which had built-up in the previous five months. In both bond and equity markets, we saw a sensible reappraisal of expectations, leading us to believe that both core asset classes remain broadly 'fair value' and reflective of the challenges ahead.

In valuation terms, we would describe most asset markets as being 'about right'. We are certainly more relaxed now that others aren't.

Key subject of the month: 'they couldn't, could they?'

- Our expectations for interest rate policy in the US, which is the 'biggest game in town', have shifted this year, just as they have for nearly everyone else
- Whilst we never subscribed to the 'six cuts in 2024' argument implied by financial markets at the turn of the year, we did believe that the Federal Reserve (Fed) would cut rates, mostly because the Fed Chair, Jay Powell, said they would
- As we slept off our New Year's hangovers, we expected two-to-three interest rate cuts in 2024, starting around the time that the England men's football team compete in the European Championships in June and July
- However, we would not be surprised if the first cut came in December, as now priced into futures markets, or didn't come at all. As mentioned above, the US simply doesn't need rate cuts at this time based on inflation, employment, and economic statistics
- The rationale that could lead to such a decision on interest rate cuts is that it is either a matter of predicting the future (not a forte for the Fed), or an attempt to get US President Biden re-elected
- A vital question has emerged in recent weeks: could the economy be so strong, and inflation so persistent, that the Fed might have to raise rates? We think this is unlikely, based on our own forecasts and everything that Fed Chair, Jay Powell has told us
- We believe that conditions for a cut will be met by the end of the year, and the Fed will likely begin on the path that it has repeatedly set out for itself
- Whilst rate cuts would probably be helpful for most markets; we're not convinced that they are necessary as bond prices are 'about right' and equity markets are marching to the beat of the economy's drum. The prospect of another rate hike would lead us to reduce our expectations
- Whilst the economy is okay, corporate profits are growing, and inflation is moving in a progressively downward direction, we think the outlook for both bonds and equities is solid but unspectacular.

Key asset allocation positioning

We are neutral in all asset classes at a 'headline level', reflecting our view that most 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 in US, large cap tech and growth themes, although we have moderated that underweight stance. Our favoured region is Asia (inc. Japan) and favoured 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.

Alternatives can add value in volatile markets, as 'relative value' trades help. However, we can now find better opportunities elsewhere in fixed interest and equity markets.

As stated repeatedly throughout the last few years, our key stance is to remain balanced, diversified and operating with a flexible mindset.

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