

MPS investment update

March 2024 (written 1 March 2024)

Portfolio asset allocation

	Risk profile 3	Risk profile 4	Risk profile 5	Risk profile 6	Risk profile 7
Debt and fixed interest	59.80	46.97	31.94	17.08	—
International	16.10	17.00	12.89	5.00	—
Government	21.58	13.11	8.20	3.81	—
Corporate	22.11	16.86	10.85	8.28	—
Equities	20.43	40.83	60.74	80.27	97.57
Emerging Markets	1.00	1.99	1.98	2.70	2.93
Far East	1.01	2.98	4.34	5.75	7.15
Japan	1.12	1.09	1.92	2.51	3.04
North America	3.72	7.70	11.48	15.98	18.81
Thematic	5.10	7.76	10.73	15.50	18.91
United Kingdom	5.80	12.60	19.86	25.33	29.68
International	2.68	6.71	10.42	12.50	17.05
Alternative investments	14.50	9.68	4.84	—	—
UCITS funds	12.52	7.71	2.89	—	—
Commodities	1.98	1.96	1.95	—	—
Cash	5.28	2.53	2.49	2.64	2.43

As at 29 February 2024

Core inputs to our asset allocation framework

The economy

The tale of economic divergence continues. The US is growing healthily, despite various issues in the manufacturing and housing sectors (both of which are showing signs of improvement), while the rest of the world languishes in a 'dull but not disastrous' growth pattern. There is no real growth in the UK, Europe, Japan or, despite official statistics saying otherwise, China. Recent economic indicators have hinted that there should be an improvement in other parts of the world as 2024 continues, which will be necessary as we suspect the US will slow later this year. In simple terms, economic activity 'isn't great' but it also 'isn't terrible' and there is no obvious sign of an imminent global recession.

Inflation

The move lower in inflation rates from extremely uncomfortable levels has been quick and predictable. This is undoubtedly good news. However, it could be that the 'last mile' of inflation and the move back towards central banks' targets (c.2% per annum) is much harder. Central banks will have been perturbed by recent data hinting at the stickiness of certain indicators. While we recognise this as an obvious risk, we remain of the view that inflation rates will continue to subside through 2024. There are a range of factors we need to consider as the year progresses, but nothing has changed our minds on this base case in the last few weeks.

Interest rates

The big change in 2024 so far has been the pricing out of the first rate cut in the US from Q1 to at least the end of Q2, and the reduction in the number of expected cuts in 2024 from six to three. This makes sense to us, and we were always of the view that the market was pricing in too aggressive a move from the Federal Reserve (Fed). Similar activity is expected from the Bank of England. This repricing of expectations means that the market is now in line with both our own and the Fed's views. This is likely to be a continued source of excitement as the year progresses.

Corporate earnings

We are just coming towards the end of another reporting season, detailing global corporate earnings from the end of 2023. The results have been mixed, but mildly positive. Similarly to the economy itself, there is wide dispersion of success and failure. US corporate earnings have again been the shining star, with the tech sector dominating, and anything linked to Artificial Intelligence (AI) creating a great deal of excitement. The rest of the world has been far less positive, but still perfectly satisfactory, justifying the solid start to the year from equity markets. A notable positive dynamic has been in profit margins, which have started to expand again, encouraging optimism about a positive earnings backdrop for equity markets this year. Let's hope that is the case.

Valuation and positioning

We are in danger of becoming repetitive as market sentiment and valuations continue to paint a similar picture to that which has been in place for some time. In equity markets, anything linked to the US, the technology sector, AI, and 'growth' themes continue to be well supported by investors, with higher valuations and excessive (but understandable) optimism. The Japanese market is also enjoying a moment in the sun, as some of the long run themes of corporate self-help and change are now being rewarded by investors. As for equity markets, scepticism exists towards Europe, the UK, Emerging Markets, China, value sectors, energy, commodities, and utilities, with levels of disinterest reaching truly remarkable levels. This could well be an attractive medium-term contrarian opportunity, even if current investor biases are easy to explain.

Key observation of the month: 'Dead calm. Will it continue?'

- The bumpy start to the year many commentators were expecting has not materialised. Aside from some volatility, the general consensus around the markets has been calm, but why is this given the complicated political and geopolitical backdrop, and the uncertainty over economic activity?
- Some of the sectors that have lagged for the last few years are showing signs of improvement
- It would be a stretch to say that the economy is 'really good', but it is perfectly capable of generating enough activity to encourage corporate profits growth and ward off any major fears of a global recession
- Certainly, the geopolitical and political fabrics of the world might become increasingly frayed as 2024 develops but concerns over the first major election of this year in Taiwan were unrealised
- The relationship between the US and China appears a little steadier, even if the thawing of relations in reality is only tactical and temporary

- Markets have broadly stated that if growth is OK, geopolitical and political noise can be dealt with
- Corporate profits growth has also been sound enough, and companies' forecasts about the future have not been worrying, helping equities to a positive start
- The inflationary indicators at the start of the year have been a little concerning, but this is more a case of delayed gratification rather than a persistently worrying sign so far
- Interest rate expectations have shifted, but investors still expect rate cuts to take place and the Fed seems committed to the cuts that investors want
- The year is likely to become more complicated and volatility will return, but the relatively relaxed start to 2024 makes sense to us and has helped justify our 'neutral' allocations across major asset classes. Long may it continue!

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

We remain underweight in UK gilts and interest rate duration in fixed interest investments, but have moderated our 'extreme' position, 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, but we can now find better opportunities elsewhere in fixed interest and equity markets.

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

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