Canaccord Genuity Wealth Management

MPS investment update

April 2024 (written 28 March 2024)

Portfolio asset allocation

	Risk profile 3	Risk profile 4	Risk profile 5	Risk profile 6	Risk profile 7
Debt and fixed interest	**59.24**	**46.52**	**31.57**	**16.97**	**–**
International	15.95	16.77	12.65	4.90	–
Government	21.34	12.92	8.06	3.72	–
Corporate	21.94	16.83	10.87	8.36	–
Equities	**20.87**	**41.36**	**61.30**	**80.63**	**97.65**
Emerging Markets	1.01	1.99	1.98	2.69	2.92
Far East	0.99	2.91	4.31	5.72	7.11
Japan	1.14	1.11	1.94	2.54	3.07
North America	3.76	7.80	11.56	16.05	18.87
Thematic	5.31	8.06	11.03	15.63	18.85
United Kingdom	5.98	12.79	20.13	25.59	29.93
International	2.68	6.70	10.36	12.41	16.90
Alternative investments	**14.53**	**9.68**	**4.82**	**–**	**–**
UCITS funds	12.54	7.71	2.87	–	–
Commodities	1.99	1.97	1.95	–	–
Cash	**5.37**	**2.44**	**2.29**	**2.39**	**2.35**

As at 31 March 2024

Core inputs to our asset allocation framework

The economy

The global economy's resilience has surprised even the most optimistic investors although there are some areas doing better than others. The US seems to have shrugged off the most aggressive interest rate hiking cycle in history, posting above-trend growth. Although economic growth dipped into negative territory in the UK last year, UK industry has been robust, particularly within the services sector, and labour markets are buoyant in both the UK and the US. The Eurozone however, especially Germany with its heavily industrial economy, is struggling with weak demand, evidenced by a sharp drop in German factory orders and weak Purchasing Manager's Indices (PMI). China faces challenges too with deflation, stresses in the property sector, and demographic headwinds. While government stimulus efforts in China have been insufficient so far, more significant measures could potentially spark a recovery.

Inflation

As anticipated, the final inflation downward trajectory from 4% to 2% is proving more challenging than that from 10% to 4%. Looking at the main headline measure in the US, progress seems to have stalled. Under the bonnet however one can still derive a subtle, finely balanced disinflation. The slow progress is to be expected given the absence of beneficial base effects, economic resilience, and the recent loosening of financial conditions. Inflation in the UK and Europe continues to subside however price pressures in the services sector remain uncomfortably high. There are risks to the disinflationary trend, but the evidence points to a further gradual easing of price pressures across the western world.

Interest rates

The European Central Bank are likely to cut rates as we head into the summer months with the Bank of England (BoE) not far behind. In the face of persistent inflation, Fed Chairman Jerome Powell remains on the market's side, maintaining that the Fed are nearing the conviction to cut rates. This has kept investor confidence buoyant; even if data keeps pushing against lower rates, we think investors will be okay with delayed cuts, so long as the belief remains that a significant easing cycle is coming. The BoE are also becoming more accommodative, with the two remaining hawks (those in favour of more restrictive policies) on the Monetary Policy Committee voting to hold rather than hike rates, a positive step towards rate cuts later this year. The outlier is Japan, where a healthy dose of inflation and seemingly sustainable wage growth has led the Bank of Japan to finally abandon their negative interest rate policy marking an end to the era of negative interest rates.

Corporate earnings

With the Q4 2023 earnings season now behind us and Q1 2024 just around the corner, there has been little new information on earnings and forecasts have broadly trended sideways. In the US companies are expected to achieve 10.7% earnings growth this year, a reasonable hurdle but growth in 2025 is expected to accelerate to 13.3% on the back of monetary easing and Artificial Intelligence (AI). Earnings expectations for eight of the 11 sectors are at or near record highs. There is plenty of sector dispersion with expectations for the information technology sector considerably higher, contrasting sharply with expectations for materials and energy, which are anticipated to see earnings contractions exceed 20%. In Europe and the UK, analysts maintain a less exuberant but still optimistic outlook, with corporate earnings growth expected in the mid-single digits for 2024. This tempered optimism is partially attributable to lower weightings in high-growth sectors like technology and reflective of the relative weakness in the underlying economies of Europe.

Valuation and positioning

Risk sentiment is high, sustained by dovish (more accommodative) noises from central banks and excitement surrounding AI, with many equity markets posting new all-time highs including the US, Japan, Europe and the UK. Credit spreads (the additional yield on corporate bonds over safer government bonds) have narrowed to levels not seen since before the start of the interest rate hiking cycle in early 2022. Investor demand for credit has been insatiable which has driven the tightening in spreads, but the all-in yield opportunity remains attractive supported by elevated government bond yields. Digging into equity markets the US looks expensive on an index level but valuations range considerably and there are opportunities. The technology sector on a forward earnings multiple (the ratio of current stock price to expected earnings) is twice as expensive as the rest of the market. Extreme scepticism exists towards the UK, particularly in the small and mid-cap space as well China, and within some sectors including utilities, materials and energy, which are all trading at depressed levels. The disinterest in some of these areas is remarkable.

Key subject of the month – 'Back in vogue: Diversification'

- Recent market performance has been robust, with positive sentiment prevailing
- The global economy has exhibited resilience in the face of stringent central bank policies geared towards curbing inflation, which, while present, have moderated from the peaks observed in 2022, although progress has slowed
- It's becoming increasingly apparent that the global economy has the necessary momentum to support corporate profit growth, assuaging fears of an imminent recession. Despite lingering risks stable economic performance has reassured investors, with optimistic profit forecasts bolstering equity markets
- Although inflation remains a concern, its current levels do not present an alarming threat but rather a challenge that may manifest over time or re-emerge following interest rate cuts
- The softening expectations regarding interest rates in the short term have not dampened investor confidence, primarily due to central banks' continued commitment to more accommodative policies, albeit further down the line
- One of the most encouraging developments amidst these trends is the resurgence of diversification. For multi-asset strategies, the return of the negative correlation between equities and bonds is reassuring
- Following the post-COVID-19 recovery, diversification was more difficult to achieve as bonds and equities moved in tandem, however, this year has witnessed a normalisation, with bond risk moderating equity risk once more
- This normalisation in financial market behaviour points to a more favourable environment for traditional multi-asset investors such as ourselves
- Embracing this equilibrium, by maintaining balanced allocations across major asset classes, holds the potential to sustain investment strategies in the months ahead
- The risk to this view is if inflation resurges bonds and equities will likely suffer together in this scenario. This is not our base case however this is a possible risk and we will maintain vigilance and flexibility as well as take precautions with inflation hedges where possible
- We remain prudently optimistic and can find opportunities across asset classes.

Key asset allocation positioning

We are happy to be 'in line' with our strategic asset allocations and believe the balance between risk and potential reward for different types of investments is appropriate. Beneath the 'in line' allocations, we still have some significant positional biases, even if we have become closer to the composite benchmarks we use for comparison.

We are emphasising a quality bias in equities (stocks that have high and stable profitability), which we believe is the best way forward for ongoing equity investment and aim to balance the portfolio between a higher level of quality exposure and contrarian themes that can potentially recover strongly from their depressed valuations.

Within fixed interest we remain underweight UK gilts and interest rate duration but have moderated our extreme positioning in light of the revival of diversification benefits as we likely head into a new, more accommodative interest rate regime. We remain comfortable taking corporate credit risk and believe 'compensation' through yields is fair.

Alternatives can add value in volatile markets and momentum strategies (buying stocks when they rise and short, or sell them, when they fall) have helped so far this year, however we can now find better opportunities elsewhere in traditional fixed interest and equity markets.

We believe that the 'base case' for 2024 is a period of decelerating but positive growth, finely balanced disinflation and eventual interest rate cuts, however, we must remain open-minded about how an uncertain year might play out.

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