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Quarterly Report Q2 2024

- Despite political volatility, global economic growth, consumer spending, and corporate earnings still prove constructive.
- Inflation rates continue to moderate globally, buoying hopes for more interest rate cuts to come over the rest of this year and beyond.
- In an uncertain world, diversification and avoiding concentration risk through a broad investment style mix remains key.

During Q2, markets had to contend with a slew of unexpected political events globally. In the UK, a general election was called for 4 July, triggering an examination of competing parties' tax and spend priorities. In Europe, the European parliamentary elections catalysed an unexpected snap French parliamentary election, where the risks of more extreme political party policy drove sharp falls in French banking stocks. Meanwhile, in the US, June saw a criminal conviction of a past president, Donald Trump, for the first time in US history. In emerging markets, investors were also at times wrong-footed by unexpected market volatility around election results in India, South Africa, and Mexico.

Weighing against the negative of such political uncertainty, at a fundamental level, the tailwinds that have supported markets so far this year continued in Q2. Company earnings painted a constructive picture, with US companies reporting earnings ahead of consensus expectations at a rate above longer-term averages. Supporting our thematic, longer-term, through-the-cycle investments in technology and healthcare in particular, these two sectors delivered the highest percentages of companies reporting earnings above estimates. Encouragingly, while markets have been led narrowly by technology stocks through 2023 and early 2024, during Q2 we saw some tentative signs of a broadening-out of sector performance. April and May saw more confidence in the outlook for a wider set of stocks, though June saw technology back on the front foot. That is not to detract from the continued meteoric rise of Nvidia, the US listed generative Artificial Intelligence semiconductor designer, which briefly became the world's biggest company in June. Valued at more than US$ 3 trillion in mid-June, Nvidia's market capitalisation was bigger than all of the companies in the UK FTSE 100 equity index combined.

From an economic perspective, belief in a 'goldilocks' soft-landing scenario, where higher interest rates bring down inflation without derailing economic growth more broadly, continued in Q2. During the period, a global central bank interest rate cutting theme tentatively started. Following Switzerland's rate cuts in March and again in June, central banks across Sweden, Canada, and the eurozone cut interest rates for the first time in their respective monetary policy cycles. However, while underlying inflation readings have generally continued to moderate, the disconnect between falling and low goods inflation versus stickier services inflation has persisted. If not monetary policy, it is fiscal policy that is arguably currently boosting economies and markets. Advanced economies are enjoying unemployment rates still reasonably close to historically low levels, wage growth rates are running above pre-pandemic averages, and economic growth estimates are still generally constructive. Despite this, governments are spending pro-cyclically, with government spending exceeding tax revenues. On both sides of the Atlantic, the US and the UK have been running budget deficits – while these cannot last indefinitely, this scale of government support arguably explains in large part the resilience of the consumer and corporate outlooks in turn.

In recent years, investors have had to navigate a marked pick-up in the frequency and size of rotation between growth and value investment styles, such as between technology companies and banks, respectively. We have also seen increased market concentration in technology stocks in particular. Helping to drive these changing narratives has been the changing outlook for inflation, interest rates and economic growth. However, as we look forward, it is important to recognise that our investment style selection is more than just a binary choice between the 'value versus growth' debate. Between value and growth sits a space occupied by a 'blend' or what we consider 'core' strategies. These are an important building block in our asset allocation approach. Alongside regular rebalancing of portfolios, in line with our stated target of balancing global equity investment styles, this helps to provide an important level of diversification not always readily available in passive equity indices.

Across our asset allocation, we think carefully about our asset choices, but also what our goals are for each of these assets. Fundamentally, we see a contrast between equities and bonds. While equities provide exposure to an encouraging economic and market outlook, our fixed-income positioning is more than just a hunt for yield. Yes, income is back in fixed income again, but a key aim for our government bond allocations is to provide an important counterbalance to the risks we take elsewhere. Between these two central pillars sit alternative assets, including property, uncorrelated multi-asset investments, and structured return products. This diversification helps us keep exposure to more than one economic and/ or market scenario materialising. What if the excitement around technology and generative AI should ebb? What if inflation should reemerge, prompting renewed rate hikes from central banks? What if geopolitical risks should escalate, challenging global supply chains once more, or worse? Ultimately, our asset allocation adheres to a central constructive scenario, but we acknowledge the potential for tail-risks to emerge.

Our top three investment risks

Inflation

Should inflation pressures see a resurgence and become engrained in the economy more broadly, including wages, this could curtail central banks' room for manoeuvre. This could risk a still-further tightening of monetary policy, with interest rates higher and for longer than expected.

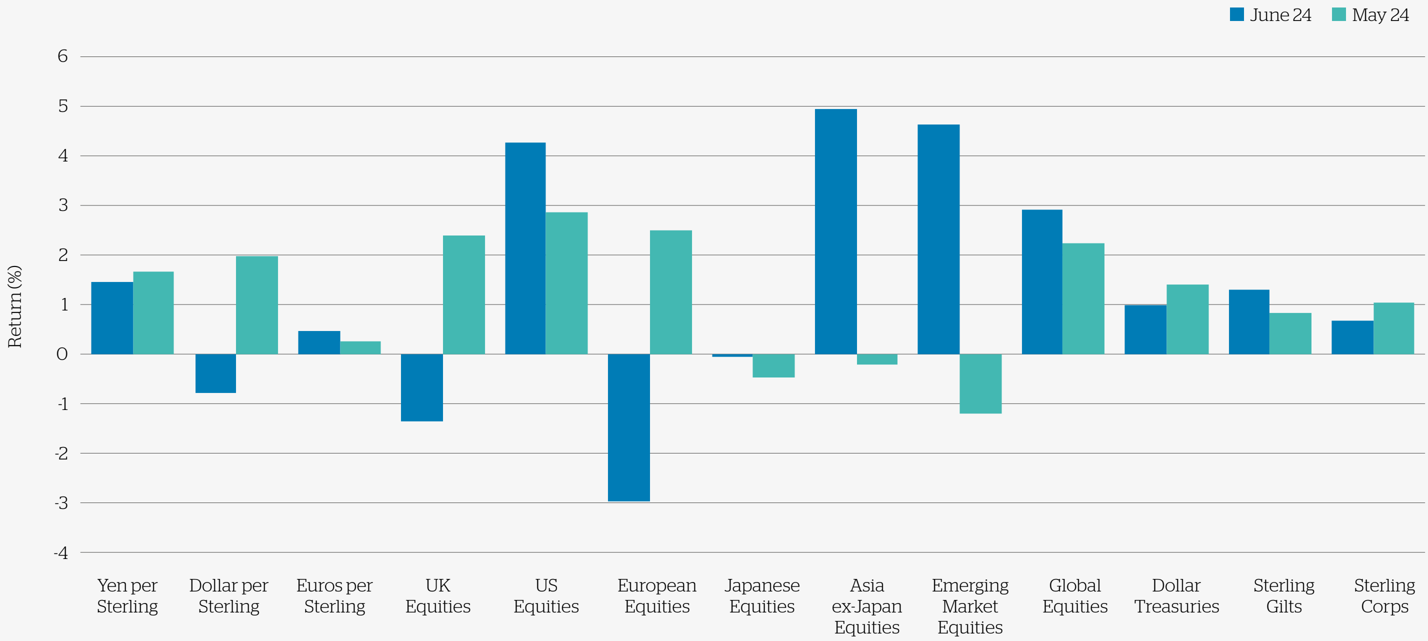
Policy error

Governments and central banks face the risk of unintended policy errors as they seek to transition their economies away from unprecedented pandemic levels of fiscal and monetary support, as evidenced by the concerns over financial systemic stress contagion in early 2023.

Geopolitical risk

Should there be an escalation in either the current theatres of conflict (namely Israel-Gaza and Russia-Ukraine), or indeed future risks of potential conflict (China-Taiwan), such so-called 'tail-risks' would likely have a significant impact on the global economic outlook.

Asset market return



Sterling-denominated market performance, total return performance figures. Past performance is not a reliable indicator of future results. Source: Bloomberg, MSCI: please see important information. Data from 31.05.24 to 30.06.24.

Important information

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