Diversification in an uncertain world

Brooks Macdonald Quarterly Market Overview Q2 2024

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Outlooks defined

We express positive, neutral, and negative outlooks across a range of asset classes. These are defined as our judgement as to the expected return relative to the relevant broader asset class benchmark over our central forecast period of twelve months.

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Robin Eggar
Chief Commercial Officer

Unlocking resilience through diversification

While political uncertainty reigned, technology was a key driver for markets.

This edition covers how the technological innovation of generative artificial intelligence (AI) continued to hold centre stage alongside global political, economic, and central bank news over the past three months to the end of June.

Turning our attention to the UK, we saw the economy make steady strides, even in the wake of an unexpected snap election. On page 5, we delve into the reasons behind our optimism over UK equities and their role in a diversified portfolio.

This quarter, the robust corporate results in the US mirrored the resilience of the US consumer, with promising earnings growth expectations for corporate America for the rest of the year and beyond. We have also observed how the dominance of megacap technology stocks propelled US indices higher. You can find out more about this and our positive view of US equities on page 6.

Our outlook on page 10 underscores the importance of avoiding concentration risk. However, balance in a portfolio is not just about 'value versus growth'. We strongly advocate diversification, especially with income in fixed income continuing to be a theme, which helps to counterbalance the risks taken in equity investments.

We carefully assess our investment decisions, knowing how important this is in working towards you and your familiy's financial goals. A world of inherently uncertain transition requires a balance of flexibility and curiosity. We are firm believers in broad market diversification, which allows you to participate when trends grow yet not be bound by them when they fade.

I hope you enjoy reading this quarter's report, and I want to express my gratitude for your continued trust and support. Our success is only possible with you, our valued clients. Thank you once again for investing with us.

Kind regards,

Robin Eggar
Chief Commercial Officer

Introduction

Politics comes to town, with mixed results for the investment landscape

Despite political uncertainty, fundamental tailwinds continued to support markets.

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 delivered a market-unwelcome shift to the political right in France. That catalysed an unexpected snap French parliamentary election, where the risks of a far-right party gaining power in a G7 country 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. Despite this, the expected Republican presidential challenger continued to narrowly lead Democrat President Biden in the polls ahead of a November election later this year. During Q2, 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 data from FactSet showing 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 size was bigger than all of the companies in the UK FTSE 100 equity index combined.

> **“At a fundamental level, the tailwinds that have supported markets so far this year continued in Q2.**

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. Since our last quarterly report, the global central bank interest rate cutting 'juggernaut' 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. In late June, Australia's central bank even contemplated a rate hike. Closer to home, the UK's all-items annual inflation rate of 2% for May masked a services inflation rate running at 5.7% year-on-year.

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 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 (as a share of Gross Domestic Product, GDP), at around 6.3% in calendar year 2023 and 4.5% for the financial year 2023-24 respectively. While this cannot last indefinitely, this scale of government support arguably explains in large part the resilience of the consumer and corporate outlooks in turn.

This is the economic and market landscape that we currently find ourselves in. Coupled with ongoing geopolitical uncertainty, with war in Ukraine, conflict in the Middle East, and ongoing tensions in Taiwan-China, it feels like a more uncertain world than usual. With such a backdrop, it is by staying invested but keeping balance through a well-thought-out diversified asset allocation, that we aim to continue to help you target your own investment goals.

Markets unmoved by summer general election call

Economic picture sees steady progress during Q2.

UK equities rose during the period under review (in sterling, total return terms) on expectations that the economy would continue to recover from its shallow technical recession of late 2023, and that interest rate cuts were on the way. Prime Minister Rishi Sunak's surprise decision in late May to call a general election on 4 July, when an autumn election had been widely expected, clouded the waters somewhat on the country's future economic direction and the Bank of England (BoE)'s intentions on interest rates.

Polls had indicated that the Conservatives were a long way behind Labour even before Sunak's announcement, and the odds of him remaining at 10 Downing Street showed little signs of improvement during the opening weeks of campaigning. Similar to the voter polls, stock market investors had appeared for some time previously to be factoring in a significant Labour victory. Despite the political surprise, markets were generally unmoved by the news, largely because the Conservatives and Labour had both agreed to keep to existing fiscal rules in managing the economy.

Overall, the UK economic picture was one of steady progress. Investors were generally encouraged by some positive corporate financial results announcements alongside signs that the economy was emerging from a shallow and short-lived recession. GDP expanded by a more-than-forecast 0.6% in the first quarter compared with the prior quarter. In fact, it was the largest growth in more than two years.

Annual all-items inflation eased from 3.2% in March to 2.3% in April, helped by falling energy and food prices, and then in May, it dropped to the BoE's 2% target. Hitting the target was significant but not, it seemed, sufficient to sway the BoE away from its 'higher-for-longer' approach on interest rates. Although May's core inflation (excluding energy and food prices) fell to 3.5%, inflation in the services sector proved to be more stubborn, declining only mildly from 5.9% to 5.7%. When deciding at its June meeting to leave interest unchanged at 5.25% for the seventh consecutive time, the BoE's Monetary Policy Committee (MPC) warned that "monetary policy needs to be restrictive for an extended period of time until the risk of inflation becoming embedded above the 2% target dissipates."

> **Despite the political surprise, markets were generally unmoved by the news, largely because the Conservatives and Labour had both agreed to keep to existing fiscal rules in managing the economy.**

That said, the minutes from the meeting indicated that the decision had been "finely balanced", suggesting that the BoE's next meeting in August could potentially see the first interest rate cut this cycle.

Other economic data was mixed. The unemployment rate rose in the three months to April to 4.4%, compared to 4.3% in the previous three-month period to March. Meanwhile, the British Retail Consortium reported mildly positive data that showed a modest 0.4% annual increase in retail sales on a like-for-like basis in May. Markets had expected sales growth to be higher, but poor weather had dampened consumer spending. Finally, encouraging news for investors in UK-listed companies came in a Bloomberg report in June that showed the London Stock Exchange had reclaimed its crown as Europe's most valuable stock market. It was the first time London had edged ahead of Paris in almost two years.

In terms of currency activity, sterling did not change very much during the quarter to mid-June. Falling against the US dollar in April, sterling strengthened back through May, before edging back a little by mid-June.

Our view

POSITIVE

We have a positive outlook for UK equities. This might appear to run counter to the present challenge of still relatively muted UK economic growth, though the inflation picture has indeed improved. However, the domestic picture is not the only driver for the UK equity market investment case. The UK economy and equity market are not the same. The UK equity market has a large international skew, with around three-quarters of revenues at an equity index level derived from outside the UK. As such, the UK stock market is particularly sensitive to global trends, which on balance continue to point to a constructive picture of broad economic growth alongside generally still-easing inflation rates. The continued relative attractiveness of UK equities on a valuation basis is an important component of the mix of investment styles we hold. The UK 'value' style exposures we seek, such as resources and financials sectors, provide an important foil to our growth exposures in other asset classes and regions globally.

United States

Rise of megacap technology stocks buoys US equities

US Federal Reserve dampens interest rate cut hopes.

US equities rose during the period under review (in sterling, total return terms), boosted by relatively upbeat corporate results from US megacap technology companies in particular. US megacap technology stocks this year have made a significant contribution to the performance of broader equity indices. Indeed, by mid-June, the 'Magnificent Seven' group of US mega-cap technology companies (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla), had contributed more than 60% share of the US S&P 500 equity index's return so far in 2024.

This market performance came despite bumpy inflation data and fading hopes that the US Federal Reserve (Fed) might reduce interest rates sooner rather than later. Annual US consumer inflation increased by 3.5% year-on-year in March following February's 3.2% gain but slowed to 3.4% in April. It then shrank slightly to 3.3% in May when it had been forecast to remain at 3.4%. Weighing up the inflation and other economic data, in June the Fed left its interest rate target range unchanged at 5.25%-5.5% for the seventh time in a row. Not only that, but the Fed's policymakers indicated that they envisaged only a single rate cut in 2024, with a further four in 2025. Earlier this year, the Fed had been hinting at three interest-rate cuts for this year. While confirming that it was closer to reaching its goals on employment and inflation, the Federal Open Market Committee was still concerned about the economic outlook, commenting that "the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%."

> **“ US megacap technology stocks this year have made a significant contribution to the performance of broader equity indices.**

As regards the economy, weaker-than-forecast economic growth saw GDP slow to a quarter-on-quarter annualised rate of just 1.3% in Q1. Weak consumer spending hampered economic growth, and the University of Michigan's Consumer Sentiment Index dropped more than expected in June for a third consecutive month to its lowest point since November. While retail sales only rose 0.1% on a month-by-month basis in May after falling by 0.2% in April, the employment picture remained constructive overall. Further, forecasts in mid-June from the Atlanta Fed regional bank suggested something of a bounce back in economic growth in Q2 versus Q1, with an estimate of around 3% annualised GDP growth for Q2.

Buoyed by the likelihood of US interest rates staying higher-for-longer, the US dollar index, which measures the value of the US dollar against a basket of advanced economy nations' currencies, strengthened marginally during the second quarter through to mid-June.

Our view — POSITIVE

We have a positive outlook for US equities, raised from neutral earlier this year. Corporate results, in general, continue to reflect a still-resilient US consumer. Analysts' earnings growth expectations for the calendar years 2024 and 2025 are encouraging compared to the outturn in 2023. Supporting our positive outlook, banks' credit lending outlooks have seen a relative improvement according to Fed Senior Loan Officer Opinion Surveys so far this year. This could herald a more helpful operating environment for Smaller and MID-sized companies (SMID), which we increased exposure to earlier this year - here we are seeking to take advantage of a relative valuation derating versus larger capitalised companies post-pandemic and capture domestic sensitivity to a generally still-resilient US economic picture. The US has an important role in providing growth investment-style exposures within the context of our balanced approach to asset allocation. Our US equity weights also support our longer-term investment themes of technology, healthcare, and decarbonisation, which the US has exposure to at an aggregate equity index level.

French parliamentary elections weigh on sentiment

European Central Bank cuts rates for first time since 2019.

Developed Europe (excluding UK) equities rose only marginally during the period under review (in sterling, total return terms), as French political risk weighed on investor sentiment during June in the region more broadly. European parliament elections in early June saw support grow for right-wing candidates. This pushed France's President Emmanuel Macron to call a surprise snap election, dissolving the National Assembly. First-round elections for the country's parliament were tabled for 30 June, with a second-round due on 7 July. Driving the market's nerves, the French political far-right party, Marine Le Pen's 'National Rally' party enjoyed a significant lead in the polls ahead of the elections.

The unexpected political news took the shine off market expectations that the European Central Bank (ECB) would cut interest rates for the first time in the current monetary policy cycle - something they did in early June and representing the first rate cut since 2019. Additionally, some robust corporate results provided further cheer and helped to lift European stocks earlier in the quarter. However, alongside French political concerns, worries persisted about restrictive US monetary policy (with the Fed keeping interest rates unchanged) as well as geopolitical risks and the conflict in Gaza in the Middle East. All in all, these headwinds ensured that markets remained choppy.

In economic news, the eurozone economy returned to growth, rising by 0.3% over the first quarter. It had contracted -0.1% in the previous quarter. The last time the growth rate was stronger was in the third quarter of 2022. Although month-on-month retail sales in the eurozone fell by a more-than-expected -0.5% in April, the European Commission's Consumer Confidence Indicator improved a little over the quarter while remaining below the long-term average.

Eurozone consumer inflation accelerated to 2.6% in May after it had been at 2.4% in both March and April. A pick-up in services sector prices was the main cause of the increase. Nevertheless, the ECB's Governing Council said it was happy that "the inflation outlook has improved markedly".

> **"Developed Europe (excluding UK) equities rose only marginally during the period under review (in sterling, total return terms), as French political risk weighed on investor sentiment during June in the region more broadly.**

So, after leaving interest rates unchanged for nine months, the ECB reduced its main three key interest rates in June by -0.25%, taking the deposit facility rate down to 3.75%. The ECB's Governing Council stated that "monetary policy has kept financing conditions restrictive. By dampening demand and keeping inflation expectations well anchored, this has made a major contribution to bringing inflation back down".

The French political uncertainty around the country's parliamentary elections weighed on the euro in June especially, with the euro down versus both the US dollar and sterling over the period under review.

Our view

NEUTRAL

We have a neutral outlook for Developed Europe (excluding UK) equities. European natural gas prices, having previously fallen sharply from the highs of 2022, are supporting an improving inflation backdrop, providing some relative relief for both businesses and households. Additionally, the hope is that a still-constructive global economic picture can help feed a European export-led economic growth narrative. Supporting value-investment-style exposures, the region's banks are expected to see an improved profit outlook over the medium term, given a backdrop of positive nominal interest rates versus the decade of weak earnings under the European Central Bank's prior negative interest rate regime. Against this, we are mindful that structural tensions remain between the euro area monetary union and fiscal and political sovereignty. Indeed, France's recent and unexpected burst of political uncertainty could potentially link back to these tensions. However, we believe that such concerns are now better balanced by the relatively more constructive medium-term outlook as well as the still relatively attractive valuations we see.

Asia Pacific (excluding Japan)

China's property outlook still challenges economic recovery

Indian election outcome drives a bout of market volatility.

Asia-Pacific equities (excluding Japan) rose over the period in review (in sterling, total return terms), though Chinese equities unwound some of its period gains from mid-May onwards, as a slew of June economic data painted a weaker picture versus expectations.

Of particular note, China's home prices continued to fall during the period. New home prices in 70 cities dropped -0.7% month-on-month (MoM) in May, the eleventh MoM decline in a row, and the steepest drop since October 2014. China's property market has continued to look challenged this year, with the value of new home sales from the top 100 developers in May down -33.6% year-on-year, and unsold housing inventory in April at around an eight-year high. Property is a big part of China's economy, and in past years has accounted as much as close to 30% of China's GDP.

"Chinese equities unwound some of its period gains from mid-May onwards, as a slew of economic data out in June painted a weaker picture relative to expectations.

Against the continued property malaise, China's central bank left its key 1-year interest rate unchanged at its latest meeting in June; despite largely absent inflation pressures, the perception is that pushing back against the opportunity for a rate cut is the need to prioritise currency stability. More broadly, alongside a growing perception that Beijing will have to do more in the way of stimulus to boost animal spirits, Chinese policy makers also faced growing headwinds from foreign resistance to exported Chinese goods in Q2. This is the wide-ranging push-back from the US, Europe and elsewhere, against the view that China is seeking to boost its economy by effectively exporting excess manufacturing capacity abroad.

Elsewhere in the region, economic growth exceeded expectations in Taiwan and South Korea. Continued interest in generative AI helped Taiwanese shares reach record levels, while worries about US monetary policy pressured South Korean equities. Taiwan's economy grew 6.56% on an annual basis in the first quarter of 2024, compared with 4.83% growth in the previous three-month period, while annual inflation crept up from 1.95% in April to 2.24% in May. The Central Bank of Taiwan kept its key discount rate at 2% in June.

In South Korea, annual inflation dropped from 2.9% in April to 2.7% in May. The economy grew on an annual basis by 3.3% in the first quarter of 2024, compared with 2.1% growth in the previous quarter. As in Taiwan, South Korea's central bank opted to leave interest rates unchanged at 3.5% over the period.

Meanwhile, a general election dominated news in India, with the result sowing some seeds of uncertainty for investors. Prime Minister Narendra Modi's BJP party won the most seats as expected, but Modi was forced to form a coalition government after failing to win a large enough majority. India's annual inflation fell back from 4.83% in April to 4.75% in May when it had been expected to go up. This kept it within the central bank's 'tolerance band' of two percentage points either side of 4%. A drop in inflation helped the Reserve Bank of India to decide to leave its benchmark policy interest rate unchanged at 6.5% in June for the eighth consecutive time.

In Australia, the economy grew 0.1% on a quarterly basis in the first quarter of 2024 after expanding 0.3% in the previous quarter, making it the tenth quarter in succession that GDP had risen. The Reserve Bank of Australia left its cash rate unchanged in June at 4.35%. It was the fifth consecutive hold in the rate as the central bank continued to warn that inflation remained above its 2-3% target.

Our view

NEUTRAL

We have a neutral outlook for Asia Pacific (excluding Japan) equities, downgraded from a positive outlook earlier this year. That downgrade reflected the steps we took in early 2024 to largely close out our relative-to-benchmark overweight to China, and in doing so, reduce our broader overweight to the wider Asia Pacific ex-Japan region. We see China more as a potential 'value-trap' rather than a 'value opportunity'. As we look forward, increasingly it appears that China's policy makers are focused on only slowly and pragmatically defusing economic structural challenges, primarily the property market which is still navigating years of overbuilding and indebtedness. However, this will take time and China's investment outlook could well turn worse before it looks better. Adding to the uncertainty, US political elections later this year are likely to mean geopolitical tensions will not be far from investors' minds. As regards our continued exposures to China, we remain vigilant towards the investment climate in the region and will be quick to adjust allocations if judged appropriate to do so.

JAPAN

Japanese yen falls to 34-year lows against the US dollar

Underlying consumer inflation ebbs to lowest since 2022.

Japanese shares fell during the period under review (in sterling, total return terms). Equities weakened through the period as investors took profits following sharp gains earlier in the year. Concerns about a rise in government bond yields amid uncertainty about the path of borrowing conditions also dampened the mood of equity investors. The economy contracted by an annualised -2% in the first quarter which was worse than initially anticipated. Consumer inflation (excluding both fresh food and energy prices) decreased to 2.1% in May from 2.4% in April, and from 2.9% in March. It was the ninth monthly fall in a row and marked the lowest reading since September 2022. Initial worries that the Bank of Japan (BoJ) would continue to tighten monetary policy caused some unease for investors, although the central bank announced no changes, leaving its main short-term interest rate at a range of 0 to 0.1% in June, in line with forecasts. Monthly industrial production figures in April were worse than forecast, shrinking -0.9% month on month. Regarding the currency, the yen declined against the US dollar, hitting fresh 34-year lows, leading the Japanese monetary authorities to intervene to support the currency.

Our view

NEUTRAL

We have a neutral outlook for Japan equities. Market performance over the past year has been supported by hopes that, after years of false dawns around stock market reforms, we might have finally reached a tipping-point. As well as past initiatives by the Tokyo Stock Exchange to promote balance sheet efficiency, a welcome re-emergence of inflation after years of stagnation has buoyed the outlook for the country's financial sector. Looking forward, Japanese banks are expected to see a margin benefit from the re-pricing higher of longer-dated bond yields following the first hike in Japanese interest rates in seventeen years earlier this year. Balancing hopes for better corporate governance and capital allocation, Japan nonetheless still has well-documented structural headwinds, including high public debt levels and a declining and aging population. These provide an unwelcome risk backdrop for the BoJ as it starts the long path of unwinding decades of unconventional monetary policy.

EMERGING MARKETS

Emerging markets see mixed performance

US dollar strength continued to present an additional challenge to investors.

Emerging markets saw mixed performance during the period under review, with the strength of the US dollar continuing to be a theme and presenting an additional challenge to investors. Brazilian stocks fell during the period (in sterling, total return terms) as investors worried about a government proposal to loosen financial targets. The dismissal of state-controlled oil giant Petrobras' chief executive also heightened concerns about political interference in Brazil. Further disruption to the economy came when flooding caused significant damage in southern Brazil. The country's annual inflation level increased by more than forecast from 3.69% in April to 3.93% in May, while GDP grew 0.8% quarter on quarter in the first three months of 2024 after shrinking 0.1% in the last quarter of 2023. Elsewhere, the run-up to elections in South Africa boosted shares when a more pro-business governing coalition appeared to be in prospect. This proved to be the case with the formation of the country's first coalition government after the ruling African National Congress party (ANC) lost its overall majority and equities ended up over the period (in sterling, total return terms). Finally, in Turkey, equities rose during the period (in sterling, total return terms), against a backdrop of the ruling party suffering heavy losses in local government elections as inflation continued to soar. The higher-than-forecast rise in annual inflation from 69.80% in April to 75.45% in May was down to higher housing and utilities prices. In more positive news, the country's economy grew by 5.7% on an annual basis in the first quarter after expanding by 4.0% in the final three months of 2023.

Our view

NEGATIVE

We have a negative outlook for emerging market equities, downgraded from a neutral outlook earlier this year. This change reflected our downshift in view on China (which is just over a one-quarter-weight of the MSCI Emerging Markets index), as well as the selective cuts we made to emerging market equity allocations at the start of the year. US dollar resilience, with gains against a basket of other currencies year-to-date, has continued to be a theme during Q2. This serves as a reminder of the challenges for dollar-denominated debt and investment flows into the Emerging Markets region more broadly. Any headwinds for commodity prices might also weigh against those emerging markets which are more resource-export-led. Notably, China, a consumer of a significant share of global commodity exports, has so far appeared reticent to lean heavily on the past model of aggressive infrastructure spending to boost its economy, especially as policymakers seek to manage the structural problems in its property market. This might challenge the traditional emerging market 'playbook' where emerging market export growth feeds off a Chinese-led global commodity reflation narrative. Coupled with the 'near-shoring' of global supply chains post-pandemic, this has undoubtedly complicated what might otherwise be a more normal economic growth profile that emerging economies might hope for.

In an uncertain world, diversification through a broad investment style mix remains important

Avoiding concentration risk is key, but balance is more than just the sum of value versus growth.

Events in recent years have resulted in a number of investor narratives. Think back to the start of the pandemic and the boom in those companies that could offer online goods and services. Or the rebound in travel and hospitality as the world emerged post-pandemic. There was the valuation tailwind for technology that we witnessed as interest rates around the world fell to zero. That was followed by hopes for a profit margin boost for financial services and banks as inflation prompted a hike in interest rates. Most recently, the enthusiasm around technology and generative AI has been fuelled by the promise of significant gains in productivity as companies invest in the hope of being able to do much more with the same or less. This has driven significant concentration risk within markets. Nvidia, the US-based generative AI semiconductor chip designer, overtook Microsoft at one point in June to become the world's biggest company. With it, by mid-June Nvidia had single-handedly powered around a third of the total gains in the US S&P 500 equity market index year-to-date.

In each of these cases, we have seen bouts of relative outperformance and concentration risk emerge. 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 technology companies and banks, respectively. Helping to drive these changing narratives has been the changing outlook for inflation, interest rates and economic growth. More broadly, while we have seen market valuations rise over the past 18 months or so, more recently, we have seen growing confidence in the earnings outlook – important if the market is to have the headroom to continue to rise.

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. With the recent strong performance of megacap technology stocks, it is key to remain balanced globally at an asset allocation level. While the US equity market provides an important contribution to our growth-investment-style exposures including technology, we also seek out value exposures, in particular, in UK equities. 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 in particular, both at home in the UK and abroad, 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. We can expect to benefit from a diversified asset allocation by having such a blended investment style exposure.

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, while our asset allocation adheres to a central constructive scenario, we nonetheless acknowledge the potential for tail-risks to emerge.

As we noted at the opening of this quarterly market overview, we aim to continue helping you to target your investment goals by staying invested, but keeping balance through a well thought out, diversified asset allocation.

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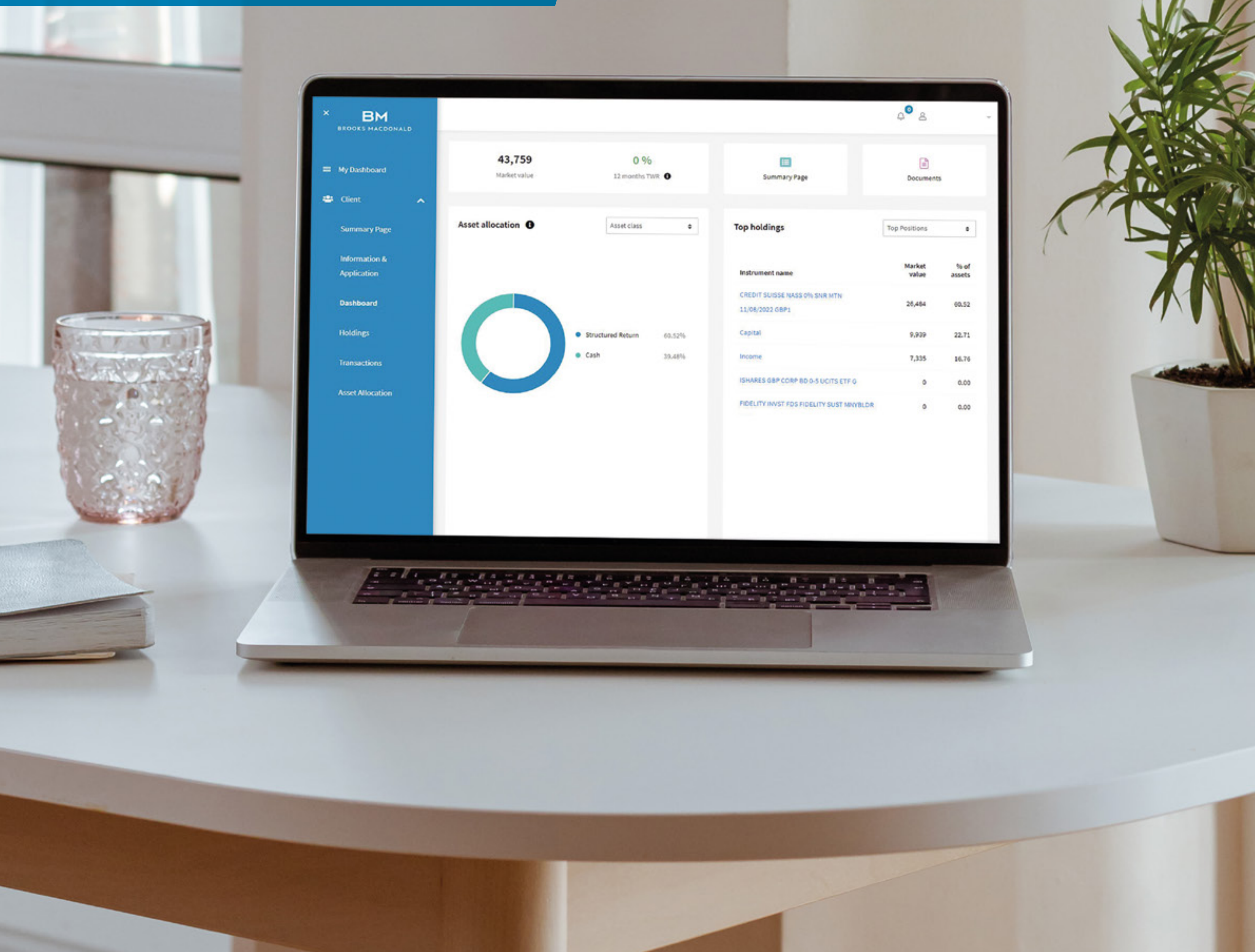

Important information

The views in this Quarterly Market Overview report are correct as at 21 June 2024. All information is current at the time of issue and, to the best of our knowledge, accurate.

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