



Brewin
Dolphin

Managed Portfolio Service

Quarterly report – Q2 2024



Introduction

Welcome to the RBC Brewin Dolphin Managed Portfolio Service (MPS) investment review. In this report, we cover information and events that influenced performance during the second quarter of 2024.

The second quarter of 2024 was characterised by a relatively benign economic backdrop that allowed the stock market to rise, left investors waiting for interest rate cuts, and was overshadowed by drama in the political sphere.

While it's had some impact on markets, the UK general election was met with market apathy, with no discernible movement in bonds or currency markets despite a historic seat gain for Sir Keir Starmer's Labour Party. Within the FTSE 100, the housebuilders were amongst the leaders. They are perceived to benefit from Labour's plan for a blitz of planning reform, which will enable more housebuilding.

Markets are now focused on the United States and the presidential election in November. As the quarter ended, the viability of President Joe Biden as an electoral candidate was being tested, following a stuttering performance in the early televised debate he held with his challenger, former President Donald Trump. The debate performance helped Trump take the lead in the race to the White House while Biden has been fighting to retain his position as the presumptive Democratic nominee.

Bond markets would likely look fondly on a change in Democratic candidate now that Biden's chances have diminished so much. They perceive Trump as a malign inflationary influence. However, a disconcerting feature of President Trump's agenda is his threat to impose tariffs on all imports to the United States, a move which would undoubtedly trigger reciprocal tariffs from trading partners.

Interest rates have generally not fallen as expected across Western economies. However, a few central banks did manage to make a start at cutting rates during the quarter, the most significant example being the European Central Bank. Most bonds will benefit from falling interest rates because they pay fixed interest, so these delayed cuts were a headwind. However, for bonds issued by companies, the stronger economy reduces the risk of non-payment, and they rise in price to reflect that.

In the UK, anticipation of the Bank of England cutting interest rates saw mortgage rates start to decline, but delays to those cuts have seen them creep back up in recent weeks, discouraging new house purchases and raising costs for those needing to remortgage.

The big picture in Q2 2024

- Q2 2024 was a quarter of economic surprises and political drama. Global equity markets saw modest gains, while bond prices moved lower as the prospect of interest rate cuts receded into the latter part of the year.

- Inflation in the UK fell back to the Bank of England's target rate of 2%, but services sector inflation remains above target, causing a dilemma for the Monetary Policy Committee.

- In the corporate world, artificial intelligence (AI) continues to be a dominant theme, with Apple announcing its approach to weaving the technology into its consumer devices. Nvidia, a chipmaker specialising in the silicon and toolkits for AI, has seen strong profit and share price growth, briefly becoming one of the world's largest companies.

- Technology stocks continued to perform strongly in Q2, but so did stocks in the UK and Asia. Political surprises came in the form of unexpected elections in the UK and France, presaging changes of government, which, in the UK at least, did not weigh on markets.

- Interest rates have not fallen as quickly as expected and this has implications for mortgage rates, company borrowing, and bond values. However, the economy remains strong, with companies hiring and wages increasing.

- As we move into Q3, the focus is on the U.S., with the viability of President Joe Biden as a presidential candidate being tested. Investors are also keeping a close eye on government plans for tax and spending, particularly in the UK.

Market overview Q2 2024

- Asset classes saw a mixed performance in Q2 2024. North America and UK Equities advanced with returns above 3%. Asian Equities (excluding Japan) also outperformed, with a 6% return. Emerging Markets ex Asia and Japan, however, slid by -4.3% and -4.6%, respectively. Gold continued to perform well with a 4.7% return, but global property fell -1.7%.
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- Bonds had a slightly negative performance overall. Although Global Corporate Bonds had a positive return of 0.2%, Global Sovereign Bonds and UK Sovereign Bonds underperformed with returns of -0.5% and -0.9% respectively. Cash was positive in the higher rate environment.
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The value of investments can fall and you may get back less than you invested.

MPS performance

MPS PERFORMANCE												
	Q2	2024 YTD	1yr	2yr	3yr	4yr	5yr	2023	2022	2021	2020	2019
Cautious Portfolio	0.9	2.9	8.7	9.0	0.5	8.8	11.9	6.8	-10.1	3.7	6.7	11.2
Cautious Higher Equity Portfolio	1.1	3.8	9.8	11.3	2.5	13.2	15.9	7.4	-9.9	5.5	6.5	11.2
Income Portfolio	1.3	4.6	10.7	13.2	4.4	18.1	20.0	7.7	-9.5	6.8	6.8	14.5
Income Higher Equity Portfolio	1.6	5.7	11.9	16.1	7.3	23.7	25.3	8.3	-8.8	8.4	6.8	14.5
Balanced Portfolio	1.9	6.8	12.9	18.6	8.7	29.4	30.7	8.8	-9.0	10.8	7.6	16.4
Growth Portfolio	2.3	8.4	14.3	22.0	11.0	38.2	39.7	9.1	-9.2	13.8	9.9	18.4
Global Equity Portfolio	2.8	10.3	16.2	26.5	14.7	47.8	47.5	9.8	-8.9	16.3	9.7	22.1

All figures shown above are calculated to 30 June 2024.

Performance Calculation: All income is reinvested. Performance is shown inclusive of underlying fund charges but gross of RBC Brewin Dolphin's investment management charge. Deduction of this charge will have the result of reducing the illustrated performance. Neither simulated nor actual past performance are reliable indicators of future performance.

MPS performance highlights Q2 2024



Asset Allocation

What worked and why?

The overweight to U.S. equities, which was increased again in Q2, was again a positive contributor. The U.S. technology sector retains its leadership amid investor optimism around artificial intelligence and the impressive earnings results from companies like Nvidia. The underweight position to global corporate bonds has also benefitted the overall performance, as they were flat during the quarter, dogged by concerns over high valuations.

Fund Selection

What worked and why?

Over Q2, the newly introduced DWS Quality Growth strategy was up two times the broader US equity market. In UK equities, the Redwheel UK Equity and Man GLG UK Equity Income strategies outperformed due to investors' renewed interest in undervalued companies. In the lower risk categories, the Man GLG UK Corporate bond strategy continued to deliver excellent returns.

What didn't work and why?

The overweight position to sovereign bonds was unhelpful, as sticky inflation meant that interest rate cuts by central banks were pushed out into the future. The returns on these bonds remain attractive and, importantly, are held in portfolios as a diversifier that should act as a protection against economic weakness. If central banks cut interest rates, as is expected later this year, we would expect interest rates to support portfolios.

What didn't work and why?

The largest detractors during Q2 were the quality growth exposed Lindsell Train and the Ninety One UK Equity Income strategies which focus on companies with stable revenues and business models. In the US, the BNY Mellon US Equity Income strategy has also been a drag. It is a strategy that focusses on undervalued companies which, at a time when investors are more focussed on growth, have not been in vogue. All of these strategies play a useful diversifying role in portfolios however and should perform better on a relative basis if markets turn.

MPS portfolio changes Q2 2024

Asset Allocation

In April, the asset allocation committee increased the overweight to US equities by 0.5% which was offset by a reduction in cash. Despite some worries about the US economy and valuations, the committee felt that this was more than offset by prospects for the big tech names in the US index and the risk-off nature of the dollar.

In June, the committee moved overweight gold. Although the gold price has risen this year, a recent price dip was felt to offer a good entry point. Gold could do well if the economy slows down or if countries that aren't aligned with the West continue investing. This was balanced by reducing the allocation to global index-linked bonds, as any potential increase in inflation could be offset by rising yields. They also decided to increase the allocation to UK equities, given the improving economic situation, the prospect of better relations with the EU, and planning reforms that could help sustain growth. They funded this increase by reducing the cash allocation.

Fund Selection

Throughout the quarter, we continued to reduce the Vanguard US Equity Index fund in favour of US Quality Growth exposure within the MI Select Managers North American fund. This is to reflect the changing shape of the U.S. equity market and the dominance of a small number of mega-caps. The new structure allows us to control exposure and costs in the most important parts of the market.

In April, the Baillie Gifford Japanese fund was decreased in favour of M&G Japan, following a change in guidance from our analysts.

In June, we increased the allocation to gold within the MI Select Managers Alternatives fund and reduced the allocation to US TIPS in the MI Select Managers Bond fund. Cash was reduced to increase exposure to some of the best UK equity fund managers.

MI Select Manager fund weights

MISM FUND WEIGHTS			
Date	MISM Fund	Mandate	Weight (%)
30/06/2024	MI Select Managers Bond Instl Inc	Robeco Global Credit	26
		Insight UK Government Bond	25
		Colchester Global Sovereign	20
		Man GLG Sterling Corporate Bond	15
		DWS US TIPS	14
30/06/2024	MI Select Managers NA Equity Instl Inc	DWS US Quality Growth	31
		Brown Advisory US Sust Growth	25
		DWS US Value	20
		BNY Mellon US Equity Income	19
		Baillie Gifford American	5
30/06/2024	MI Select Managers UK Eq Inc Instl Inc	Man GLG UK Equity Income	41
		Ninety One UK Equity Income	41
		CT UK Equity Income	18
30/06/2024	MI Select Managers UK Equity Instl Inc	JJPM UK Core	33
		Redwheel UK Equity Income	30
		Lindsell Train UK Equity	28
		Teviot UK Smaller Companies	9
30/06/2024	MI Select Managers Alternatives	Commodities and other alternatives	46
		Schroder Global Cities	23
		Muzinich Global Tactical Credit	17
		Absolute Return funds	14

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Asset Allocation Committee

investment outlook

These views are implemented across our portfolios but there may be deviations where asset classes or suitable investments are unavailable or excluded.



Cash

Although cash continues to offer a decent yield, we retain a small underweight. We see continued scope for equity market gains, and scope for government bonds to rally moderately as central banks adopt less tight policy stances.



Bonds

Over time, tighter policy, a better functioning supply side of the economy, and already stretched housing affordability should combine to bring inflation lower. This should allow a growing number of central banks to begin to cut rates and justifies sticking with a modest overweight in government bonds.



Global Equities

The resilience the U.S. economy has exhibited is supportive of the global equity market. Indeed, the probability of a soft landing appears to have risen. Meanwhile, there is the potential for AI-related themes to push equity prices higher.

Finally, market momentum is strong. Tempering our optimism is the stage of the economic cycle (late), U.S. valuation metrics (high), sentiment (bullish), and the risk of trade uncertainty following the U.S. elections in November.



Alternatives

Gold has rallied at a time when real yields have risen substantially, which is atypical. Meanwhile, sentiment and positioning toward gold are bullish, which is unsupportive as it points to good news being priced in. But a Donald Trump win in the U.S. presidential election in November could cause U.S. growth to weaken and inflation to strengthen – a supportive backdrop for gold.

Gold could benefit from continued inflows from countries not geopolitically aligned with the West. Chinese households may be increasingly attracted to gold as a store of value. Gold could also do well on the back of just a simple moderation in real rates as the economy slows. Turning to property, a light at the end of the tunnel is emerging. Macro fundamentals appear to be getting less bad, and real estate investment trusts (REITs) would benefit proportionally from lower bond yields. Meanwhile, valuations have improved, and sentiment toward the sector is negative (which is attractive from a contrarian perspective). Finally, while fundamentals are challenging in the office space, the market cap weighting of this sector is small, and the backdrop is notably stronger in other REIT subsectors. Nevertheless, commercial property prices continue to decline. In addition, safe haven bond yields may not drop that much in the event of a soft landing. Only a small decline in yields might not be enough to drive strong relative performance in this interest-sensitive sector. Against this mixed backdrop, we maintain a neutral position.

UK Equities

UK relative performance should continue to be closely linked to value vs growth performance, and there are reasons to believe the outlook for the growth style remains brighter. However, some diversification into the value plays that the UK is so heavily weighted in makes sense at this stage, in our view. While the domestic economic outlook is less important for UK equity relative performance, it still matters. Indeed, there is a reasonably close relationship between the performance of UK vs global gross domestic product and UK vs global equity performance. The key event on investor radar screens was the UK general election, which Labour won with a strong majority. Labour may have some success in boosting economic growth with policies that require a limited fiscal outlay. However, the pathway to success is not guaranteed, and implementation will require careful navigation. In addition, in light of the substantial economic challenges confronting the UK, any growth uplift compared to the Conservative Party is likely to be moderate at best. The UK equity market trades on very undemanding valuation multiples and we hold a small overweight relative to benchmark.

US Equities

The main concern with regards to U.S. equity exposure relates to valuation. Both equity valuation multiples and the valuation of the dollar appear stretched. Nevertheless, we are more optimistic on U.S. equities than other regions, for two main reasons. The first is the secular outlook, which appears relatively bright for tech stocks. The main upside risk for the global equity market over the next few years is if an “AI boom” scenario unfolds. With the Federal Reserve on hold and likely to begin cutting rates this year, a weaker version of the second half of the 1990s is a possibility this cycle. Back then, excitement linked to the growth of the internet drove gains. This cycle, AI could be the driver. The U.S. has much greater exposure than any other region to the “pick and shovel” plays positioned to benefit from an AI investment spending boom. The second reason for favouring the U.S. relates to the cyclical outlook. Even though the odds of a soft landing have gone up, economic growth risks appear higher than in any given year. The U.S. is the most defensive of our six equity regions, which is an attractive characteristic at a time when growth risks are elevated.

Europe ex UK Equities

If we can predict where the relative performance of global tech and continental European FX are going, we stand a good chance of successfully predicting whether Europe ex UK equities will outperform. We are optimistic on the secular outlook for the global tech sector, which bodes poorly for Europe ex UK as it has low weightings in this sector. Regarding continental European FX, over the longer term, there appears to be room for appreciation, which would support regional equity relative performance in common currency terms. Importantly, the euro is cheaply valued (based on purchasing power parity conversion rates), and regional existential risks have declined. However, over the medium term, sluggish economic growth in Europe vis-à-vis the US should limit the upside in continental European FX.

Japan Equities

Shareholder-friendly reform momentum has picked up in Japan, which could help spark a further expansion in relatively depressed price-to-book multiples. However, demographics amount to a major structural headwind to Japanese equity relative performance. From a cyclical perspective, with the unemployment rate low and labour force participation high, Japan does not have much scope to put idle economic resources to work to drive growth. Despite low price-to-book multiples, Japan does not stand out as cheap, in our view. Indeed, it trades at a premium to the world ex US market on 12-month forward price-to-earnings.

Asia ex Japan Equities

China's economy is likely to continue to grow faster than most major economies for the foreseeable future. But there is little reason to believe the historical lack of a link between economic and corporate profit relative performance will strengthen. The geopolitical outlook is challenging, and a Donald Trump win in the U.S. presidential election in November would weigh on the Chinese economy and markets. Bigger picture, China is saddled with debt, and its demographics are a headwind to growth. Nevertheless, we are not bearish on Asia ex Japan relative performance prospects. There are structural growth bright spots. This includes India and semiconductor-heavy markets like Taiwan. Meanwhile, policy support should help slow the downturn in the hard-hit Chinese residential property sector.

Emerging Markets ex Asia Equities

Emerging Markets ex Asia is very cheap, but there does not appear to be a catalyst on the horizon to unlock that value. Brazil, Saudi Arabia, South Africa, Mexico, and the United Arab Emirates have the highest market cap weightings in the EM ex Asia equity index, making it very commodity exposed. We do not expect much upside to commodity prices in an environment where global growth is lacklustre and China refrains from large scale stimulus.

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