Tactical Active

Quarterly Update, Q2 2024

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The big picture: Macro and Markets

In a nutshell

- **Risk assets continue to lead the way**

  Equities continue to outperform fixed interest and Emerging Markets maintain momentum.

- **Politics takes centre stage**

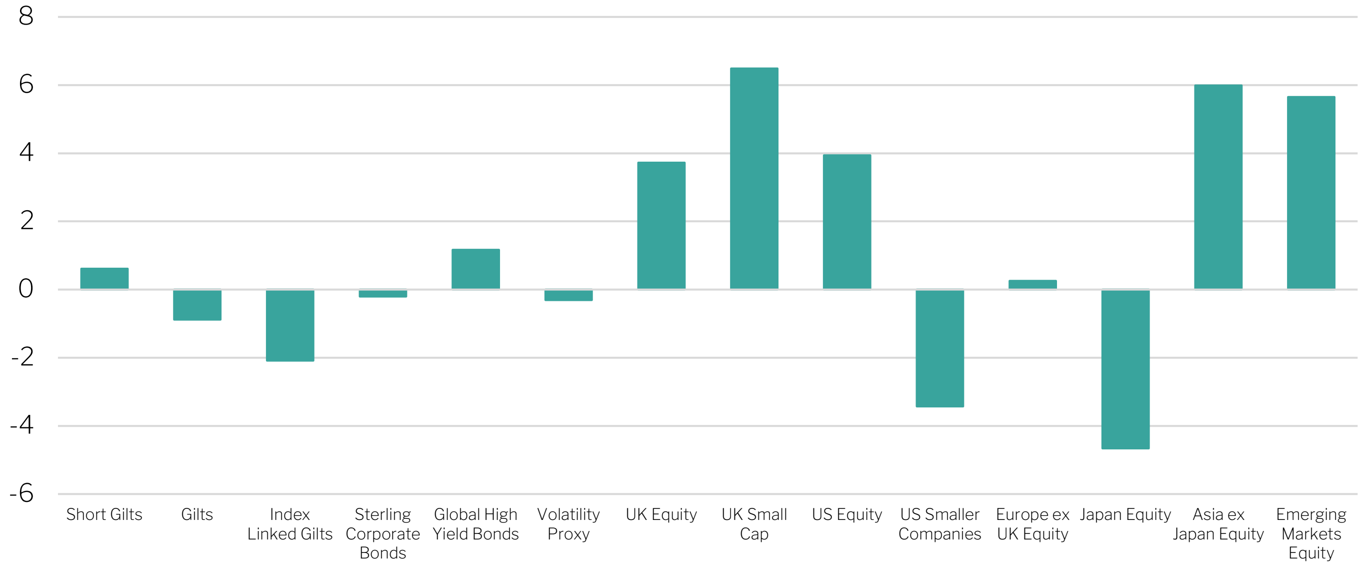
  Voters are rallying, with elections taking place across the world.

- **Inflation continues its downward path**

  The UK finally reached its 2% target but we're still waiting for rate cuts.

What's been happening in Q2?

Asset class returns (Q2 2024)



Asia and Emerging Markets led the way in Q2, continuing their strong performance this year, while Fixed Interest returns were broadly flat with risk assets still providing the lion's share of returns.

Politics continues to dominate headlines, with campaigning and voting happening across the world. The US, UK, France, India, Mexico and South Africa have all had elections recently or are on the campaign trail. This means uncertainty for a large proportion of global markets. Though this hasn't materialised into any notable losses or volatility yet.

President Biden and Donald Trump had the first of their two presidential debates. Biden's performance was unanimously panned, though neither candidate shone. The lack of coherence from Biden has left many in his party wondering if it's not too late to put someone else forward. This combined with Trump being the first criminally convicted former president, makes all this somewhat of a circus.

Macron surprised everyone by calling an election after a poor showing in EU Parliamentary voting. A strong initial showing from the Rassemblement National (RN) party was surprisingly reversed in the second round of voting, following a left-wing coalition. A hung parliament now awaits.

AI mania continues to push Nvidia (and US equity indices) even higher, briefly overtaking Apple and Microsoft to become the world's most valuable company. Index concentration is extremely high which raises questions about diversification. How long the momentum can last is anyone's guess, but active fund managers will tell you it's a painful bet to be on the wrong side of.

Inflation continued to fall over the quarter. The UK hit its 2% target, although wage and services inflation remain elevated. This led the Bank of England to hold interest rates until at least August. The Fed is cautious not to cut rates too quickly - a recession is less concerning than the embarrassment of having to reverse course. The ECB has been on the front foot, taking their deposit rate down from 4% to 3.75%.

China announced support measures to revive the property sector and boost confidence amongst consumers. To hit its GDP growth targets, China needs its population to be spending not saving.

What does that mean for performance?

Cumulative Performance (%)

This table outlines the cumulative investment performance of this solution across various risk grades, versus their IA benchmark.

	Q2	YTD	1 Year	3 Year	5 Year
Risk Grade 1	0.83	1.60	5.13	1.83	3.81
IA Standard Money Market	**1.29**	**2.60**	**5.44**	**8.81**	**9.61**
Risk Grade 2	0.32	1.45	6.17	1.08	8.37
Risk Grade 3	0.33	2.04	7.24	1.84	12.32
Risk Grade 4	0.35	2.72	8.36	3.98	15.73
IA Mixed Investment 0-35% Shares	**0.63**	**2.14**	**7.59**	**-2.46**	**5.57**
Risk Grade 5	0.51	3.20	8.54	3.26	17.59
Risk Grade 6	0.60	3.84	9.04	3.73	19.75
IA Mixed Investment 20-60% Shares	**1.14**	**3.65**	**9.38**	**2.83**	**15.20**
Risk Grade 7	0.72	4.22	9.16	2.76	19.52
Risk Grade 8	0.92	4.71	9.19	1.73	21.14
IA Mixed Investment 40-85% Shares	**1.67**	**5.91**	**11.82**	**7.19**	**25.58**
Risk Grade 9	0.99	5.22	9.30	1.25	23.46
Risk Grade 10	1.08	5.76	9.63	0.28	25.64
IA Flexible Investment	**1.71**	**6.27**	**11.78**	**7.27**	**28.57**

Discrete Annual Performance (%)

This table outlines the discrete annual performance of this across various risk grades, versus their IA benchmark.

	2023	2022	2021	2020	2019
Risk Grade 1	4.39	-4.63	-0.51	2.16	4.58
IA Standard Money Market	**4.74**	**1.28**	**-0.05**	**0.43**	**0.73**
Risk Grade 2	5.58	-7.99	3.57	4.44	6.96
Risk Grade 3	6.21	-8.76	5.70	5.10	9.25
Risk Grade 4	7.03	-8.78	7.96	3.68	11.34
IA Mixed Investment 0-35% Shares	**5.97**	**-10.87**	**2.84**	**3.90**	**8.70**
Risk Grade 5	6.38	-9.13	8.96	4.33	14.43
Risk Grade 6	6.28	-9.02	9.96	4.19	16.13
IA Mixed Investment 20-60% Shares	**6.81**	**-9.47**	**7.20**	**3.51**	**11.84**
Risk Grade 7	5.82	-9.54	10.43	4.14	16.72
Risk Grade 8	5.19	-9.97	10.83	5.69	17.87
IA Mixed Investment 40-85% Shares	**8.08**	**-10.04**	**10.94**	**5.32**	**15.78**
Risk Grade 9	4.80	-10.21	11.07	7.58	18.45
Risk Grade 10	4.73	-10.90	10.48	10.25	19.05
IA Flexible Investment	**7.08**	**-8.98**	**11.30**	**6.70**	**15.66**

What worked and what didn't?

Equities outperformed fixed interest over the quarter, leading to sequential performance through the risk grades. This was reinforced by emerging market equities outperforming developed markets.

This is also the case for YTD, 1-year performance, with growth assets notably outperforming defensive assets over 2024 so far. Whilst performance was positive in an absolute sense, all risk grades lagged the benchmark over the quarter. YTD returns are much closer, however.

Asset classes

An overweight position in emerging markets helped boost returns, with the asset class one of the best performers over the quarter. Higher risk grades naturally have a larger allocation to the region, and this again aided their performance.

Taking an underweight position to Europe ex UK has also been beneficial, as the region has given back some of the strong previous performance. Mixed growth prospects and election uncertainty within France have acted as a headwind.

Fixed interest was broadly flat over the quarter. Yield level moved around in response to interest rate cut expectations and this offset the income clients received. We expect returns to improve as rate cuts start to materialise later in the year.

However, whilst equities are performing well, there is less reliance on bonds to do the same. The important job will be to provide a cushion for portfolios when equities fall.

After performing very well for us, Japan has been a strong detractor over the period. It was a notable negative performer within a broadly favourable quarter for risk assets. However, it is interesting to note that this was largely due to currency weakness. Our chosen active fund managers also protected well and so portfolio returns were closer to zero than the negative return of the market, shown in the earlier bar chart.

Manager selection

Gresham House UK Smaller Companies had a strong quarter, returning 8.17% versus the global small cap index which was down -2.84%. It also produced good alpha versus the UK small cap index, returning 1.83% more.

Lightman European also performed very well versus the wider European index. The fund has a strong value bias and value as a style outperformed over the quarter so the fund performed exactly as we would hope in that environment.

Given the concentration of the US index and how narrow the returns drivers have become we were pleased to see that Amundi Pioneer US Fundamental Growth kept up with the index return. This fund is our highest growth active manager however it is also very disciplined in terms of valuation so doesn't own all the top weighted tech names.

Over what was a flat quarter across most fixed income sub asset classes our credit managers both UK and global all held up well albeit we didn't see significant out performance.

The other active fund within our global smaller company's asset class is Brown Advisory US Smaller Companies and the fund underperformed both the global index and US specific small cap index over the quarter. The index was down nearly -4% and the fund down -5.18%. We met the manager over the quarter and the fund will be discussed within our research committee shortly.

Premier Miton US Opportunities pulled down our US asset class versus benchmark. The fund is positioned very differently to the index with no allocation at all to large cap tech names and more cyclical exposure. The fund offers good diversification versus the now very concentrated index which means it will perform differently. Over this quarter that was not in our favour however we anticipate the fund offering good relative returns if/when returns broaden out within the index.

How are we positioned as a result?

Portfolios are now broadly risk neutral, with the changes made during the quarter adding a small amount of equities into models.

Equities have continued to outperform fixed interest over the year, as the market has become more comfortable with the idea of a "soft landing". This has come in conjunction with interest rates not falling as quickly as initially expected and therefore not providing bonds with capital gains alongside the income generated.

Within equities we continue to favour areas of the market that appear better value. Namely, Global Smaller Companies and Emerging Markets. In contrast, we're cautious on the US after such strong momentum within the technology space, the narrowness of earnings growth and current concentration within the index.

Smaller Companies ought to perform relatively well through a rate cutting cycle as they're generally more sensitive to the direction of monetary policy due to having higher debt. If we do move into a recession, we see the negative impact already priced in and so would hope for a degree of downside protection. The overweight to Gilts is also maintained, which should offer a cushion to portfolio in a recessionary environment as well.

Asset Allocation

Asset Class	(--) Double underweight	(-) Underweight	(=) Neutral	(+) Overweight	(++) Double overweight
Managed Liquidity	○	○	●	○	○
Global Government Bonds	○	○	○	●	○
Global Index Linked Government Bonds	○	●	○	○	○
UK Corporate Bonds	○	○	●	○	○
Global Strategic Bonds	○	○	●	○	○
Diversified Alternatives	○	○	● ←	◌	○
UK Equity	○	●	○	○	○
US Equity	○	●	○	○	○
Europe ex UK Equity	○	●	○	○	○
Japan Equity	○	○	○	●	○
Global Smaller Companies	○	○	○	●	○
Asia Pacific ex Japan Equity	○	○	●	○	○
Emerging Markets	○	○	○	●	○

Fund changes

Reduce	Increase
Japan Equity	**Europe ex UK Equity**

A few changes were made by the Tactical committee over the quarter. Japan Equity was reduced in recognition of the gains made since going overweight, albeit a slight overweight position is still maintained. The proceeds were reinvested into the Europe ex UK Equity asset class to reduce the underweight. This move brings both asset classes closer to their neutral positions.

Sell	Buy
Alternatives/Global Govt. Bonds	**UK Equity**

The committee also added to UK Equity as it was felt the underweight was too big, particularly given the associated inflation protection of the region. This was done via a reduction to Diversified Alternatives for low and mid risk portfolios and via Global Government Bonds for higher risk models.

Sell	Buy
Jupiter UK Special Situations	**Invesco UK Opportunities**

The changes to our UK Equity asset class were initiated by Ben Whitmore deciding to leave Jupiter later this year to set up a new fund house. His UK Special Situations fund provided the 'value' component of our UK asset class, and so we've selected a fund with this style factor, Invesco UK Opportunities, as a replacement.

The fund offers consistent large cap value, but to a lesser degree than Jupiter. As such, we looked to rework the overall fund weights within the asset class to ensure a balanced overall blend. Furthermore, we've condensed the number of funds from 6 to 5. Alongside Jupiter, Lindsell Train UK Equity is being removed.

Asset allocation (%)

Risk Grade	1	2	3	4	5	6	7	8	9	10
Managed Liquidity	63.00	27.50	17.50	10.00	5.00	2.50	0.00	0.00	0.00	0.00
Global Government Bonds	13.50	22.00	19.50	16.25	13.50	10.00	8.00	4.50	1.50	0.00
Global Index Linked Government Bonds	4.50	7.50	6.00	4.25	2.50	1.00	0.00	0.00	0.00	0.00
UK Corporate Bonds	4.50	7.75	8.50	8.50	8.25	7.00	6.00	4.00	1.75	0.00
Global Strategic Bonds	4.50	7.75	8.50	8.50	8.25	7.00	6.00	4.00	1.75	0.00
Diversified Alternatives	10.00	10.00	10.00	10.00	10.00	10.00	10.00	7.50	5.00	0.00
UK Equity	0.00	6.50	11.75	17.50	18.50	18.50	19.50	20.50	18.50	16.50
US Equity	0.00	3.50	7.25	11.75	13.00	16.75	18.00	19.50	23.00	27.00
Europe ex UK Equity	0.00	1.50	1.50	2.00	2.25	3.50	4.00	4.50	5.75	7.00
Japan Equity	0.00	3.00	4.25	5.25	5.25	5.25	5.00	4.50	4.00	3.50
Global Smaller Companies	0.00	3.00	3.00	3.00	4.50	5.50	6.50	8.00	9.50	11.00
Asia Pacific ex Japan Equity	0.00	0.00	0.00	0.00	1.50	2.50	3.50	5.00	6.50	8.00
Emerging Markets	0.00	0.00	2.25	3.00	7.50	10.50	13.50	18.00	22.75	27.00

OCF & Yield

Risk Grade	1	2	3	4	5	6	7	8	9	10
OCF (%)	0.24	0.42	0.50	0.58	0.64	0.69	0.73	0.77	0.80	0.83
Yield (%)	4.60	3.64	3.27	2.93	2.63	2.31	2.10	1.89	1.60	1.34

A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	1.93	2.83	2.47	-0.19	-6.54	-6.54
IA Standard Money Market	**0.08**	**0.66**	**0.62**	**0.00**	**-0.08**	**-0.10**
Risk Grade 2	4.09	5.28	4.99	-1.22	-10.25	-10.25
Risk Grade 3	4.82	6.23	6.07	-1.86	-11.52	-11.52
Risk Grade 4	5.50	7.06	7.41	-2.41	-12.10	-12.10
IA Mixed Investment 0-35 Shares	**5.49**	**6.09**	**6.47**	**-2.37**	**-13.28**	**-13.28**
Risk Grade 5	5.95	7.44	8.50	-3.05	-12.50	-12.50
Risk Grade 6	6.35	7.80	9.32	-3.50	-12.53	-13.36
IA Mixed Investment 20-60 Shares	**6.23**	**6.89**	**8.36**	**-3.30**	**-12.14**	**-12.89**
Risk Grade 7	6.73	8.18	9.74	-3.94	-13.01	-14.31
Risk Grade 8	7.21	8.56	10.62	-4.48	-13.18	-16.33
IA Mixed Investment 40-85 Shares	**7.28**	**8.19**	**10.12**	**-4.39**	**-12.54**	**-15.41**
Risk Grade 9	7.77	8.99	11.18	-4.95	-13.41	-17.26
Risk Grade 10	8.42	9.51	12.10	-5.40	-14.36	-18.84
IA Flexible Investment	**6.98**	**7.81**	**9.97**	**-4.31**	**-11.20**	**-15.53**

What's the outlook?

As we move through the year, politics looks set to keep the limelight. The run up to the US Presidential election in November is sure to create some headlines, with potential ramifications for international trade and relations top of the agenda for markets.

The narrative for the US economy is more and more that a 'soft landing' is most likely, with markets priced as though it's a certainty.

We do see downside risk, like widening credit spreads or equities correcting. However, we still expect a shallow recession, with risk assets (particularly small cap) outperforming in the medium term.

Given the strong starting yields, we expect fixed interest to produce good, absolute performance regardless of how quickly interest rates might fall. We *should* also see the Bank of England cut rates next quarter, as long as inflation data is stable.

Finally, after years of post-Brexit uncertainty and all the changes at No.10, Kier Starmer's sizeable majority might actually mean the UK is a relative stable political option. The idea of a Prime Minister staying in power for a full term could provide a catalyst to the UK market. Given the extent of recent underperformance (even with the FTSE 100 reaching a new high), any boost to sentiment would be welcome. UK valuations remain cheap, emphasised by the level of interest in private equity – just look at Hargreaves Lansdown.

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