Parmenion
Investment Management

Strategic Passive ESG

Quarterly Update, Q1 2024

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The big picture: Macro and Markets

In a nutshell

- **Equities outperform bonds in a very strong first quarter**

  Risk of a recession is put to one side by markets as they focus on the positives

- **Bond yields trend back up**

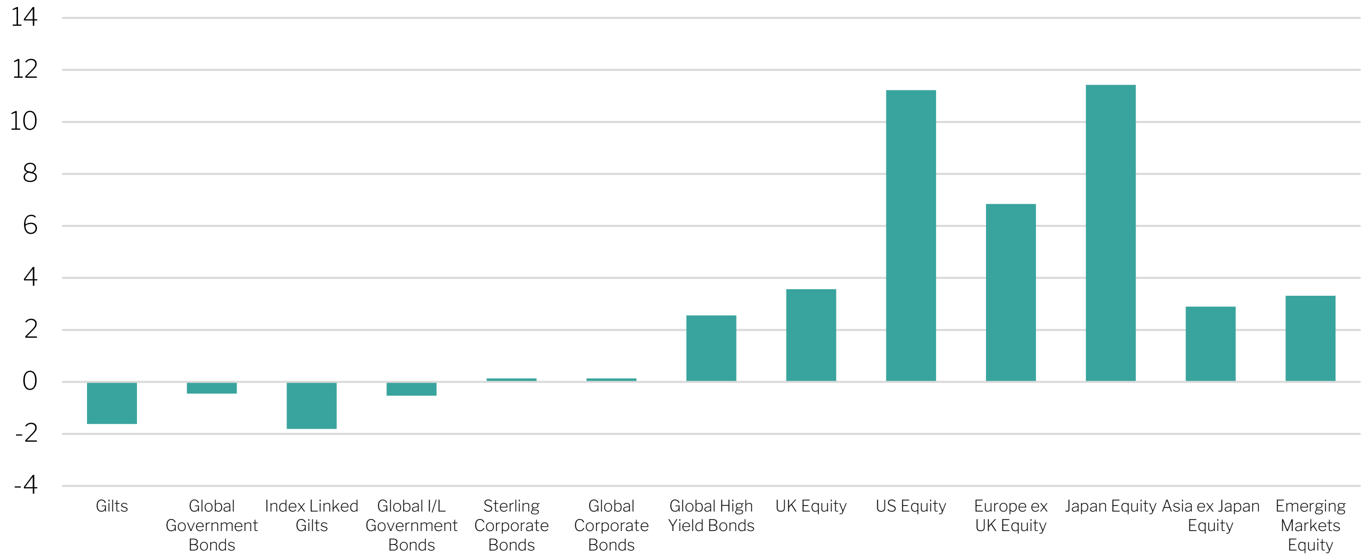
  After the sharp rally in Q4 last year, Government Bond yields move back to the 4% range as rate cuts are reevaluated

- **“Magnificent Seven” are not all magnificent**

  As AI excitement continues, those stocks with more to benefit are being rewarded

What's been happening in Q1?

Asset class returns (Q1 2024)



Risk assets led the way in Q1. With the prospect of a deep recession seemingly reduced, equity markets rewarded investors that avoided the allure of high interest rates.

Q4 last year captured the excitement around possible rate cuts, with yields coming in sharply following talk of lots (and lots) of cuts this year from the Fed. The market then spent Q1 digesting the overreaction and priced in something closer to reality. This saw yields move back up and 10yr government bonds settle at around 4%, creating a sort of 'V' shape over the last 6 months. This meant losses for bond holders, with the negative impact on capital values more than offsetting the income earned.

For credit investors, the picture was slightly different. The positive sentiment that pushed equities higher also meant credit spreads (a measure of how much you need to be paid to take on the risk of lending to a company) reduced, boosting returns. This offset rising yields, flattening returns for corporate bonds overall, and returning over 2% for high yield bonds.

In the US, the AI momentum continued which, alongside robust economic data, led the FTSE USA to double digit returns so far this year. There's also been a broadening of returns, and large differences in performance of the 'Magnificent Seven', which collectively contributed so much to returns last year.

Japan was the other standout performer. If it weren't for a weakening Yen, returns would've been higher still. The irony is that the Bank of Japan finally ended their negative interest rate policy, moving to a 0-0.1% window, slightly reducing their interest rate differential with other regions.

After a tough start to the year, several support measures and a change of tone from China gave the emerging markets a boost. Still lagging developed markets, but positive nonetheless. Whether there'll be more significant intervention to strengthen markets remains to be seen. Economic data has been steady recently, and sentiment appears to be turning. However, issues with the property sector will likely continue to be a strong headwind.

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.

	Q1	YTD	1 Year	3 Year	5 Year
Risk Grade 1	0.66	0.66	4.34	-	-
IA Standard Money Market	**1.29**	**1.29**	**5.18**	**7.42**	**8.43**
Risk Grade 2	1.32	1.32	5.57	-	-
Risk Grade 3	2.03	2.03	6.84	-	-
Risk Grade 4	2.64	2.64	7.95	-	-
IA Mixed Investment 0-35% Shares	**1.50**	**1.50**	**5.85**	**-0.64**	**7.48**
Risk Grade 5	2.75	2.75	7.87	-	-
Risk Grade 6	3.17	3.17	8.55	-	-
IA Mixed Investment 20-60% Shares	**2.49**	**2.49**	**7.71**	**5.34**	**17.16**
Risk Grade 7	3.36	3.36	8.69	-	-
Risk Grade 8	3.52	3.52	8.74	-	-
IA Mixed Investment 40-85% Shares	**4.17**	**4.17**	**10.16**	**10.65**	**28.73**
Risk Grade 9	3.81	3.81	9.13	-	-
Risk Grade 10	4.03	4.03	9.44	-	-
IA Flexible Investment	**4.48**	**4.48**	**10.08**	**10.88**	**31.49**

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	5.23	-	-	-	-
IA Standard Money Market	**4.74**	**1.28**	**-0.05**	**0.43**	**0.73**
Risk Grade 2	6.94	-	-	-	-
Risk Grade 3	8.17	-	-	-	-
Risk Grade 4	9.23	-	-	-	-
IA Mixed Investment 0-35% Shares	**5.97**	**-10.87**	**2.84**	**3.90**	**8.70**
Risk Grade 5	9.06	-	-	-	-
Risk Grade 6	9.40	-	-	-	-
IA Mixed Investment 20-60% Shares	**6.81**	**-9.47**	**7.20**	**3.51**	**11.84**
Risk Grade 7	9.41	-	-	-	-
Risk Grade 8	9.04	-	-	-	-
IA Mixed Investment 40-85% Shares	**8.08**	**-10.04**	**10.94**	**5.32**	**15.78**
Risk Grade 9	8.97	-	-	-	-
Risk Grade 10	8.97	-	-	-	-
IA Flexible Investment	**7.08**	**-8.98**	**11.30**	**6.70**	**15.66**

What worked and what didn't?

Strong developed market equity returns provided the most benefit for middle to higher risk grades, while weakness in bond markets didn't stop all models finishing the quarter in positive territory.

Although risk assets outperformed, regional differences meant developed markets finished ahead of emerging markets. Despite this, the Q1 and 1-year figures broadly retained their standardised sequential alignment with risk. Portfolios at the higher and lower end of the risk spectrum lagged their benchmark over the quarter, which fed into the 1-year numbers. This comes after all portfolios outperformed their IA sectors in 2023.

Asset classes

US Equity was the stand-out performer in Q1. It has more ESG-oriented indices, that often hold a reduced 'Magnificent 7' allocation, so benefitted from a broadening out of the rally. As referenced in the market review, Japan also performed very well, as did Europe despite some ongoing economic concerns in the region.

While still producing a positive absolute returns, Emerging Markets and Asia Pacific ex Japan equities underperformed Europe and the US as China continued to lag, despite a strong February, and solid returns in both India and Taiwan.

Fixed Interest had a tough quarter. Global Government Bonds, Global Index-Linked Bonds and US Corporates produced small negative returns as expectations around interest rate cuts tapered down following overly optimistic Q4 2023 assumptions. However, Euro Corporates still finished in positive territory.

Fund changes

Reduce	Buy
Amundi MSCI Pacific ex Japan SRI PAB Amundi MSCI Emerging Markets SRI PAB UBS MSCI Emerging Markets Socially Responsible	UBS MSCI World Small Cap Socially Responsible

Annual Strategic Asset Allocation Amendments

To increase diversification and capture attractive long term valuation opportunities, we've introduced a new Global Smaller Companies asset class from the middle risk grades upwards. We've introduced the UBS ETF MSCI World Small Cap Socially Responsible ETF to the portfolio and dialled down exposure to Asia Pacific ex Japan Equity and Emerging Markets. We remain positive on the long term prospects for these markets, these changes simply help improve diversification in the higher risk grades.

Passive ESG due diligence review

Our semi-annual passive due diligence has been completed and the report is available on our website. This quantitative analysis concludes that our current two providers, Amundi and UBS, remain the most suitable for use within the portfolio. We also undertake ongoing qualitative due diligence of these providers on an annual basis, with input from our Ethical Oversight Committee, to ensure they continue to deliver to our very high ESG standards.

Asset allocation (%)

Risk Grade	1	2	3	4	5	6	7	8	9	10
Managed Liquidity	60.00	30.00	20.00	12.50	7.50	2.50	0.00	0.00	0.00	0.00
Global Government Bonds	10.50	14.50	14.00	13.00	12.00	10.50	8.50	6.00	3.00	0.00
Global Index Linked Government Bonds	5.50	8.00	7.50	7.00	6.50	6.00	4.50	3.00	1.50	0.00
US Corporate Bonds	12.00	13.75	11.75	10.00	8.25	6.75	5.00	3.00	1.00	0.00
European Corporate Bonds	12.00	13.75	11.75	10.00	8.25	6.75	5.00	3.00	1.00	0.00
UK Equity	0.00	9.00	16.00	21.50	22.00	22.50	23.00	23.50	21.00	18.00
US Equity	0.00	6.50	11.75	16.25	17.25	21.50	23.50	24.25	27.25	30.00
Europe ex UK Equity	0.00	2.25	4.00	5.50	6.25	7.00	7.75	8.25	9.00	10.00
Japan Equity	0.00	2.25	3.25	4.25	4.00	4.00	3.75	3.00	2.75	2.00
Global Smaller Companies	0.00	0.00	0.00	0.00	1.50	2.50	3.75	5.25	6.75	8.00
Asia Pacific ex Japan Equity	0.00	0.00	0.00	0.00	1.50	2.50	3.75	5.25	6.75	8.00
Emerging Markets	0.00	0.00	0.00	0.00	4.50	7.50	11.50	15.50	20.00	24.00

OCF & Yield

Risk Grade	1	2	3	4	5	6	7	8	9	10
OCF (%)	0.09	0.13	0.15	0.17	0.18	0.19	0.20	0.21	0.21	0.22
Yield (%)	4.15	3.16	2.66	2.26	1.99	1.68	1.45	1.31	1.13	0.97

A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	2.46	-	-	-0.48	-	-
IA Standard Money Market	**0.18**	**0.67**	**0.59**	**0.00**	**-0.08**	**-0.10**
Risk Grade 2	4.98	-	-	-2.61	-	-
Risk Grade 3	6.29	-	-	-3.73	-	-
Risk Grade 4	7.36	-	-	-4.62	-	-
IA Mixed Investment 0-35 Shares	**5.55**	**6.10**	**6.47**	**-2.69**	**-13.28**	**-13.28**
Risk Grade 5	8.07	-	-	-5.39	-	-
Risk Grade 6	8.77	-	-	-6.03	-	-
IA Mixed Investment 20-60 Shares	**6.34**	**6.97**	**8.42**	**-3.30**	**-12.14**	**-12.89**
Risk Grade 7	9.44	-	-	-6.63	-	-
Risk Grade 8	9.95	-	-	-7.06	-	-
IA Mixed Investment 40-85 Shares	**7.30**	**8.36**	**10.25**	**-4.39**	**-12.54**	**-15.41**
Risk Grade 9	10.42	-	-	-7.43	-	-
Risk Grade 10	10.84	-	-	-7.68	-	-
IA Flexible Investment	**7.03**	**8.04**	**10.13**	**-4.31**	**-11.20**	**-15.53**

Industry exposure

This table compares the exposure of Strategic Passive ESG Risk Grade 6 with a representative benchmark. Data sourced from Morningstar as of **31st March 2024**.

Industry	Passive ESG Risk Grade 6	Benchmark*
Adult Entertainment	0.00	0.00
Alcohol	0.04	1.36
Animal Testing	16.89	17.83
Abortive/Contraceptives/Stem Cell	8.13	8.45
Controversial Weapons	0.20	1.55
Fur & Speciality Leather	0.00	0.00
Gambling	0.00	0.28
GMO	0.01	0.09
Military Contracting	0.07	2.35
Nuclear	0.09	1.08
Palm Oil	0.05	0.03
Pesticides	0.08	0.18
Small Arms	0.10	0.97
Thermal Coal	0.03	1.09
Tobacco	0.25	1.04

About this data

The Morningstar UK Moderately Aggressive Target Allocation category has been used as an equivalent benchmark.

Based on the latest available data from Morningstar, but there may be gaps or time lags in some of the information.

Please note animal testing includes all animal testing. That means pharmaceutical products, medical devices, biotechnology, non-pharmaceutical products like cosmetics, and chemicals like pesticides and food additives.

Risk Grade 6 is shown for illustration because it invests in all asset classes and funds used in the solution, actual exposure may differ by risk grade.

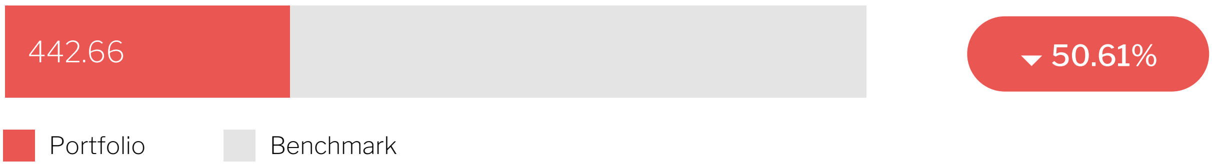
Carbon metrics

Data shown for Strategic Passive ESG, Risk Grade 6 vs. Morningstar UK Moderately Adventurous Targeted Allocation Index.

% below benchmark

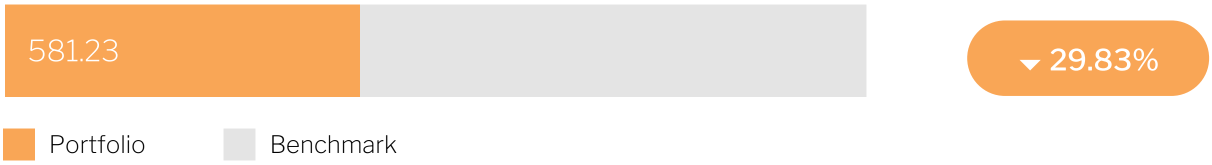
Carbon footprint

Tonnes CO_2 per $1m invested



Weighted average carbon intensity

Tonnes CO_2 per $1m revenue



Data coverage

About this data

Based on the latest available data from Morningstar as of 31st March 2024. There may be gaps or time lags in some of the information. Risk Grade 6 is shown for illustration because it invests in all asset classes and funds used in the solution, actual carbon metrics may differ by risk grade.

What’s the outlook?

After such a strong start to the year, it’s easy to get carried away. The narrative of a shallow (or avoided) recession and gradually reducing interest rates is a favourable one. So, whilst its likelihood has certainly increased - it isn’t without risk.

Holding government bonds at a 4% yield offers an attractive way to hedge against this. If there’s an equity market sell-off, we believe they’ll provide positive performance to support client portfolios.

Inflation continues to fall in line with expectations, boosting both real wages across developed markets and the chances of rate cuts from around the middle of the year. The Bank of England have given the clearest guidance that they won’t be waiting for inflation to hit 2% before making their move.

Small cap and emerging market equities offer investors access to strong potential returns at an attractive entry point. The same is true for UK equities, with many companies buying back shares in a sign that current price levels appear too low.

Time in the market continues to be a strong mantra to follow. The potential outcomes are wide, from avoiding a recession to a rate hike induced, delayed but deep recession (or anything in between). Predicting the near-term direction of markets is particularly hard in this environment, but backing the market over the long term is never in question.

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- Past performance is not an indicator of future performance and investment returns can go down as well as up.
- All data sourced from FE fundinfo.

Get in touch

If you'd like to chat to us about our Strategic Passive ESG solution, please get in touch.

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