Parmenion
Investment Management

Tactical Income

Quarterly Update, Q2 2024

Simon Molica
Senior Investment Manager

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**

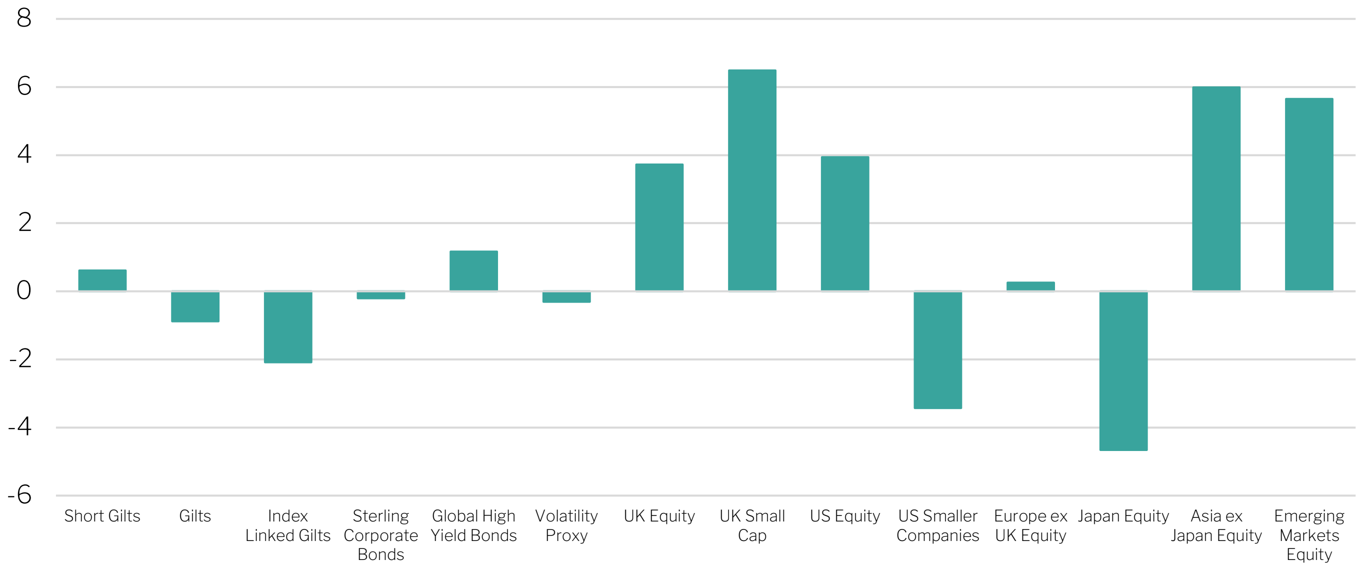
  Voters are rallying, with elections taking place across the world.

- **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	0.91	0.81	4.74	-0.03	4.72
IA Standard Money Market	1.29	2.60	5.44	8.81	9.61
Risk Grade 2	0.88	1.09	6.08	3.15	8.93
Risk Grade 3	1.12	1.90	7.35	2.76	10.15
Risk Grade 4	1.33	2.71	8.40	4.49	12.70
IA Mixed Investment 0-35% Shares	0.63	2.14	7.59	-2.46	5.57
Risk Grade 5	1.72	3.60	9.44	6.81	15.64
Risk Grade 6	2.02	4.39	10.17	9.70	19.42
IA Mixed Investment 20-60% Shares	1.14	3.65	9.38	2.83	15.20
Risk Grade 7	2.27	4.94	10.65	12.46	22.44
Risk Grade 8	2.64	6.16	11.60	15.51	25.32
IA Mixed Investment 40-85% Shares	1.67	5.91	11.82	7.19	25.58
Risk Grade 9	2.97	6.82	11.70	17.52	27.12
Risk Grade 10	3.11	7.66	12.37	18.02	28.18
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	4.04	-5.58	1.64	2.50	5.01
IA Standard Money Market	4.74	1.28	-0.05	0.43	0.73
Risk Grade 2	4.64	-4.89	5.13	0.70	7.16
Risk Grade 3	5.45	-7.01	6.10	0.84	9.46
Risk Grade 4	5.70	-6.92	7.58	0.27	10.80
IA Mixed Investment 0-35% Shares	5.97	-10.87	2.84	3.90	8.70
Risk Grade 5	5.84	-6.22	8.95	-0.34	11.77
Risk Grade 6	6.22	-5.12	10.55	-1.15	13.07
IA Mixed Investment 20-60% Shares	6.81	-9.47	7.20	3.51	11.84
Risk Grade 7	6.22	-3.72	12.07	-2.12	13.71
Risk Grade 8	5.97	-2.30	13.27	-3.29	14.24
IA Mixed Investment 40-85% Shares	8.08	-10.04	10.94	5.32	15.78
Risk Grade 9	5.51	-0.99	14.28	-4.21	14.75
Risk Grade 10	6.08	-1.45	14.12	-4.35	15.92
IA Flexible Investment	7.08	-8.98	11.30	6.70	15.66

What worked and what didn't?

Small losses on gilts, global government bonds and UK corporate bonds were offset by high managed liquidity rates, and positive UK and US equities. All Risk Grades delivered positive returns over the quarter.

A strong start to the year for equities meant all Risk Grades over the first half of 2024 delivered strong absolute returns. They've also been delivered in sequential alignment - so far this year, risk has been rewarded handsomely.

The model portfolios continue to outperform their respective IA benchmarks over the 3-years (aside from Risk Grade 1). Higher risk grades have fallen behind longer term due to the reliance on Asia and Emerging Markets. Over the 5-year time horizon, with exception of Risk Grade 1, lower Risk Grades are ahead but higher Risk Grades slightly lag.

Asset classes

Equity returns were mixed over the quarter. UK, Asia Pacific ex Japan and Emerging Markets continued to perform. Emerging Market returns were driven mainly by the biggest countries within the index, China, Taiwan, and India with South Africa also performing well.

US equities were once again one of the top performers. The return profile of the US index remains unchanged from previous quarters with small and mid-caps struggling however the large cap and tech focused part of the market continues its upward trajectory. This is leading to significant concentration at the top of the US index. Global indices are also becoming very dependent on the US equity market.

Bond yields were range bound over the quarter with the UK 10 gilt yield moving within a 40bps range around 4.00 and 4.40%. The 10-year yield ultimately ended the month slightly above where it started leading to marginally negative returns despite still high absolute yields.

A similar story played out across other sub-indices within the portfolios overall bond allocation.

Japanese equities were the worst performing asset class over the quarter. This is possibly a short-term correction after a period of outperformance from the region following positive corporate governance reforms playing through to equity returns. Regional returns looked even worse in GBP terms due to Yen weakness.

Manager selection

Asia Pacific equities and Diversified Alternatives led the way in absolute terms. Diversified Alternatives also delivered the strongest relative outperformance over the quarter, entirely due to the performance of VT Gravis Clean Energy Income. This fund has been volatile due to its linkage to long term bond yields owing to its investment in large scale infrastructure projects. But inflation falling back down to target is helping.

The WS Morant Wright Nippon Yield fund, while only producing a slightly positive quarterly return, did significantly outperform its very weak index returns. A bias towards income stocks bolstered relative returns through this period.

In absolute terms, Allianz Gilt Yield detracted value as gilt yields edged higher. This led to a fall in bond capital values. In both absolute and relative terms, JPM US Equity Income held back portfolio returns. This driven by the continued enthusiasm for AI propping up large cap technology stocks. Conversely in the UK (with limited technology companies represented in the index), where value stocks have been performing well, the Evenlode Income fund has struggled against its benchmark.

Fund changes

There were no fund changes to note, for the recent quarterly period.

How are we positioned as a result?

Our Tactical Asset Allocation for our income portfolios has additional considerations around yield. Therefore, portfolios retain a slightly defensive tilt, given the attractiveness of core fixed income and the availability of yield on offer.

The UK equity market is very much unloved and under owned despite compelling valuations. Given the undervaluation of the UK equity market and by extension the additional yield opportunity, we've decided to take the asset class back to neutral. This was funded by reducing the solution's cash overweight broadly back to neutral. This works well with the BoE seemingly getting closer to a rate cut, particularly as inflation has now hit 2%.

The tactical views reflected in the solution are overweight Government Bonds, Corporate Bonds and Emerging Markets, offset by underweights to Global Index Linked Bonds, High Yield and US Equity. The latter two areas are appearing expensive.

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 High Yield	○	●	○	○	○
Emerging Market Debt	○	○	●	○	○
Diversified Alternatives	○	○	●	○	○
UK Equity	○	◐ →	●	○	○
US Equity	○	●	○	○	○
Europe ex UK Equity	○	○	●	○	○
Japan Equity	○	○	●	○	○
Asia Pacific ex Japan Equity	○	○	●	○	○
Emerging Markets	○	○	○	●	○

Asset allocation (%)

Risk Grade	1	2	3	4	5	6	7	8	9	10
Managed Liquidity	46.50	26.00	19.50	15.50	8.00	6.00	3.75	2.50	1.75	2.00
Global Government Bonds	14.50	22.25	20.00	16.50	13.00	7.75	6.00	2.50	1.75	0.00
Global Index Linked Government Bonds	7.25	9.25	8.00	6.50	4.50	2.00	1.00	0.00	0.00	0.00
Short Dated Corporate Bonds	14.25	6.50	3.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK Corporate Bonds	4.50	10.00	12.00	12.00	13.00	12.00	10.25	6.75	4.24	3.00
Global High Yield	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Emerging Market Debt	3.00	5.00	5.50	5.50	7.00	7.75	7.00	5.00	3.50	3.50
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	4.00	9.00	15.00	16.50	19.00	21.25	23.00	20.75	19.00
US Equity	0.00	1.50	5.00	9.00	10.00	11.50	13.50	17.25	18.26	20.50
Europe ex UK Equity	0.00	1.75	2.50	4.00	4.00	5.00	5.50	6.75	7.50	9.00
Japan Equity	0.00	1.75	2.50	3.00	3.50	3.50	3.00	3.00	1.50	0.00
Asia Pacific ex Japan Equity	0.00	0.00	0.00	0.00	2.00	3.00	4.00	5.75	8.25	10.00
Emerging Markets	0.00	2.00	3.00	3.00	8.50	12.50	14.75	20.00	27.50	33.00

OCF & Yield

Risk Grade	1	2	3	4	5	6	7	8	9	10
OCF (%)	0.23%	0.35%	0.41%	0.46%	0.52%	0.56%	0.58%	0.61%	0.60%	0.60%
Yield (%)	4.77%	4.46%	4.40%	4.36%	4.29%	4.29%	4.25%	4.13%	3.94%	3.86%

A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	3.09	4.10	3.88	-0.89	-7.52	-7.52
IA Standard Money Market	**0.08**	**0.66**	**0.62**	**0.00**	**-0.08**	**-0.10**
Risk Grade 2	4.70	5.30	5.31	-1.73	-7.40	-7.40
Risk Grade 3	5.30	6.54	6.69	-2.23	-10.46	-10.46
Risk Grade 4	5.84	7.18	7.59	-2.72	-10.78	-10.89
IA Mixed Investment 0-35% Shares	**5.49**	**6.09**	**6.47**	**-2.37**	**-13.28**	**-13.28**
Risk Grade 5	6.31	7.58	8.32	-3.21	-10.37	-12.62
Risk Grade 6	6.65	7.89	9.25	-3.61	-9.88	-14.97
IA Mixed Investment 20-60% Shares	**6.23**	**6.89**	**8.36**	**-3.30**	**-12.14**	**-12.89**
Risk Grade 7	7.01	8.07	9.90	-3.99	-8.73	-16.64
Risk Grade 8	7.31	8.33	10.64	-4.34	-8.21	-18.43
IA Mixed Investment 40-85% Shares	**7.28**	**8.19**	**10.12**	**-4.39**	**-12.54**	**-15.41**
Risk Grade 9	7.62	8.59	11.38	-4.71	-7.72	-20.10
Risk Grade 10	7.82	9.08	12.24	-4.75	-8.82	-21.66
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.

Important information

This document for financial professionals only.

Any news and/or views in this document are meant as general information and shouldn't be seen as financial advice, or a personal recommendation.

Parmenion accepts no duty of care or liability for loss to any person acting or refraining from acting because of reading anything in this document.

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 Tactical Income solution, please get in touch.

Phone:
03300 945 900

Email:
mail@parmenion.co.uk

Parmenion
Investment Management

Registered office: Aurora, Counterslip, Bristol BS1 6BX.

Website: www.parmenion.co.uk

Parmenion Capital Partners LLP Authorised and regulated by the Financial Conduct Authority. FCA Number 462085.

Registered in England and Wales OC322243.