Parmenion
Investment Management

Strategic Conviction

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.

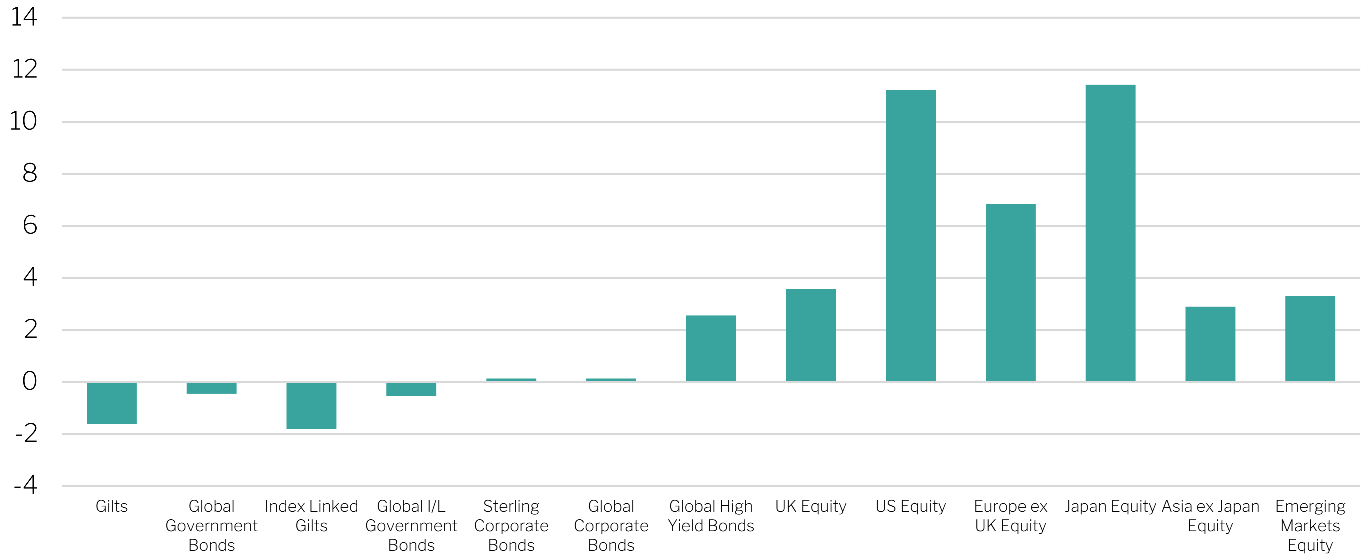
- **"Magnificent Seven" are not all magnificent**

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

For financial professionals only

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	0.67	0.67	3.99	0.32	1.22
IA Standard Money Market	**1.29**	**1.29**	**5.18**	**7.42**	**8.43**
Risk Grade 2	1.27	1.27	5.32	2.16	7.77
Risk Grade 3	1.99	1.99	6.83	5.34	13.53
Risk Grade 4	2.74	2.74	8.33	9.02	17.97
IA Mixed Investment 0-35% Shares	**1.50**	**1.50**	**5.85**	**-0.64**	**7.48**
Risk Grade 5	3.04	3.04	8.49	9.70	21.57
Risk Grade 6	3.63	3.63	9.39	11.75	25.50
IA Mixed Investment 20-60% Shares	**2.49**	**2.49**	**7.71**	**5.34**	**17.16**
Risk Grade 7	3.90	3.90	9.56	12.37	26.62
Risk Grade 8	4.23	4.23	9.73	13.27	31.84
IA Mixed Investment 40-85% Shares	**4.17**	**4.17**	**10.16**	**10.65**	**28.73**
Risk Grade 9	4.75	4.75	10.34	14.53	37.04
Risk Grade 10	5.27	5.27	11.09	15.34	43.39
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	4.77	-6.46	-0.65	1.97	2.21
IA Standard Money Market	**4.74**	**1.28**	**-0.05**	**0.43**	**0.73**
Risk Grade 2	6.29	-9.80	3.60	3.64	6.54
Risk Grade 3	7.29	-9.80	5.95	3.96	8.42
Risk Grade 4	8.23	-9.31	8.33	2.15	10.68
IA Mixed Investment 0-35% Shares	**5.97**	**-10.87**	**2.84**	**3.90**	**8.70**
Risk Grade 5	7.98	-9.13	9.40	2.57	13.32
Risk Grade 6	8.18	-8.41	10.45	2.42	14.96
IA Mixed Investment 20-60% Shares	**6.81**	**-9.47**	**7.20**	**3.51**	**11.84**
Risk Grade 7	8.00	-8.15	11.10	2.24	15.18
Risk Grade 8	7.77	-7.70	11.92	3.97	17.16
IA Mixed Investment 40-85% Shares	**8.08**	**-10.04**	**10.94**	**5.32**	**15.78**
Risk Grade 9	7.73	-7.35	12.77	5.88	18.23
Risk Grade 10	7.91	-7.41	13.23	8.54	20.41
IA Flexible Investment	**7.08**	**-8.98**	**11.30**	**6.70**	**15.66**

What worked and what didn't?

Higher risk grades outperformed lower risk grades over the quarter, as equity markets rose strongly, and bonds were impacted by rising yields.

Most risk grades outperformed their IA sector benchmarks over the first three months of the year. The only exceptions being risk grades 2 and 7, both of which have a lower risk profile than their respective IA sector comparator. 1,3- and 5-year performance is entirely sequential across the 10 risk grades, as we'd expect, with clients being rewarded for taking on additional risk. All models are ahead of benchmark over 3 and 5 years, bar risk grade 7 over 5 years.

Asset classes

Equities broadly added value for clients, with the US and Japan in particular performing well with double digit returns. Given the size of the allocation to the US, this had the most meaningful impact on portfolios.

Elsewhere, Europe ex UK had a strong quarter. Falling inflation and expectations of rate cuts from the ECB have been well received, with the market looking past less positive areas such as German economic data and the continued conflict in Ukraine.

The UK and Emerging Markets asset classes produced positive returns for Q1 but lagged those of other Developed Market regions.

There's still a fair amount of negative sentiment around the UK market, with UK investors consistently preferring to allocate to Global and US equities instead.

Earnings growth within Emerging Markets is expected to outstrip that of Developed. Couple this with sentiment towards China changing, and there's scope for stronger performance ahead.

Apart from High Yield Bonds, Fixed Interest detracted performance over the quarter. The market began to unwind its view on the number of interest rate cuts this year and so yields began to move back up. This hurt capital values and the more rate sensitive areas such as UK Government Bonds, fell by the most.

After such a strong Q4 last year, it isn't overly surprising to see some of the gain given back.

Manager selection

Morant Wright Nippon Yield had a very impressive quarter, comfortably outperforming the Japan index through a strongly upward period of performance. The fund focuses in the midcap area of the market, targeting stocks that are trading a big valuation discount.

Various components of our Diversified Alternatives asset class added and detracted over the quarter. AQR Managed Futures, a trend following strategy, returned circa 11%. However, this was offset by Gravis UK Infrastructure Income falling by nearly 8%. Infrastructure is quite correlated with long dated bond yields, and lost value as they rose this year.

Within our corporate bond asset class, Royal London Sterling Credit and Twentyfour Corporate Bond materially outperformed the index albeit absolute returns were unexciting, returning just under 2% over the quarter. This is versus the index that returned 0.13% though.

Lightman European lagged over the quarter, even with a strong return in March. The fund is a recent addition and offers value style exposure, which pairs well with other funds in the asset class. It makes up a small allocation in portfolios, so whilst disappointing to underperform, it isn't too impactful on risk grade returns.

Active / Passive Splits

We've made several fund changes to refocus our active fund allocation on managers with higher active share, whilst also increasing the use of passive funds. This has enabled us to materially lower overall risk grade OCF without compromising on potential outperformance.

Asset Class	100% Active	75 / 25	50 / 50	25 / 75	100% Passive
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	○	○	●	○	○

Changes

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 reduced exposure to Asia Pacific ex Japan Equity and Emerging Markets to accommodate this. We remain positive on the long-term prospects for these markets, these changes simply help improve the balance in the higher risk grades. We've also combined the UK Equity Growth and the UK Equity Income asset classes, now called UK Equity. This change will make it easier to blend our selected UK fund managers.

Sell	Increase
PIMCO GIS Global Bond	**Abrdn Global Corporate Bond Tracker**

Within Global Bonds we've reduced the number of active funds from three to two by selling the PIMCO GIS Global Bond fund given its benchmark orientated approach. The proceeds were added to the lower cost Abrdn Global Corporate Bond Screened Tracker fund.

Sell	Increase
Artemis Income & Jupiter UK Special Situations	**Vanguard FTSE UK All Share Index & Vanguard FTSE UK Equity Income**

Within UK Equities we sold Artemis Income and Jupiter UK Special Situations. The former provided core UK market exposure while the latter was driven by an upcoming fund manager change. We replaced them with passive alternatives.

Sell	Increase
US Active Funds	**US Passive Funds**

US Equities moved to fully passive, in recognition that historically it's proven a harder market to outperform in. This also somewhat hedges the risk of the large tech stocks continuing to lead the market, as they are an area often underweighted by active manager due to their size in the index. This active reduction was offset by taking a fully active approach in the new Global Smaller Companies asset class, where there is a 70% allocation to the US.

Sell	Increase
Fidelity European	**Vanguard FTSE Developed Europe ex UK Index**

In European ex UK equities, we sold the Fidelity European fund, which was a benchmark orientated core active fund in favour of passive.

Reduce	Increase
Active EM Funds	**iShares Emerging Market Index**

Finally, within Emerging Markets, we increased the passive exposure to pare back our regional tilts and increase diversification, while still maintaining some active exposure in the existing funds given the attractive valuations across the region.

Asset allocation (%)

Risk Grade	1	2	3	4	5	6	7	8	9	10
Managed Liquidity	60.00	27.50	17.50	10.00	5.00	2.50	0.00	0.00	0.00	0.00
Global Government Bonds	13.50	19.00	16.50	13.25	10.50	7.00	5.25	3.00	1.00	0.00
Global Index Linked Government Bonds	7.50	10.50	9.00	7.25	5.50	4.00	2.75	1.50	0.50	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	8.00	13.50	19.00	20.00	20.00	21.00	22.00	20.00	18.00
US Equity	0.00	5.50	10.25	14.75	16.00	19.75	21.00	22.50	26.00	30.00
Europe ex UK Equity	0.00	2.00	3.25	5.00	5.25	6.50	7.00	7.50	8.75	10.00
Japan Equity	0.00	2.00	3.00	3.75	3.75	3.75	3.50	3.00	2.50	2.00
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	0.00	0.00	1.50	2.50	3.50	5.00	6.50	8.00
Global Smaller Companies	0.00	0.00	0.00	0.00	4.50	7.50	10.50	15.00	19.75	24.00

OCF & Yield

Risk Grade	1	2	3	4	5	6	7	8	9	10
OCF (%)	0.19	0.25	0.27	0.29	0.32	0.33	0.35	0.36	0.36	0.35
Yield (%)	4.20	3.50	3.27	3.09	2.90	2.73	2.61	2.52	2.36	2.23

A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	2.21	3.21	2.72	-0.50	-8.16	-8.16
IA Standard Money Market	**0.18**	**0.67**	**0.59**	**0.00**	**-0.08**	**-0.10**
Risk Grade 2	4.34	5.58	4.99	-1.67	-11.70	-11.70
Risk Grade 3	5.14	6.42	5.93	-2.05	-12.07	-12.07
Risk Grade 4	5.87	7.15	7.29	-2.56	-12.14	-12.14
IA Mixed Investment 0-35 Shares	**5.55**	**6.10**	**6.47**	**-2.69**	**-13.28**	**-13.28**
Risk Grade 5	6.38	7.51	8.43	-3.14	-12.07	-12.07
Risk Grade 6	6.75	7.82	9.28	-3.55	-11.51	-13.37
IA Mixed Investment 20-60 Shares	**6.34**	**6.97**	**8.42**	**-3.30**	**-12.14**	**-12.89**
Risk Grade 7	7.15	8.15	9.68	-3.94	-11.30	-14.42
Risk Grade 8	7.61	8.54	10.75	-4.41	-10.77	-16.74
IA Mixed Investment 40-85 Shares	**7.30**	**8.36**	**10.25**	**-4.39**	**-12.54**	**-15.41**
Risk Grade 9	8.09	9.01	11.25	-4.86	-10.47	-17.45
Risk Grade 10	8.65	9.62	12.22	-5.32	-10.82	-18.83
IA Flexible Investment	**7.03**	**8.04**	**10.13**	**-4.31**	**-11.20**	**-15.53**

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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- All data sourced from FE fundinfo.

Get in touch

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