

Strategic Conviction

Quarterly Update, Q2 2024



Jasper Thornton-Boelman
Investment Director

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**

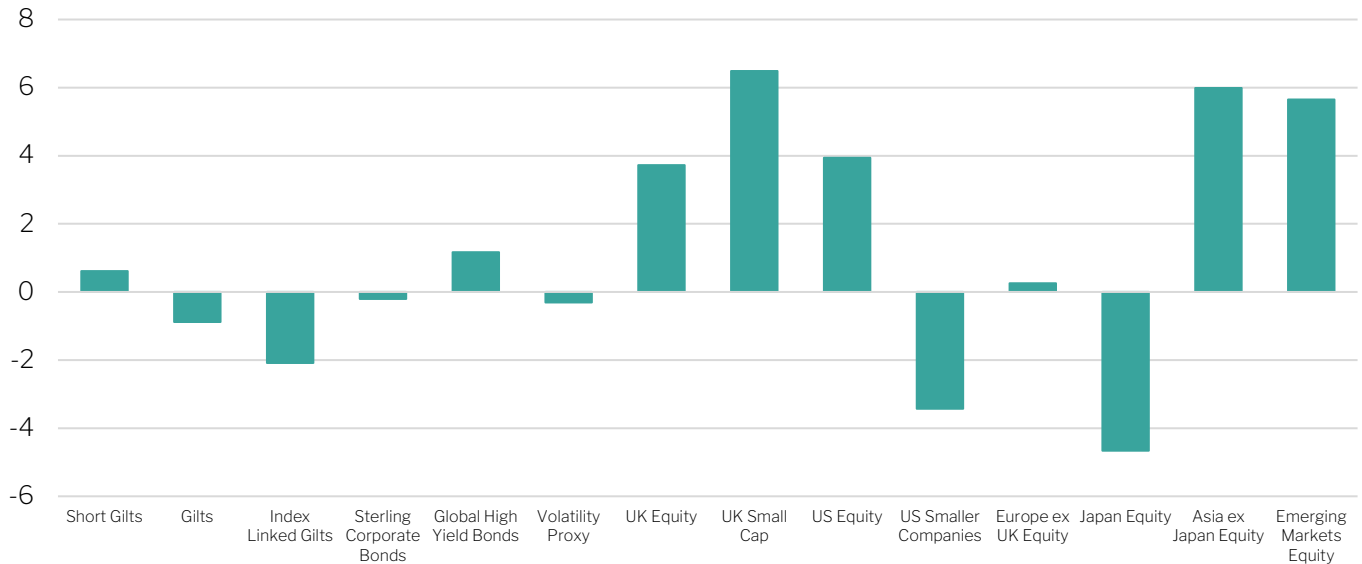
Voters are rallying, with elections taking place across the world.

- **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	0.79	1.47	5.09	0.19	1.41
IA Standard Money Market	1.29	2.60	5.44	8.81	9.61
Risk Grade 2	0.89	2.18	7.03	0.78	6.92
Risk Grade 3	1.20	3.23	8.71	3.57	12.46
Risk Grade 4	1.54	4.34	10.34	6.91	16.76
IA Mixed Investment 0-35% Shares	0.63	2.14	7.59	-2.46	5.57
Risk Grade 5	1.84	4.95	10.93	7.41	19.77
Risk Grade 6	2.18	5.90	11.93	9.32	23.51
IA Mixed Investment 20-60% Shares	1.14	3.65	9.38	2.83	15.20
Risk Grade 7	2.43	6.43	12.39	9.81	24.80
Risk Grade 8	2.79	7.15	12.91	10.61	29.47
IA Mixed Investment 40-85% Shares	1.67	5.91	11.82	7.19	25.58
Risk Grade 9	3.15	8.04	13.65	11.73	34.43
Risk Grade 10	3.49	8.93	14.50	12.38	40.02
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	4.77	-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?

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

This pattern means solution risk grades are sequential across all cumulative time periods, rewarding clients for the risk they've taken. In relative terms, all risk grades outperformed their benchmark over the quarter. The magnitude of outperformance generally increases with higher risk grades, with Risk Grade 10 returning more than double the IA Flexible sector average. Long term figures continue to be very favourable.

Asset classes

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 continued its upward trajectory. This is leading to significant concentration at the top of the US index.

Emerging markets and Asia Pacific ex Japan both also performed well over the quarter. Emerging market returns were driven mainly by the biggest countries within the index, China, Taiwan, and India with South Africa also performing well.

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, this was largely due to currency weakness.

Small caps were a drag on returns over the quarter. The negative return was driven particularly by US small caps, making up a significant part of the global small cap index. However, UK small caps delivered positive returns and our UK Small Cap manager provided extra alpha above its index to boost returns further.

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.

The solution uses entirely passive funds within the US Equity allocation, and this meant full participation in what was a strong upward market. Nvidia and the AI momentum continues to lead the way and there are not many active fund managers that have managed to keep up.

In aggregate, our emerging market managers performed in line with the wider market. Schroder had a strong month, offset by JPM and Blackrock lagging a little.

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.

Active / Passive Splits

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	●	●	●	●	●

Fund changes

No changes this quarter.

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
Global Smaller Companies	0.00	0.00	0.00	0.00	1.50	2.50	3.50	5.00	6.50	8.00
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	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 (%)	4.38	3.59	3.33	3.14	2.92	2.73	2.59	2.49	2.31	2.14

A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	2.10	3.23	2.73	-0.23	-8.16	-8.16
IA Standard Money Market	0.08	0.66	0.62	0.00	-0.08	-0.10
Risk Grade 2	4.23	5.58	5.01	-1.49	-11.70	-11.70
Risk Grade 3	5.01	6.40	5.95	-2.05	-12.07	-12.07
Risk Grade 4	5.71	7.12	7.27	-2.56	-12.14	-12.14
IA Mixed Investment 0-35 Shares	5.49	6.09	6.47	-2.37	-13.28	-13.28
Risk Grade 5	6.22	7.44	8.36	-3.14	-12.07	-12.07
Risk Grade 6	6.64	7.74	9.18	-3.55	-11.51	-13.37
IA Mixed Investment 20-60 Shares	6.23	6.89	8.36	-3.30	-12.14	-12.89
Risk Grade 7	7.03	8.03	9.55	-3.94	-11.30	-14.42
Risk Grade 8	7.50	8.39	10.52	-4.41	-10.77	-16.74
IA Mixed Investment 40-85 Shares	7.28	8.19	10.12	-4.39	-12.54	-15.41
Risk Grade 9	8.04	8.83	11.00	-4.86	-10.47	-17.45
Risk Grade 10	8.67	9.43	11.92	-5.32	-10.82	-18.83
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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If you'd like to chat to us about our Strategic Conviction 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

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