Parmenion
Investment Management

Strategic Guardian

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 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 re-evaluated.

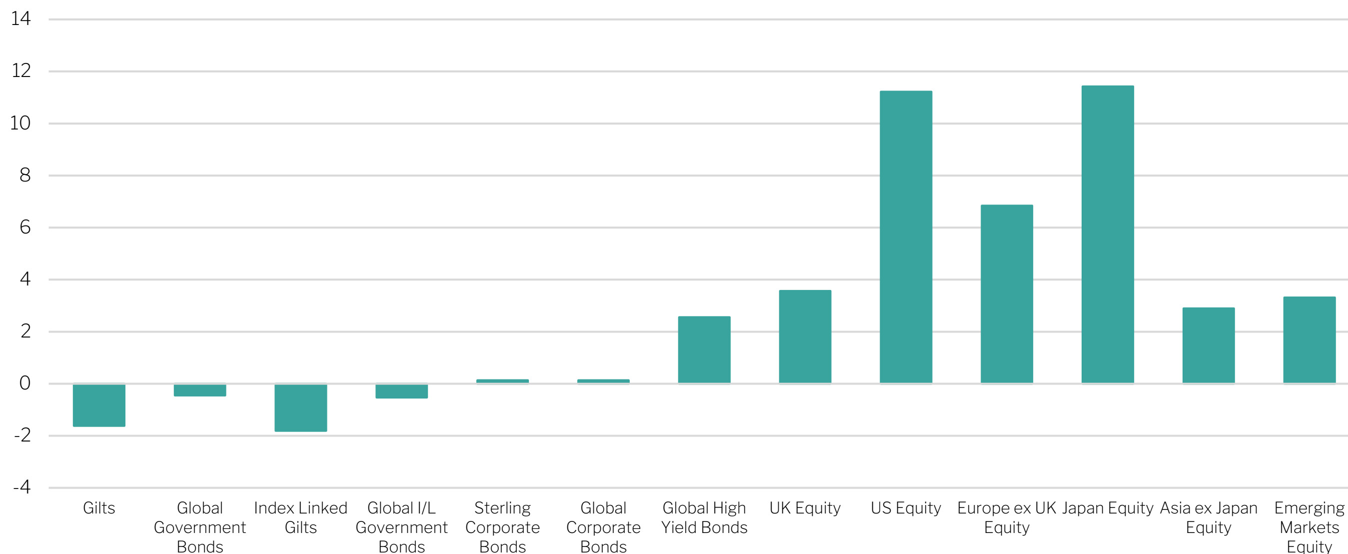
- **“Magnificent Seven” are not all magnificent**

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

For financial professionals only

What's been happening in Q1 2024?

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	0.56	0.56	3.91	1.31	3.17
IA Standard Money Market	**1.29**	**1.29**	**5.18**	**7.42**	**8.43**
Risk Grade 2	0.37	0.37	2.68	-3.70	0.50
Risk Grade 3	1.31	1.31	3.32	-3.45	3.22
Risk Grade 4	1.93	1.93	3.95	-1.98	8.06
IA Mixed Investment 0-35% Shares	**1.50**	**1.50**	**5.85**	**-0.64**	**7.48**
Risk Grade 5	2.38	2.38	4.38	-1.02	12.07
Risk Grade 6	2.86	2.86	5.26	1.06	17.40
IA Mixed Investment 20-60% Shares	**2.49**	**2.49**	**7.71**	**5.34**	**17.16**
Risk Grade 7	3.28	3.28	5.83	2.22	21.33
Risk Grade 8	3.61	3.61	6.13	2.64	24.56
IA Mixed Investment 40-85% Shares	**4.17**	**4.17**	**10.16**	**10.65**	**28.73**
Risk Grade 9	3.98	3.98	6.47	3.12	28.05
Risk Grade 10	4.33	4.33	6.98	3.08	30.65
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	4.68	-4.86	0.16	1.29	2.84
IA Standard Money Market	**4.74**	**1.28**	**-0.05**	**0.43**	**0.73**
Risk Grade 2	3.58	-9.76	1.37	2.63	5.55
Risk Grade 3	2.97	-10.98	2.96	3.64	7.65
Risk Grade 4	2.96	-11.32	5.06	4.67	10.02
IA Mixed Investment 0-35% Shares	**5.97**	**-10.87**	**2.84**	**3.90**	**8.70**
Risk Grade 5	2.97	-11.74	6.77	5.47	12.32
Risk Grade 6	3.49	-11.63	8.71	5.92	14.59
IA Mixed Investment 20-60% Shares	**6.81**	**-9.47**	**7.20**	**3.51**	**11.84**
Risk Grade 7	3.71	-11.73	10.02	6.56	16.34
Risk Grade 8	3.73	-11.93	10.86	7.64	17.91
IA Mixed Investment 40-85% Shares	**8.08**	**-10.04**	**10.94**	**5.32**	**15.78**
Risk Grade 9	3.84	-11.92	11.37	8.86	19.48
Risk Grade 10	4.13	-12.28	11.50	9.92	21.16
IA Flexible Investment	**7.08**	**-8.98**	**11.30**	**6.70**	**15.66**

What worked and what didn't?

Positive returns from all sub equity asset classes versus negative or flat returns from fixed income asset classes has led to higher risk models outperforming over the quarter.

A strong start to the year for equities has led to more standardised sequential alignment of performance with risk within the solution. The middle risk grades were in line or ahead of their sector benchmarks over the quarter, however the sequence risk protection embedded in Guardians approach naturally led to a drag in the lower risk grades given the risk-on environment for equities. The higher risk grades also lagged marginally due to higher exposures to Emerging Markets and smaller companies. Over the longer-term, performance is slightly behind as you'd expect in a rising market and the sequence risk protection in the solution.

Asset classes

Two regions dominated returns for the last quarter – Japan and the US, both delivering more than 11%. Large growth returned the most, but there was a reasonably broad contribution from across the spectrum.

Within Japan, the corporate governance guidance continued to improve valuation multiples, with an expectation that cash will be worked much harder. Elsewhere US Small Cap Equity offered good 3 month returns.

Returns of between 2% and 4% for Asia, Emerging Markets, and the UK asset classes were more than respectable for the quarter albeit far less than elsewhere. This is all the more positive given the unloved nature of both regions. The UK has had a strong month, with the Bank of England signposting of potential rate cuts leading to market support.

Elsewhere, in a quarter where risk assets thrived, Hedge Assets held up well, being broadly flat. Also of benefit to portfolios was the short-dated bond allocation – returns were flat in an environment where Government Bond yields rose.

UK Gilts and UK Index Linked gilts were the only asset classes providing negative returns for the quarter. Having rallied over 8% in Q4 2023 on expectations of 6 rate cuts for 2024, returns for Q1 have seen some of this given back. However, both asset classes are down less than 2% which is still a healthy 6-month return. Markets don't move in straight lines, and the losses this month are a tempering of rate expectations rather than a reversal of the trend.

Manager selection

On an absolute basis Morant Wright Nippon Yield and Amund Pioneer US Growth performed the strongest, aligning to the outperformance seen at the asset class level. Morant Wright in particular plays into the corporate governance rule changes given its value approach.

On a relative basis, Artemis Income performed very well, up almost 6% compared to the benchmark return of less than 3%. Goldman Sachs Emerging Markets also outperformed its benchmark, up 5.1% compared to the FTSE Emerging up 3.3%

Our two Asia ex Japan funds complemented each other, producing a good outcome at the asset class level. Veritas was up 2.87% whereas Schroder Asian Income was up 3.48%. With the benchmark up 2.89% the asset class offered a good relative return in a balanced way.

Elsewhere Fidelity European continues to deliver consistent returns, matching the benchmark in the short-term but delivering strong alpha over the long-term.

Our largest relative underperformance came from Jupiter Japan Income. This fund blends with Morant Wright which as a small cap value manager has benefited the most from the structural reform. Jupiter is the foil for Morant Wright and thus is behaving as expected.

Elsewhere JPM EM Small Cap lagged the Emerging Markets benchmark, having been the standout performer for the last year – it is however in line or ahead of benchmark on a medium to long time horizon.

Fund changes

Sell	Buy
Liontrust UK Smaller Companies	**Gresham House UK Smaller Companies**

The Liontrust UK Smaller Companies fund has generally been positive for portfolios over the longer term, although it's been more challenging in recent years. This is in part a function of the quality growth approach embedded in process and philosophy.

While we still hold the team in high regard, the fund is one of the most expensive in its peer group. In contrast we have developed high confidence in the process and team of the Gresham House UK Smaller Companies fund. The fund has a more balanced style approach, meaning alpha is less dependent on style tailwinds, and the OCF is far more competitive.

Asset allocation (%)

Risk Grade	1	2	3	4	5	6	7	8	9	10
Managed Liquidity	60.00	22.50	16.50	12.75	9.00	7.25	5.25	3.00	1.50	0.00
Short Dated Bonds	12.75	20.00	14.50	11.50	8.50	7.25	5.50	3.75	2.00	0.00
UK Gilts	7.75	12.25	9.25	7.50	6.50	5.25	4.00	3.00	1.50	0.00
Index Linked Government Bonds	6.50	10.25	7.25	6.00	5.25	4.25	3.25	2.50	1.50	0.00
Sterling Corporate Bonds	7.00	9.75	6.00	3.75	3.25	2.75	2.25	1.75	1.00	0.00
Global High Yield Bonds	3.50	4.25	1.50	1.00	1.00	1.00	0.75	0.50	0.00	0.00
Hedge Assets	2.50	11.00	15.00	15.50	14.50	11.25	8.00	5.50	2.50	0.00
UK Equity Income	0.00	1.25	3.50	5.00	6.50	8.00	9.50	11.00	12.25	13.25
Large Cap UK Equity Growth	0.00	1.00	3.00	4.00	4.25	4.50	4.50	4.50	5.00	6.00
UK Mid Cap Equity	0.00	0.50	1.25	1.50	1.50	1.75	2.50	3.00	3.50	4.75
UK Small Cap Equity	0.00	0.50	1.25	1.25	1.50	1.75	2.25	3.00	3.50	4.50
US Equity	0.00	2.25	6.75	9.50	11.25	13.50	15.25	16.75	17.25	17.25
US Equity Small Cap	0.00	0.50	1.75	3.50	5.00	6.50	8.00	10.00	12.50	14.00
Europe ex UK Equity	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.50	3.25
Japan Equity	0.00	1.00	2.75	3.50	3.75	3.50	2.75	1.25	0.00	0.00
Asia Pacific ex Japan Equity	0.00	1.25	4.50	6.50	8.75	10.75	13.25	15.25	16.75	17.00
Emerging Markets Equity	0.00	1.75	5.25	7.25	9.50	10.75	13.00	15.25	17.75	20.00

OCF & Yield

Risk Grade	1	2	3	4	5	6	7	8	9	10
OCF (%)	0.17	0.34	0.48	0.56	0.61	0.63	0.66	0.70	0.73	0.78
Yield (%)	4.11	2.95	2.46	2.22	2.07	2.05	2.00	1.92	1.85	1.82

A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	2.39	2.85	2.42	-1.01	-6.31	-6.31
IA Standard Money Market	**0.18**	**0.67**	**0.59**	**0.00**	**-0.08**	**-0.10**
Risk Grade 2	4.06	4.91	4.35	-2.77	-11.43	-11.43
Risk Grade 3	4.36	5.66	5.34	-2.55	-12.84	-12.84
Risk Grade 4	4.81	6.31	6.47	-2.29	-13.43	-13.43
IA Mixed Investment 0-35 Shares	**5.55**	**6.10**	**6.47**	**-2.69**	**-13.28**	**-13.28**
Risk Grade 5	5.46	7.11	7.75	-2.59	-14.20	-14.20
Risk Grade 6	6.14	7.79	9.02	-2.91	-14.35	-14.35
IA Mixed Investment 20-60 Shares	**6.34**	**6.97**	**8.42**	**-3.30**	**-12.14**	**-12.89**
Risk Grade 7	7.03	8.51	10.14	-3.82	-14.65	-14.91
Risk Grade 8	7.93	9.18	11.23	-4.82	-14.89	-16.86
IA Mixed Investment 40-85 Shares	**7.30**	**8.36**	**10.25**	**-4.39**	**-12.54**	**-15.41**
Risk Grade 9	8.92	9.86	12.39	-5.94	-15.39	-18.97
Risk Grade 10	9.80	10.60	13.51	-6.94	-16.53	-20.97
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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