

# Strategic Passive

Quarterly Update, Q2 2024



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## 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**

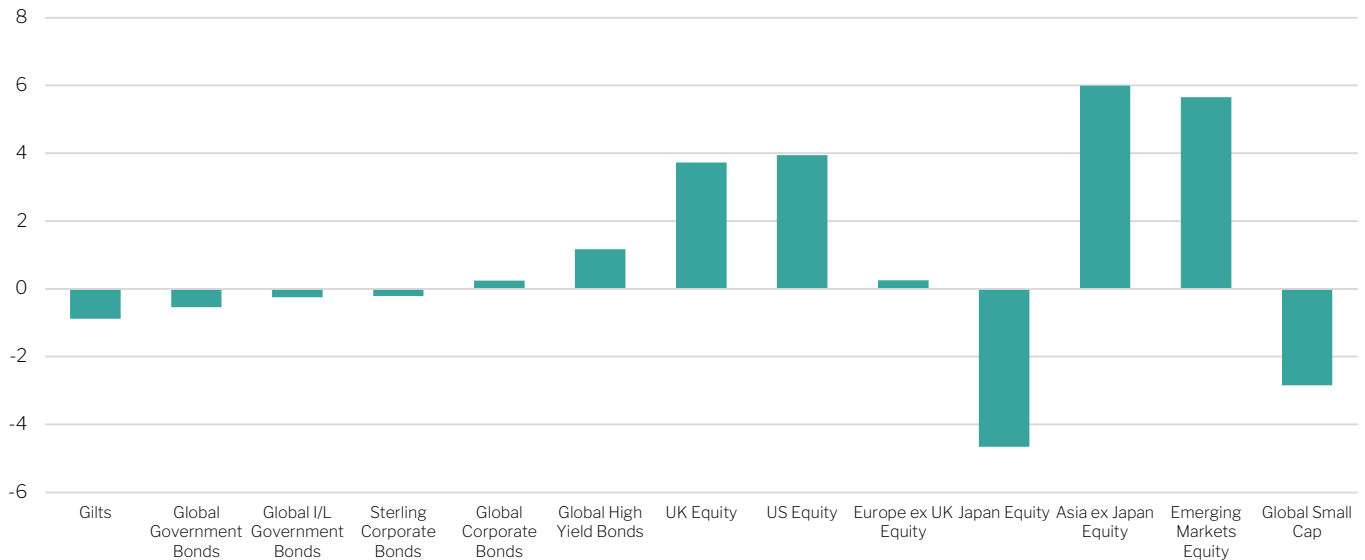
Voters are rallying, with elections taking place across the world.

- **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	0.80	1.50	5.09	-0.12	0.77
<b>IA Standard Money Market</b>	<b>1.29</b>	<b>2.60</b>	<b>5.44</b>	<b>8.81</b>	<b>9.61</b>
Risk Grade 2	0.90	2.33	7.10	1.15	5.93
Risk Grade 3	1.21	3.45	8.83	4.59	11.65
Risk Grade 4	1.56	4.64	10.53	8.69	15.67
<b>IA Mixed Investment 0-35% Shares</b>	<b>0.63</b>	<b>2.14</b>	<b>7.59</b>	<b>-2.46</b>	<b>5.57</b>
Risk Grade 5	1.88	5.39	11.48	10.23	19.83
Risk Grade 6	2.22	6.46	12.72	13.14	24.59
<b>IA Mixed Investment 20-60% Shares</b>	<b>1.14</b>	<b>3.65</b>	<b>9.38</b>	<b>2.83</b>	<b>15.20</b>
Risk Grade 7	2.49	7.09	13.44	14.14	26.46
Risk Grade 8	2.89	7.96	14.36	15.90	32.76
<b>IA Mixed Investment 40-85% Shares</b>	<b>1.67</b>	<b>5.91</b>	<b>11.82</b>	<b>7.19</b>	<b>25.58</b>
Risk Grade 9	3.27	9.00	15.46	17.98	39.54
Risk Grade 10	3.62	10.03	16.66	19.51	47.21
<b>IA Flexible Investment</b>	<b>1.71</b>	<b>6.27</b>	<b>11.78</b>	<b>7.27</b>	<b>28.57</b>

## 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	4.69	-6.73	-0.81	1.87	2.14
<b>IA Standard Money Market</b>	<b>4.74</b>	<b>1.28</b>	<b>-0.05</b>	<b>0.43</b>	<b>0.73</b>
Risk Grade 2	6.21	-9.73	3.51	2.68	6.36
Risk Grade 3	7.26	-9.40	6.01	2.53	8.33
Risk Grade 4	8.26	-8.56	8.57	-0.29	10.74
<b>IA Mixed Investment 0-35% Shares</b>	<b>5.97</b>	<b>-10.87</b>	<b>2.84</b>	<b>3.90</b>	<b>8.70</b>
Risk Grade 5	8.37	-7.98	9.69	0.13	13.47
Risk Grade 6	8.87	-6.86	10.88	-0.10	15.15
<b>IA Mixed Investment 20-60% Shares</b>	<b>6.81</b>	<b>-9.47</b>	<b>7.20</b>	<b>3.51</b>	<b>11.84</b>
Risk Grade 7	8.96	-6.51	11.60	-0.30	15.09
Risk Grade 8	9.12	-5.83	12.62	1.68	16.62
<b>IA Mixed Investment 40-85% Shares</b>	<b>8.08</b>	<b>-10.04</b>	<b>10.94</b>	<b>5.32</b>	<b>15.78</b>
Risk Grade 9	9.52	-5.31	13.71	3.98	17.01
Risk Grade 10	10.12	-5.23	14.44	7.15	18.54
<b>IA Flexible Investment</b>	<b>7.08</b>	<b>-8.98</b>	<b>11.30</b>	<b>6.70</b>	<b>15.66</b>

# What worked and what didn't?

Despite marginally negative returns from gilts and UK corporate bonds, the high managed liquidity rates and positive UK and US equities meant all risk grades delivered positive returns over the quarter.

Returns are now fully aligned across risk grades and periods. All periods and risk grades show positive returns, except for Risk Grade 1 over three years, which returned -0.12%. This reflects a challenging period for lower-risk investors, as the rate hiking cycle of 2022 and 2023 resulted in negative returns from bonds.

All models continue to outperform their respective IA benchmarks over all cumulative time periods.

## Asset classes

Equity returns were mixed over the quarter. UK, Asia Pacific ex Japan and emerging markets continued to perform well. 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 continued 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 40bp range between 4.00 and 4.40%. The 10-year yield ultimately ended the month slightly above where it started. This led to marginally negative returns despite still high absolute yields.

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

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. UK small caps however delivered positive returns as did Asia and emerging markets. Japanese small caps were the worst performing region returning -5.84%. The allocation to Japanese small caps within the global index is small relative to the US though.

Japanese equities were the lowest 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.

## Fund changes

There were no changes made to any of the passive funds used within the solution over Q2 and also following the strategic asset allocation change in Q1 we made no further changes in Q2.

We will carry out half-yearly passive due diligence in July using data to the end of Q2 - and will produce a report on our findings in due course. While it's unlikely, this could lead to a passive fund switch in Q3.

## 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 (%)	0.15	0.14	0.14	0.14	0.14	0.15	0.15	0.14	0.13	0.11
Yield (%)	4.27	3.44	3.20	3.04	2.88	2.74	2.64	2.60	2.48	2.37

## A view on risk

	Volatility (%)			Max Drawdown (%)		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	2.21	2.73	2.23	-0.28	-5.57	-5.57
<b>IA Standard Money Market</b>	<b>0.08</b>	<b>0.66</b>	<b>0.62</b>	<b>0.00</b>	<b>-0.08</b>	<b>-0.10</b>
Risk Grade 2	4.42	5.49	4.96	-1.45	-11.52	-11.52
Risk Grade 3	5.21	6.34	5.90	-2.02	-12.28	-12.28
Risk Grade 4	5.91	6.91	6.95	-2.55	-10.98	-10.98
<b>IA Mixed Investment 0-35 Shares</b>	<b>5.49</b>	<b>6.09</b>	<b>6.47</b>	<b>-2.37</b>	<b>-13.28</b>	<b>-13.28</b>
Risk Grade 5	6.35	7.34	7.76	-3.14	-10.85	-10.85
Risk Grade 6	6.73	7.78	8.61	-3.55	-11.17	-11.56
<b>IA Mixed Investment 20-60 Shares</b>	<b>6.23</b>	<b>6.89</b>	<b>8.36</b>	<b>-3.30</b>	<b>-12.14</b>	<b>-12.89</b>
Risk Grade 7	7.08	8.20	9.70	-3.95	-10.68	-13.80
Risk Grade 8	7.49	8.64	10.58	-4.42	-10.54	-15.27
<b>IA Mixed Investment 40-85 Shares</b>	<b>7.28</b>	<b>8.19</b>	<b>10.12</b>	<b>-4.39</b>	<b>-12.54</b>	<b>-15.41</b>
Risk Grade 9	7.98	9.12	11.21	-4.85	-11.40	-15.94
Risk Grade 10	8.59	10.21	12.67	-5.29	-14.45	-17.31
<b>IA Flexible Investment</b>	<b>6.98</b>	<b>7.81</b>	<b>9.97</b>	<b>-4.31</b>	<b>-11.20</b>	<b>-15.53</b>

## 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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