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Quarterly Investment Review

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Grayside
Quarterly Portfolio Review
July 2021

Background

The asset allocations and fund selections are reviewed formally on a quarterly basis. This Quarterly Review documents the review that has taken place and any changes resulting from it.

To put this review in context, it should be read in conjunction with our investment bulletin issued earlier in the month.

Quarterly Market Commentary

In the second quarter of 2021, global equities extended their strong run, with most major equity markets posting positive returns. The Covid-19 vaccination roll-out across the developed world has continued with relative success, particularly in countries like the USA and the UK, although the emergence of new strains such as the delta variant has proved problematic. Data would suggest, however, that despite an increase in the rate of infection, there does not appear to be a material increase in the number of deaths or hospitalisations attributable to Covid-19. Some governments, including in the UK, have seen this as sufficient evidence of the efficacy of the measures deployed to fight the virus to begin opening up their economies once more. Fiscal and monetary support remain in place and are unlikely to be removed in the short-term to ensure that the economic recovery is sufficiently robust.

Inflation expectations continue to be a key driver of returns across a range of markets. Investors are looking to understand whether the recent return of inflation is a long-term trend or merely a transitory consequence of the significant disruption to global supply chains and economic fallout resulting from the pandemic. It would appear conviction in the former is beginning to wane, and the value investment style lagged growth and quality during the second quarter. Currency movements continue to exhibit volatility with the US dollar strengthening markedly against sterling during the quarter before reversing the shift and ending the period slightly down. Sterling weakened against the euro and a basket of emerging currencies, enhancing returns from these regions for UK-based investors.

The UK equity market delivered another quarter of positive returns but underperformed the US and Europe. Growth and quality outperformed value and higher yielding stocks by a significant margin. Smaller companies performed better than mid-caps, with large caps achieving a return broadly in line with the wider market.

The US market led major equity indices over the quarter, producing a strong return following significant outperformance from large cap growth stocks. Small cap companies bucked the general trend as value slightly outperformed growth at this end of the market cap spectrum. There were generally positive returns in most Asia Pacific and emerging market countries, but headline returns for the regions were muted due to weak performance from the Chinese market, which makes up a large proportion of the regional indices. The main Japanese market was one of the few to finish the quarter in negative territory for sterling-investors, impacted by the underperformance of growth relative to value as well as a slightly weaker yen.

In a reversal of quarter one, most major fixed income indices achieved a positive return in the second quarter. UK index-linked gilts were the top performers, although this was not enough to fully offset losses in the year to date. Conventional gilts also delivered positive returns, particularly at the long end of the yield curve where changes in long-term interest rate expectations have a more pronounced effect. Emerging market debt was the next best performer, in sharp contrast to the previous quarter. Global high yield and inflation linked bonds typically outperformed investment grade and global government bonds. Short dated US Treasuries and Treasury Bills struggled to make headway.

In other asset classes, UK commercial property returns were marginally positive, as cautious optimism began to return to a sector which has seen significant headwinds since the pandemic began. Globally, property securities continued to perform strongly, being lifted alongside equity markets more broadly, with the US and Europe producing the strongest returns. Asia excluding Japan was the exception, with a negative return for sterling-based investors for the quarter. The oil price continues to rise unabated, a little over a year since the price turned negative in some markets. Gold and silver arrested their recent slide with returns returning to positive territory.

Comparative Performance - Benchmarks

Each of the portfolios has a composite benchmark for performance comparison purposes whose underlying constituents represent the sector averages for each fund selected within the portfolio (e.g. IA UK Gilt for any UK gilt holdings and IA UK All Companies for any UK equity growth).

Strategic Asset Allocations

We made some changes to the high-level asset allocations in last quarterly review, which became effective from 1st May. We are not proposing any changes in this review.

Below are the strategic asset allocations that became effective from 1st May 2021:

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
Cash	2.00%	2.00%	2.00%	2.00%	2.00%
UK Equities	7.50%	20.00%	29.00%	36.00%	38.00%
International Equities	7.50%	20.00%	29.00%	42.00%	60.00%
Property	10.00%	10.00%	10.00%	10.00%	0.00%
Fixed Interest	58.00%	36.00%	25.00%	10.00%	0.00%
Absolute Return	15.00%	12.00%	5.00%	0.00%	0.00%
Others	0.00%	0.00%	0.00%	0.00%	0.00%

Growth Portfolios

Portfolio Allocations

The tables below show the model asset allocations of the Growth model portfolios, as at the end of June 2021, and the differences to the strategic asset allocations:

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
Cash	2.00%	2.00%	2.00%	2.00%	2.00%
UK Equities	8.50%	21.00%	30.00%	37.00%	38.00%
International Equities	8.50%	21.00%	30.00%	44.00%	60.00%
Property	2.00%	2.00%	2.00%	2.00%	0.00%
Fixed Interest	57.00%	34.00%	22.00%	7.00%	0.00%
Absolute Return	16.00%	14.00%	8.00%	5.00%	0.00%
Others	6.00%	6.00%	6.00%	3.00%	0.00%

Differences to SAA

Risk Level	Cautious	Balanced	Progressive	Adventurous	Specialist
Asset Allocation	**%**	**%**	**%**	**%**	**%**
Cash	0.00%	0.00%	0.00%	0.00%	0.00%
UK Equities	1.00%	1.00%	1.00%	1.00%	0.00%
International Equities	1.00%	1.00%	1.00%	2.00%	0.00%
Property	-8.00%	-8.00%	-8.00%	-8.00%	0.00%
Fixed Interest	-1.00%	-2.00%	-3.00%	-3.00%	0.00%
Absolute Return	1.00%	2.00%	3.00%	5.00%	0.00%
Others	6.00%	6.00%	6.00%	3.00%	0.00%

Cautious Growth Portfolio

The Cautious Growth Portfolio produced a good, positive return but underperformed its composite benchmark, although it did outperform its most comparable IA sector average, albeit not significantly. The portfolio is marginally overweight equities, which was positive, although the small overweight to the UK was negative given its relative underperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was another positive. The latest 1-year portfolio volatility figure has decreased versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure remains comfortably below that of the benchmark. The portfolio's average 1-yr volatility since launch remains just below that of the benchmark.

Only having a small exposure to conventional UK gilts and global government bonds was positive for relative performance but the lack of exposure to UK index-linked gilts was a key negative within fixed income. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. There were no significant outperformers or underperformers within the fixed income fund selections, although the majority of funds underperformed their respective IA sector average. The best performers in absolute terms were M&G Emerging Markets Bond and Rathbone Ethical Bond.

The portfolio has 17% in direct equity funds with an equal focus on UK and international equities. Two of the three UK equity funds outperformed the UK All Companies sector average whilst the Ninety One UK Alpha fund only underperformed by a relatively small margin. Two of the three global equity funds outperformed the IA Global sector average with the Troy Trojan Global Equity fund producing a strong, double-digit return. The fund's bias towards quality growth was a definite positive this quarter and a number of the fund's largest holdings (Alphabet, PayPal, Microsoft, Facebook) performed well. By contrast, the value-focused Ninety One Global Special Situations fund underperformed by a large margin, suffering from not holding some of these high growth global stocks and seeing small negative/lower returns from its portfolio holdings. The impact was lessened due to the smaller portfolio weighting.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There were good returns from Liontrust Diversified Real Assets and VT Gravis Infrastructure Income, the latter comfortably outperforming conventional direct commercial property. Returns from the remaining funds were relatively muted with the Ninety One Diversified Income fund the largest underperformer relative to its IA sector average.

Changes

We are recommending a number of portfolio changes this quarter. Performance of the ASI Global Inflation Linked Bond fund has been a little disappointing, struggling to outperform its own benchmark on a consistent basis. We recommend replacing this with the **L&G Global Inflation Linked Bond Index** fund, which does not invest in UK index-linked bonds. At the same time, we recommend replacing the iShares UK Gilts All Stocks fund with the **iShares Index Linked Gilt Index** fund, as we now have a slightly more positive view on UK index-linked bonds relative to conventional gilts, although we recommend having a higher weighting to the global fund versus the UK-only fund.

We have become a little more negative on the outlook for corporate bonds and we would like to reflect this within the portfolio by reducing exposure to investment grade and strategic bonds. This will be reallocated to some of the more defensive fixed income funds, namely BNY Mellon, Nomura and TwentyFour.

Balanced Growth Portfolio

The Balanced Growth Portfolio produced a good positive return but underperformed its composite benchmark, although it outperformed its most comparable IA sector average, albeit not significantly. The portfolio is marginally overweight equities and underweight fixed income, which was positive, although the small overweight to the UK was negative given its relative underperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was another positive. The latest 1-year portfolio volatility figure has decreased versus the last quarter, which is the same for the composite benchmark. The latest portfolio figure remains below that of the benchmark and the portfolio's average 1-yr volatility since launch remains just below that of the benchmark.

Only having a small exposure to conventional UK gilts and global government bonds was positive for relative performance but the lack of exposure to UK index-linked gilts was a key negative within fixed income. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. There were no significant outperformers or underperformers within the fixed income fund selections, although the majority of funds underperformed their respective IA sector average. The best performers in absolute terms were M&G Emerging Markets Bond and Rathbone Ethical Bond whilst the M&G Global Macro Bond fund produced the smallest positive return.

The portfolio has 42% in direct equity funds with an equal focus on UK and international equities. Only two of the five UK equity funds outperformed the UK All Companies sector average with the largest underperformance coming from the value-focused Schroder Recovery fund. Three of the four global equity funds outperformed the IA Global sector average with the Troy Trojan Global Equity fund producing a strong, double-digit return. The fund's bias towards quality growth was a definite positive this quarter and a number of the fund's largest holdings (Alphabet, PayPal, Microsoft, Facebook) performed well. By contrast, the value-focused Ninety One Global Special Situations fund underperformed by a large margin, suffering from not holding some of these high growth global stocks and seeing small negative/lower returns from its portfolio holdings. The impact was lessened due to the slightly smaller portfolio weighting.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There were good returns from Liontrust Diversified Real Assets and VT Gravis Infrastructure Income, the latter comfortably outperforming conventional direct commercial property. Returns from the remaining funds were relatively muted with the Ninety One Diversified Income fund the largest underperformer relative to its IA sector average.

Changes

We are recommending a number of portfolio changes this quarter. Performance of the ASI Global Inflation Linked Bond fund has been a little disappointing, struggling to outperform its own benchmark on a consistent basis. We recommend replacing this with the **L&G Global Inflation Linked Bond Index** fund, which does not invest in UK index-linked bonds. At the same time, we recommend replacing the iShares UK Gilts All Stocks fund with the **iShares Index Linked Gilt Index** fund, as we now have a slightly more positive view on UK index-linked bonds relative to conventional gilts, although we recommend having a higher weighting to the global fund versus the UK-only fund.

We have become a little more negative on the outlook for corporate bonds and we would like to reflect this within the portfolio by reducing exposure to investment grade and strategic bonds. This will be reallocated to the more defensive BNY Mellon fund.

Progressive Growth Portfolio

The Progressive Growth Portfolio produced a good positive return but very marginally underperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities and underweight fixed income, which was positive, although the small overweight to the UK was negative given its relative underperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was another positive. The latest 1-year portfolio volatility figure has decreased versus the last quarter, which is the same for the composite benchmark. The latest portfolio figure is slightly higher than that of the benchmark and the portfolio's average 1-yr volatility since launch remains just above that of the benchmark.

Having no exposure to conventional UK gilts and only small exposure to global government bonds was positive for relative performance but the lack of exposure to UK index-linked gilts was a key negative within fixed income. Exposure to more flexible funds was mixed based on individual fund performance. There were no significant outperformers or underperformers within the fixed income fund selections, although the majority of funds underperformed their respective IA sector average. The best performers in absolute terms were M&G Emerging Markets Bond and Rathbone Ethical Bond whilst the M&G Global Macro Bond fund produced the smallest positive return.

Half of the six UK equity funds outperformed the UK All Companies sector average . There was strong outperformance from the Premier Miton UK Value Opportunities fund with a number of stocks across the portfolio producing strong returns, including some of the top holdings such as Reach and Ashtead. The largest underperformance came from the value-focused Schroder Recovery fund. Two of the three global equity funds outperformed the IA Global sector average with the Troy Trojan Global Equity fund producing a strong, double-digit return. The fund's bias towards quality growth was a definite positive this quarter and a number of the fund's largest holdings (Alphabet, PayPal, Microsoft, Facebook) performed well. By contrast, the value-focused Ninety One Global Special Situations fund underperformed by a large margin, suffering from not holding some of these high growth global stocks and seeing small negative/lower returns from its portfolio holdings. The impact was lessened due to the slightly smaller portfolio weighting.

Within the regional equity funds there were small negative returns from the Baillie Gifford Japanese Income Growth and Invesco Asian funds, the latter leading to large underperformance relative to its sector average. There was good outperformance from the JPM Japan fund, which benefited from the return to strong outperformance from growth stocks, whilst the remaining funds performed relatively close to their respective sector averages.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There were good returns from Liontrust Diversified Real Assets and VT Gravis Infrastructure Income, the latter comfortably outperforming conventional direct commercial property. Returns from the two absolute return funds were relatively muted.

Changes

We have become a little more negative on the outlook for corporate bonds and we would like to reflect this within the portfolio by reducing exposure to investment grade and strategic bonds. This will be reallocated to a new holding, **BNY Mellon Global Dynamic Bond**, which is already held in the lower risk portfolios.

Adventurous Growth

The Adventurous Growth Portfolio produced a good return and outperformed its composite benchmark, although it underperformed its most comparable IA sector average. The portfolio is marginally overweight equities and underweight fixed income, which was positive, although the small overweight to the UK was negative given its relative underperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was another positive. The latest 1-year portfolio volatility figure has decreased significantly versus the last quarter, which is the same for the composite benchmark. The latest portfolio figure is slightly below that of the benchmark but the portfolio's average 1-yr volatility since launch remains above that of the benchmark, albeit not significantly.

The preference for credit/strategic bonds over government bonds was positive for relative performance. Fund selection was a little disappointing, as both strategic bond funds underperformed their sector average, albeit not significantly.

The portfolio has 81% in direct equity funds with a bias towards international equities. Three of the seven UK equity funds outperformed the UK All Companies sector average. There was strong outperformance from the Premier Miton UK Value Opportunities fund with a number of stocks across the portfolio producing strong returns, including some of the top holdings such as Reach and Ashtead. The largest underperformance came from the value-focused Schroder Recovery fund.

Within the regional equity funds there were small negative returns from the Baillie Gifford Japanese Income Growth and Invesco Asian funds, the latter leading to large underperformance relative to its sector average. By contrast there was significant outperformance from the Baillie Gifford Pacific fund, benefiting from the strong outperformance of growth stocks but also from strong individual stock performance across the portfolio. There was good outperformance from the FSAA Japan Focus and JPM Japan funds, which both benefited from the return to strong outperformance from growth stocks, plus strong outperformance from the BlackRock European Dynamic fund. This benefited from positive sector positioning and strong stock selection. The main underperformer was Premier Miton US Opportunities, which suffered from the lack of exposure to any of the largest tech stocks within the US market (e.g. Apple, Alphabet, Facebook, Microsoft, Amazon, Nvidia), whilst the remaining funds performed relatively close to their respective sector averages.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There was a good return from VT Gravis Infrastructure Income, comfortably outperforming conventional direct commercial property. Returns from the two absolute return funds were relatively muted.

Changes

We have become a little more negative on the outlook for corporate bonds and we would like to reflect this within the portfolio by reducing exposure to the two and strategic bond funds. This will be reallocated to a new holding, **BNY Mellon Global Dynamic Bond**, which is already held in the lower risk portfolios.

Specialist Growth Portfolio

The Specialist Growth Portfolio produced a good positive return and outperformed its composite benchmark, although it underperformed its most comparable IA sector average. The portfolio is fully invested in equities and is neutrally positioned in the UK and overseas versus the strategic asset allocation. The latest 1-year portfolio volatility figure has decreased versus the last quarter, which is the same for the composite benchmark. The latest portfolio figure is above that of the benchmark and the portfolio's average 1-yr volatility since launch remains above that of the benchmark, albeit not significantly.

Three of the seven UK equity funds outperformed the UK All Companies sector average. There was strong outperformance from the Premier Miton UK Value Opportunities fund with a number of stocks across the portfolio producing strong returns, including some of the top holdings such as Reach and Ashtead. The largest underperformance came from the value-focused Schroder Recovery fund.

Within the regional equity funds there were small negative returns from the Baillie Gifford Japanese Income Growth and Invesco Asian funds, the latter leading to large underperformance relative to its sector average. By contrast there was significant outperformance from the Baillie Gifford Pacific fund, benefiting from the strong outperformance of growth stocks but also from strong individual stock performance across the portfolio. Specific Chinese exposure would have been more positive but for reasonably large underperformance from Fidelity China Consumer, although it underperformed its own benchmark by a smaller margin. There was good outperformance from the FSAA Japan Focus and JPM Japan funds, which both benefited from the return to strong outperformance from growth stocks, plus strong outperformance from the BlackRock European Dynamic fund. This benefited from positive sector positioning and strong stock selection. The main underperformer was Premier Miton US Opportunities, which suffered from the lack of exposure to any of the largest tech stocks within the US market (e.g. Apple, Alphabet, Facebook, Microsoft, Amazon, Nvidia), whilst the remaining funds performed relatively close to their respective sector averages.

Changes

We are not recommending any changes this quarter.

Income Portfolios

Portfolio Allocations

The tables below show the current asset allocations of the Income model portfolios, as at the end of June 2021, and the differences to the strategic asset allocations:

Risk Level	Cautious	Balanced	Progressive
Asset Allocation	**%**	**%**	**%**
Cash	2.00%	2.00%	2.00%
UK Equities	8.00%	21.00%	30.00%
International Equities	8.00%	21.00%	30.00%
Property	2.00%	2.00%	2.00%
Fixed Interest	57.00%	34.00%	23.00%
Absolute Return	15.00%	12.00%	7.00%
Others	8.00%	8.00%	6.00%

Differences to SAA

Risk Level	Cautious	Balanced	Progressive
Asset Allocation	**%**	**%**	**%**
Cash	0.00%	0.00%	0.00%
UK Equities	0.50%	1.00%	1.00%
International Equities	0.50%	1.00%	1.00%
Property	-8.00%	-8.00%	-8.00%
Fixed Interest	-1.00%	-2.00%	-2.00%
Absolute Return	0.00%	0.00%	2.00%
Others	8.00%	8.00%	6.00%

Cautious Income Portfolio

The Cautious Income Portfolio produced a good positive return but marginally underperformed its composite benchmark and its most comparable IA sector average. The small overweight to equities and small underweight to fixed income were positive, although equity income generally underperformed in the UK and globally. The current historic yield is just under 2.8%. The latest 1-year portfolio volatility figure has reduced quite significantly versus the previous quarter, but this was also the case for the composite benchmark. The latest portfolio figure remains comfortably below that of the benchmark and the portfolio's average 1-yr volatility since launch remains marginally below that of the benchmark.

Having no direct exposure to UK conventional gilts, relatively low exposure to global government bonds and a preference for credit was positive for relative performance. Exposure to more flexible funds was mixed based on individual fund performance. There were no significant outperformers or underperformers within the fixed income fund selections, although the majority of funds underperformed their respective IA sector average. The best performers in absolute terms were M&G Emerging Markets Bond, Janus Henderson Strategic Bond and Rathbone Ethical Bond whilst the Royal London Short Duration Credit fund produced the smallest positive return.

The portfolio has 16% in direct equity funds with an equal weighting between UK and international equities. Both UK equity income funds outperformed their IA sector average, albeit not by large margins, but both global equity income funds underperformed their sector average. The greater value bias of the Schroder Global Equity Income fund was a detrimental factor whilst the covered call strategy on the Fidelity Global Enhanced Income fund held back returns during a strong period for equity markets.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There were good returns from Liontrust Diversified Real Assets and VT Gravis Infrastructure Income, the latter comfortably outperforming conventional direct commercial property. Returns from the remaining two funds were relatively muted with the Ninety One Diversified Income fund the largest underperformer relative to its IA sector average.

Changes

Although we have become a little more negative on the outlook for corporate bonds, this part of the portfolio is providing a decent level of income and going more defensive would mean sacrificing some of this income. In addition, the strategic bond funds are able to de-risk should they deem this appropriate. One change we would recommend is switching from the LeggMason Brandywine Global Fixed Income fund to the recently RSMR-rated **LeggMason Brandywine Global Income Optimiser** fund, which, as the name suggests, is more income focused and also has more asset class flexibility.

We have been advised about some changes to the Fidelity Global Enhanced Income fund that, we believe, are enough to revisit the fund's position in the portfolio with the underlying portfolio moving away from the RSMR-rated Fidelity Global Dividend fund to another Fidelity strategy. We would recommend replacing this with the **Fidelity Global Dividend** fund, as we continue to have confidence in this fund and the management team and this will retain the quality focus for this part of the allocation, albeit with a lower income.

Balanced Income Portfolio

The Balanced Income Portfolio produced a good positive return but marginally underperformed its composite benchmark and its most comparable IA sector average. The overweight to equities and underweight to fixed income were positive, although equity income generally underperformed in the UK and globally. The current historic yield is just under 2.9%. The latest 1-year portfolio volatility figure has reduced versus the previous quarter, but this was also the case for the composite benchmark. The latest portfolio figure remains below that of the benchmark whilst the portfolio's average 1-yr volatility since launch remains very marginally above that of the benchmark.
Having no direct exposure to UK conventional gilts, relatively low exposure to global government bonds and a preference for credit was positive for relative performance. Exposure to more flexible funds was mixed based on individual fund performance. There were no significant outperformers or underperformers within the fixed income fund selections, although the majority of funds underperformed their respective IA sector average. The best performers in absolute terms were M&G Emerging Markets Bond, Janus Henderson Strategic Bond and Rathbone Ethical Bond whilst the Royal London Short Duration Credit fund produced the smallest positive return.

The portfolio has 42% in direct equity funds with an equal weighting between UK and international equities. All four UK equity income funds outperformed their IA sector average with the largest outperformance coming from Marlborough Multi Cap Income. All four global equity income funds, however, underperformed their sector average. The greater value bias of the Schroder Global Equity Income fund was a detrimental factor whilst the covered call strategy on the Fidelity Global Enhanced Income fund held back returns during a strong period for equity markets.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There were good returns from Liontrust Diversified Real Assets and VT Gravis Infrastructure Income, the latter comfortably outperforming conventional direct commercial property. Returns from the remaining two funds were relatively muted with the Ninety One Diversified Income fund the largest underperformer relative to its IA sector average.

Changes

Although we have become a little more negative on the outlook for corporate bonds, this part of the portfolio is providing a decent level of income and going more defensive would mean sacrificing some of this income. In addition, the strategic bond funds are able to de-risk should they deem this appropriate. One change we would recommend is switching from the LeggMason Brandywine Global Fixed Income fund to the recently RSMR-rated **LeggMason Brandywine Global Income Optimiser** fund, which, as the name suggests, is more income focused and also has more asset class flexibility.

We have been advised about some changes to the Fidelity Global Enhanced Income fund that, we believe, are enough to revisit the fund's position in the portfolio with the underlying portfolio moving away from the RSMR-rated Fidelity Global Dividend fund to another Fidelity strategy. We would recommend replacing this with the **Fidelity Global Dividend** fund, as we continue to have confidence in this fund and the management team and this will retain the quality focus for this part of the allocation, albeit with a lower income.

Progressive Income Portfolio

The Progressive Income Portfolio produced a good positive return but marginally underperformed its composite benchmark and its most comparable IA sector average. The overweight to equities and underweight to fixed income were positive, although equity income generally underperformed in the UK and globally. The current historic yield is just over 3.2%. The latest 1-year portfolio volatility figure has reduced versus the previous quarter, but this was also the case for the composite benchmark. The latest portfolio figure is marginally above that of the benchmark whilst the portfolio's average 1-yr volatility since launch is now virtually equal to that of the benchmark.

Having no direct exposure to UK conventional gilts, relatively low exposure to global government bonds and a preference for credit was positive for relative performance. Exposure to more flexible funds was mixed based on individual fund performance. There were no significant outperformers or underperformers within the fixed income fund selections, although the majority of funds underperformed their respective IA sector average. The best performers in absolute terms were M&G Emerging Markets Bond, Janus Henderson Strategic Bond and Rathbone Ethical Bond.

The portfolio has 60% in direct equity funds with an equal split between UK and international equities. Four of the five UK equity income funds outperformed their IA sector average, the exception being the more value-biased Schroder Income Maximiser fund, with the largest outperformance coming from Marlborough Multi Cap Income. All four global equity income funds, however, underperformed their sector average. The greater value bias of the Schroder Global Equity Income fund was a detrimental factor whilst the covered call strategy on the Fidelity Global Enhanced Income fund held back returns during a strong period for equity markets.

Absolute return/alternatives exposure was mixed in terms of relative performance. There was a strong absolute return from Schroder Global Cities Real Estate, although it performed in line with its own benchmark. There were good returns from Liontrust Diversified Real Assets and VT Gravis Infrastructure Income, the latter comfortably outperforming conventional direct commercial property. Returns from the Ninety One fund was relatively muted with the fund being the largest underperformer relative to its IA sector average.

Changes

Although we have become a little more negative on the outlook for corporate bonds, this part of the portfolio is providing a decent level of income and going more defensive would mean sacrificing some of this income. In addition, the strategic bond funds are able to de-risk should they deem this appropriate. One change we would recommend is switching from the LeggMason Brandywine Global Fixed Income fund to the recently RSMR-rated **LeggMason Brandywine Global Income Optimiser** fund, which, as the name suggests, is more income focused and also has more asset class flexibility.

We have been advised about some changes to the Fidelity Global Enhanced Income fund that, we believe, are enough to revisit the fund's position in the portfolio with the underlying portfolio moving away from the RSMR-rated Fidelity Global Dividend fund to another Fidelity strategy. We would recommend replacing this with the **Fidelity Global Dividend** fund, as we continue to have confidence in this fund and the management team and this will retain the quality focus for this part of the allocation, albeit with a lower income.

SRI Portfolios

Strategic Asset Allocations

We made some changes to the high-level asset allocations in the October 2020 quarterly review. The current strategic asset allocations are:

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
Platform Charge	2.00%	2.00%	2.00%
UK Equities	7.50%	21.00%	30.50%
International Equities	7.50%	21.00%	28.00%
Specialist Equities	0.00%	0.00%	3.00%
Fixed Interest	72.00%	49.00%	31.50%
Others	0.00%	0.00%	0.00%
Cash	11.00%	7.00%	5.00%

Portfolio Allocations

The tables below show the model asset allocations of the SRI model portfolios, as at the end of June 2021, and the differences to the main strategic asset allocations:

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
Platform Charge	2.00%	2.00%	2.00%
UK Equities	7.00%	20.00%	28.50%
International Equities	8.00%	22.00%	30.00%
Specialist Equities	0.00%	0.00%	3.00%
Fixed Interest	64.00%	43.00%	26.50%
Others	6.00%	4.00%	3.00%
Cash	13.00%	9.00%	7.00%

Differences to SAA

Risk Level	SRI Cautious	SRI Balanced	SRI Progressive
Asset Allocation	**%**	**%**	**%**
Platform Charge	0.00%	0.00%	0.00%
UK Equities	-0.50%	-1.00%	-2.00%
International Equities	0.50%	1.00%	2.00%
Specialist Equities	0.00%	0.00%	0.00%
Fixed Interest	-8.00%	-6.00%	-5.00%
Others	6.00%	4.00%	3.00%
Cash	2.00%	2.00%	2.00%

Portfolio Performance and Volatility

All three portfolios produced good absolute returns but each underperformed its respective composite benchmark and most comparable IA sector average, albeit not significantly. The underweight to fixed income and preference for a multi-asset alternative was positive based on relative fund performance, although the small overweight to cash was negative. The latest 1-year portfolio volatility figures have reduced versus the previous quarter, but this was also the case for the composite benchmarks. The latest portfolio figures are all below those of the benchmarks and the portfolios' average 1-yr volatility since launch figures are also below those of the benchmarks.

Underlying Fund Performance

Most ethical fixed income funds do not invest in conventional UK gilts, which was positive for absolute returns this quarter, as they underperformed credit markets, although the lack of any index-linked gilt exposure within these funds was negative. Fund performance versus the fixed income index in the composite benchmark was negative overall with only two funds outperforming. The best performing funds were Rathbone Ethical Bond and Royal London Ethical Bond whilst the main underperformers were EdenTree Responsible and Sustainable Short Dated Bond and Threadneedle UK Social Bond.

Half of the six UK equity funds across the portfolios outperformed the main UK equity index and their respective IA sector average. There was particularly strong performance from BMO Responsible UK Equity whilst the main underperformer was Liontrust SF UK Growth.

Global equity fund selection was also disappointing, as only one fund, Quilter Investors Ethical Equity, outperformed the global equity index in the composite benchmark, although the Stewart Investors Worldwide Sustainability fund did outperform the IA sector average. The main underperformance came from Jupiter Ecology, although it did perform virtually in line with its own benchmark index.

There was a strong absolute return from the Troy Trojan Ethical fund and the fund outperformed its own IA sector average.

Changes

We would like to introduce the recently RSMR-rated **Royal London Sustainable Managed Income** fund into all the portfolios, as this will provide further diversification of approaches and styles within the fixed income allocation. The fund is managed by a different team to that of the Royal London Ethical Bond fund with, as the name suggests, a focus on sustainable investing as opposed to ethical investing. The existing fund weightings will be reduced to accommodate this new holding with a greater reduction to ethical-focused funds where required.

Summary

The economic recovery has continued into 2021 and, at the halfway point, most major equity markets are sitting on healthy returns year-to-date. Some immediate problems due to the pandemic and subsequent economic slowdown persist, but markets are fundamentally forward looking. Positive news flow surrounding vaccines appears to have led investors to look through the short-term noise to a longer-term economic expansion. The true long-term implications of the pandemic will not be fully realised for some time and the pandemic itself has reminded investors that unexpected events can and do happen.

Inflation is likely to play a key role in the short to medium term, with central banks and governments keen to support their respective economies by any means necessary. In the short-term, inflation was expected to exceed central bank targets due to base effects, whereby the extraordinary decrease in economic activity in the depths of the pandemic would create a lower basis for comparison a year later, artificially raising the rate of inflation. However, in addition to this technical aspect, other factors such as supply chain challenges and a potential labour shortage, coupled with the huge fiscal stimulus packages that have been introduced in the interim, have raised fears that higher inflation may be here to stay. This would call into question the viability of maintaining ultra-loose monetary policy over the medium to long term, and markets began to price in future interest rate rises more aggressively last year and throughout the first quarter of this year. This in turn added fuel to the rally in value stocks as well as increasing bond yields. Enthusiasm for this reflation trade abated during the second quarter, compressing yields and providing some respite for growth stocks that had underperformed during the period.

These themes, coupled with the speed at which market leadership changed in the final few months of 2020, highlight the importance of maintaining diversification across asset classes and within sector allocations. Taking a long-term view can help when navigating short-term headwinds.

In equities, market participants will have to guard against complacency as valuation metrics are near the top end of their historical ranges. This leaves less room to manoeuvre if sentiment turns or the recovery does not keep pace with expectations. What may not be apparent at index level is the heightened level of volatility in the underlying constituents that has accompanied the swift and aggressive style rotation in markets. Value strategies significantly outperformed growth and quality from November 2020 and throughout the first quarter of 2021, a trend that reversed in the second quarter. To attempt to predict which style will prevail for the remainder of 2021 and beyond is likely to be a fool's errand, but we do expect the growth versus value debate to continue to be a theme. That aside, and valuations notwithstanding, we remain slightly positive on equities generally. Question marks continue to surround Europe and it is the region we have least conviction in, preferring Asia, Japan, and UK mid and small caps. We have a neutral stance towards the US and emerging markets.

We have reaffirmed our negative medium to long-term view on fixed income as an asset class, although due to the inflationary background we slightly upgraded our view of UK Index-Linked gilts to negative, from very negative. Conversely, there was a small downgrade for investment grade corporate bonds, from neutral to slightly negative. In the midst of the pandemic the additional yield above government bonds was relatively high. This spread has been subsequently eroded and means that these assets are now less attractive on a risk-adjusted basis. We maintain a negative view on conventional and inflation-linked global government bonds, with a slightly negative view on high yield bonds. Emerging market debt is our highest conviction pick, with a neutral rating.

We continue to be marginally positive on cash as, in the shorter-term, there is a less compelling case to hold assets like fixed income. Single strategy absolute return funds may provide an alternative source of return to portfolios in challenging markets. We are still negative on UK commercial property.

Stewart Smith, Investment Research Manager
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