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Quarterly Investment Review

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Grayside

Quarterly Portfolio Review

October 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

For UK-based investors, global equity returns were marginally positive in most sectors in the third quarter, aided in some areas by currency movements over the period. In local currency terms, the picture was typically less positive as most markets struggled to make meaningful headway. The global economy continues to slowly recover from the depths of the pandemic, with GDP and company earnings creeping upwards, albeit at a substantially reduced pace compared to previous quarters. There are clouds gathering on the horizon and uncertainty continues to rise, often the harbinger of heightened volatility in equity markets. Concerns over global supply chains have increased and the UK experienced panic buying across petrol forecourts up and down the country, despite assurances from industry heavyweights and the UK government that supplies remained bountiful. Other markets have seen demand outstrip supply, the substantial increase in the price of wholesale gas being one such example, with commentators warning of large increases in household expenditure this winter. Disruption in the Chinese economy, one of the core drivers of global growth for many years, has also sent shockwaves across markets with regulators reigning in the activity of some large companies in recent months.

The discussion surrounding inflation has only intensified heading into the final quarter of 2021. Whilst high inflation prints were expected for a short period of time following the pandemic due to technical reasons, some market participants now believe that inflation will persist for a lot longer than had been initially envisaged. Some central banks in emerging economies have already reacted by raising interest rates, with Norway following suit to become the first developed economy to do so since the pandemic hit. The US Federal Reserve and the Bank of England have so far resisted the temptation, but their rhetoric has been ever more hawkish in recent months. Current consensus would indicate an initial rate rise is likely to be announced in early 2022, but consensus has been wrong in the past. The extent to which individuals and companies can shoulder the burden of higher interest rates remains to be seen, debt has increased to record levels and a significant move in rates would risk derailing the global economic recovery due to the commensurate rise in the cost of servicing the debt mountain. There is a delicate balance to be struck.

UK equities extended their run of positive returns with small and mid-caps leading the way and investors favouring growth ahead of value and quality. The US market was broadly flat at the index level thanks to a recovery in large cap growth names but there was a wide dispersion of returns with large areas of the market posting a negative quarter. This was less evident for UK based investors as a strengthening dollar enhanced returns. European markets were muted, driven by the underperformance of German equities cancelling out more encouraging figures from some of the smaller markets in regions like Scandinavia. Asian markets were dominated by the struggles emanating from China, by far the largest constituent of regional indices, as well as a significant influence on neighbouring economies through trade. Indian equities bucked the trend in an otherwise terrible quarter. There was a wide spread of returns for other emerging markets, with the middle east and emerging European equities performing strongly, contrasting with exceptionally poor numbers from Brazil. Japan was one of the few highlights during the quarter, generating strong returns.

Conventional gilts continued to struggle under the weight of the expectation of rate rises, along with most fixed income indices. UK index-linked gilts delivered a positive return in the quarter, as did short-dated US Treasuries but this was primarily due to currency translation effects.

UK commercial property had another quarter of modest but positive returns. Similarly, property securities were positive apart from in Asia ex Japan where weakness from the Chinese market weighed on returns. The oil price shows no signs of slowing down and through the end of September reached levels not seen since 2018. Gold edged slightly lower in dollar terms and silver had an extremely tough quarter.

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 September 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 positive return and outperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was marginally negative this quarter. The latest 1-year portfolio volatility figure has increased 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.

Having no exposure to conventional UK gilts was very positive for relative performance given their negative return. The marginal outperformance, globally, of corporate bonds versus government bonds was also positive for relative performance, although sterling and sterling-hedged exposure was negative for absolute returns. The strongest returns came from the UK and global index-linked weightings plus the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. Four funds (LeggMason, Invesco, Vanguard and Nomura) produced small negative returns with sterling hedged share classes impacting the returns of the latter two funds.

The model 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 with the UK Buffettology fund outperforming by a reasonably large margin, although the Ninety One UK Alpha fund also underperformed by a relatively large margin. This fund has more than given back its longer-term outperformance over the last 12 months. We are expecting the fund to return to outperformance, but we will be monitoring performance closely. Two of the three global equity funds outperformed the IA Global sector average with the Stewart Investors Worldwide Sustainability fund outperforming by a reasonably large margin. By contrast, the value-focused Ninety One Global Special Situations fund underperformed, although its performance in September alone was very strong.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performers were Liontrust MA Diversified Real Assets and Schroder Global Cities Real Estate, the latter also comfortably outperforming its own benchmark index. The weakest performers were Ninety One Diversified Income and TM Fulcrum Diversified Core Absolute Return. The former was affected by negative returns from equities, developed market sovereign bonds and emerging market debt. The latter suffered from some of its currency (mainly in Asia), commodities (precious metals) and short US duration exposure.

Changes

We are recommending one change this quarter, which is to replace the Invesco Corporate Bond fund with specific short-dated exposure through the recently rated **Fidelity Short Dated Corporate Bond** fund.

Balanced Growth Portfolio

The Balanced Growth Portfolio produced a positive return and outperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was marginally negative this quarter. The latest 1-year portfolio volatility figure has increased 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.

Having no exposure to conventional UK gilts was very positive for relative performance given their negative return. The marginal outperformance, globally, of corporate bonds versus government bonds was also positive for relative performance, although sterling and sterling-hedged exposure was negative for absolute returns. The strongest returns came from the UK and global index-linked weightings plus the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. Two funds (Invesco and Vanguard) produced small negative returns with sterling hedged share classes impacting the returns of the latter.

The portfolio has 42% in direct equity funds with an equal focus on UK and international equities. Three of the five UK equity funds outperformed the UK All Companies sector average with the largest outperformance coming from the value-focused Schroder Recovery and the UK Buffettology funds, although the Ninety One UK Alpha fund underperformed by a relatively large margin. Two of the four global equity funds outperformed the IA Global sector average with the Stewart Investors Worldwide Sustainability fund outperforming by a reasonably large margin. By contrast, the Baillie Gifford International fund produced a small negative return and underperformed by a reasonable margin.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performers were Liontrust MA Diversified Real Assets and Schroder Global Cities Real Estate, the latter also comfortably outperforming its own benchmark index. The weakest performers were Ninety One Diversified Income and TM Fulcrum Diversified Core Absolute Return. The former was affected by negative returns from equities, developed market sovereign bonds and emerging market debt. The latter suffered from some of its currency (mainly in Asia), commodities (precious metals) and short US duration exposure.

Changes

We are recommending one change this quarter, which is to replace the Invesco Corporate Bond fund with specific short-dated exposure through the recently rated **Fidelity Short Dated Corporate Bond** fund.

There has been a change to the fund management team for the Artemis Strategic Bond fund, but we are recommending maintaining the fund holding at the moment.

Progressive Growth Portfolio

The Progressive Growth Portfolio produced a positive return but very marginally underperformed its composite benchmark and very marginally outperformed its most comparable IA sector average. The portfolio is marginally overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was marginally negative this quarter. The latest 1-year portfolio volatility figure has marginally increased 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 was very positive for relative performance given their negative return. The marginal outperformance, globally, of corporate bonds versus government bonds was also positive for relative performance, although sterling exposure was negative for absolute returns. The strongest returns came from the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average, and the M&G Global Macro Bond fund Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. The Invesco fund produced a small negative return but marginally outperformed its peer group average.

Half of the six UK equity funds outperformed the UK All Companies sector average with the largest outperformance coming from the value-focused Schroder Recovery and the UK Buffettology funds, although the Ninety One UK Alpha fund underperformed by a relatively large margin and the Premier Miton UK Value Opportunities fund produced a small negative return. Only one of the three global equity funds, Troy Trojan Global Equity, outperformed the IA Global sector average with the Baillie Gifford International fund producing a small negative return and underperforming by a reasonable margin.

Within the regional equity funds there were negative returns in Asia and emerging markets and fund selection was a little disappointing, with only the FSSA Asia Focus fund outperforming, although this was by a reasonably large margin. Japan was easily the strongest region for absolute returns and there was also good outperformance from the JPM Japan fund, although the Baillie Gifford Japanese Income Growth fund underperformed by a reasonable margin. US fund selection was marginally negative with the value-focused Dodge & Cox US Stock fund underperforming by the larger margin of the two US funds.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performers were Liontrust MA Diversified Real Assets and Schroder Global Cities Real Estate, the latter also comfortably outperforming its own benchmark index. The weakest performer was TM Fulcrum Diversified Core Absolute Return. The fund suffered from some of its currency (mainly in Asia), commodities (precious metals) and short US duration exposure.

Changes

We are recommending a small number of portfolio changes this quarter.

Firstly, we recommend replacing the Invesco Corporate Bond fund with specific short-dated exposure through the recently rated **Fidelity Short Dated Corporate Bond** fund.

Due to our increased positivity on European equities, we would like to add some exposure to this portfolio, adjusting weightings to some other regions to compensate. The **Premier Miton European Opportunities** fund will be added. At the same time, we recommend replacing the Baillie Gifford Japanese Income Growth fund with the **Nikko Japan Value** fund. This has been recently rated and is more of a pure value play within Japan and will better complement the JPM Japan fund.

There has been a change to the fund management team for the Artemis Strategic Bond fund, but we are recommending maintaining the fund holding at the moment.

Adventurous Growth

The Adventurous Growth Portfolio produced a positive return and very marginally outperformed its composite benchmark, although it very marginally underperformed its most comparable IA sector average. The portfolio is overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The lack of exposure to UK direct commercial property and preference for property alternatives was marginally negative this quarter. The latest 1-year portfolio volatility figure has increased versus the last quarter, which is the same for the composite benchmark. The latest portfolio figure is slightly above that of the benchmark and the portfolio's average 1-yr volatility since launch remains above that of the benchmark, albeit not significantly.

The marginal outperformance, globally, of corporate bonds versus government bonds would have been positive for relative performance, but for although sterling exposure was negative for absolute returns. The strongest returns came from the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average, and the M&G Global Macro Bond fund Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. The Invesco fund produced a small negative return but marginally outperformed its peer group average.

The portfolio has 81% in direct equity funds with a bias towards international equities. Four of the seven UK equity funds outperformed the UK All Companies sector average with the largest outperformance coming from the value-focused Schroder Recovery and the UK Buffettology funds, although the Ninety One UK Alpha fund underperformed by a relatively large margin and the Premier Miton UK Value Opportunities fund produced a small negative return.

Within the regional equity funds there were negative returns in Asia and emerging markets and fund selection was a little disappointing, with only the FSSA Asia Focus and Baillie Gifford Pacific funds outperforming, although this was by a reasonably large margin for the former. Japan was easily the strongest region for absolute returns and there was also strong outperformance from FSSA Japan Focus and good outperformance from the JPM Japan fund, although the Baillie Gifford Japanese Income Growth fund underperformed by a reasonable margin. US fund selection was marginally negative with the value-focused Dodge & Cox US Stock fund the main underperformer, whilst the BlackRock fund outperformed within Europe.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performer was Schroder Global Cities Real Estate, which comfortably outperformed its own benchmark index. The weakest performer was TM Fulcrum Diversified Core Absolute Return. The latter suffered from some of its currency (mainly in Asia), commodities (precious metals) and short US duration exposure.

Changes

We are recommending a couple of portfolio changes this quarter.

Due to our increased positivity on European equities, we would like to increase exposure within this portfolio, adjusting weightings to some other regions to compensate. We would recommend adding the **MI Chelverton European Select** fund to complement the existing BlackRock fund. At the same time, we recommend replacing the Baillie Gifford Japanese Income Growth fund with the **Nikko Japan Value** fund. This has been recently rated and is more of a pure value play within Japan and will better complement the JPM Japan fund.

There has been a change to the fund management team for the Artemis Strategic Bond fund, but we are recommending maintaining the fund holding at the moment.

Specialist Growth Portfolio

The Specialist Growth Portfolio produced a positive return but underperformed its composite benchmark and 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 increased 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.

Four of the seven UK equity funds outperformed the UK All Companies sector average with the largest outperformance coming from the value-focused Schroder Recovery and the UK Buffettology funds, although the Ninety One UK Alpha fund underperformed by a relatively large margin and the Premier Miton UK Value Opportunities fund produced a small negative return.

Within the regional equity funds there were negative returns in Asia and emerging markets and fund selection was a little disappointing, with only the FSSA Asia Focus and Baillie Gifford Pacific funds outperforming, although this was by a reasonably large margin for the former. Specific China exposure was a significant negative and this was exacerbated by large underperformance from Fidelity China Consumer. Some of the stocks in the fund suffered from the regulatory changes to in certain sectors. Japan was easily the strongest region for absolute returns and there was also strong outperformance from FSSA Japan Focus and good outperformance from the JPM Japan fund, although the Baillie Gifford Japanese Income Growth fund underperformed by a reasonable margin. US fund selection was marginally negative with the value-focused Dodge & Cox US Stock fund the main underperformer, whilst the BlackRock fund outperformed within Europe.

Changes

We are recommending a couple of portfolio changes this quarter.

Due to our increased positivity on European equities, we would like to increase exposure within this portfolio, adjusting weightings to some other regions to compensate. We would recommend adding the **MI Chelverton European Select** fund to complement the existing BlackRock fund. At the same time, we recommend replacing the Baillie Gifford Japanese Income Growth fund with the **Nikko Japan Value** fund. This has been recently rated and is more of a pure value play within Japan and will better complement the JPM Japan fund.

Income Portfolios

Portfolio Allocations

The tables below show the current asset allocations of the Income model portfolios, as at the end of September 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 positive return and outperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The current historic yield is just under 2.9%. The latest 1-year portfolio volatility figure has increased 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 exposure to conventional UK gilts was very positive for relative performance given their negative return. The marginal outperformance, globally, of corporate bonds versus government bonds was also positive for relative performance, although sterling and sterling-hedged exposure was negative for absolute returns. The strongest returns came from the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average, and the Janus Henderson Strategic Bond fund. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. Three funds (LeggMason, BlackRock and Invesco) produced small negative returns, although the latter marginally outperformed its peer group average.

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. The Fidelity Global Dividend fund underperformed its sector average, albeit not significantly, but the best performing equity fund was Schroder Global Equity Income, which comfortably outperformed its peer group average.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performers were Liontrust MA Diversified Real Assets and Schroder Global Cities Real Estate, the latter also comfortably outperforming its own benchmark index. The weakest performer was Ninety One Diversified Income. The fund was affected by negative returns from equities, developed market sovereign bonds and emerging market debt.

Changes

We are recommending no changes this quarter.

There has been a change to the fund management team for the Artemis Strategic Bond fund, but we are recommending maintaining the fund holding at the moment.

Balanced Income Portfolio

The Balanced Income Portfolio produced a positive return and outperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The current historic yield is just above 2.9%. The latest 1-year portfolio volatility figure has marginally increased 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 exposure to conventional UK gilts was very positive for relative performance given their negative return. The marginal outperformance, globally, of corporate bonds versus government bonds was also positive for relative performance, although sterling and sterling-hedged exposure was negative for absolute returns. The strongest returns came from the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average, and the Janus Henderson Strategic Bond fund. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. Two funds (LeggMason and Invesco) produced small negative returns, although the latter marginally outperformed its peer group average.

The portfolio has 42% in direct equity funds with an equal weighting between UK and international equities. Three of the four UK equity income funds outperformed their IA sector average with the largest outperformance coming from Marlborough Multi Cap Income. Half of the global equity income funds outperformed their sector average with the best performing equity fund being Schroder Global Equity Income, which comfortably outperformed its peer group average.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performers were Liontrust MA Diversified Real Assets and Schroder Global Cities Real Estate, the latter also comfortably outperforming its own benchmark index. The weakest performer was Ninety One Diversified Income. The fund was affected by negative returns from equities, developed market sovereign bonds and emerging market debt.

Changes

We are recommending no changes this quarter.

There has been a change to the fund management team for the Artemis Strategic Bond fund, but we are recommending maintaining the fund holding at the moment.

Progressive Income Portfolio

The Progressive Income Portfolio produced a positive return and outperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was a small negative on a relative basis based on global equity and fixed income index performance in sterling terms, although the small overweight to the UK was positive given its relative outperformance. The latest 1-year portfolio volatility figure has reduced versus the previous quarter, but the composite benchmark figure is almost identical to the previous quarter. The latest portfolio figure is marginally below that of the benchmark whilst the portfolio's average 1-yr volatility since launch is virtually equal to that of the benchmark.

Having no exposure to conventional UK gilts was very positive for relative performance given their negative return. The marginal outperformance, globally, of corporate bonds versus government bonds was also positive for relative performance, although sterling and sterling-hedged exposure was negative for absolute returns. The strongest returns came from the M&G Emerging Markets Bond fund, which comfortably outperformed its sector average, and the Janus Henderson Strategic Bond fund. Exposure to more flexible and absolute return-type funds was mixed based on individual fund performance. Two funds (LeggMason and Invesco) produced small negative returns, although the latter marginally outperformed its peer group average.

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 with the largest outperformance coming from Marlborough Multi Cap Income. Half of the global equity income funds outperformed their sector average with the best performing equity fund being Schroder Global Equity Income, which comfortably outperformed its peer group average.

Absolute return/alternatives exposure was mixed in terms of relative performance. The best performers were Liontrust MA Diversified Real Assets and Schroder Global Cities Real Estate, the latter also comfortably outperforming its own benchmark index. The weakest performer was Ninety One Diversified Income. The fund was affected by negative returns from equities, developed market sovereign bonds and emerging market debt.

Changes

We are recommending no changes this quarter.

There has been a change to the fund management team for the Artemis Strategic Bond fund, but we are recommending maintaining the fund holding at the moment.

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 September 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 positive returns and each underperformed its respective composite benchmark and most comparable IA sector average. The underweight to fixed income and preference for a multi-asset alternative was positive based on relative fund performance and the small overweight to cash was also marginally positive. The latest 1-year portfolio volatility figures have increased 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 very 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 EdenTree Responsible and Sustainable Short Dated Bond and Threadneedle UK Social Bond whilst there was little difference in the performance of the remaining funds.

Half of the six UK equity funds across the portfolios outperformed the main UK equity index, but the performance differentials, both positive and negative, were not significant except for the underperformance from Unicorn UK Ethical Income.

Global equity fund selection was very positive, as all the funds outperformed the global equity index in the composite benchmark and the Global sector average. The best performers were Jupiter Ecology and Stewart Investors Worldwide Sustainability. Specific emerging markets exposure was negative but fund selection was very positive, as the Stewart Investors Global Emerging Markets Sustainability fund comfortably outperformed its sector average.

There was a small positive return from the Troy Trojan Ethical fund but the fund marginally underperformed its own IA sector average.

Changes

We are recommending no changes this quarter.

Summary

Although the economic recovery has continued further into 2021, the pace of expansion has slowed down and there are some questions as to the likely impact of more recent issues, such as supply-driven inflation and increasing wholesale energy prices, particularly on interest rate/monetary policy. The global equity market sits on a healthy return year to date but this has not been without significant interim volatility and this may continue through the remainder of the year and into 2022. The impact of the pandemic continues to lessen in the developed world, as the vaccine rollout becomes more widespread amongst the populations, although problems remain in much of the emerging world. 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, whilst being conscious of any temporary inflation factors becoming more ingrained. 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, and this has come to fruition. However, in addition to this technical aspect, other factors such as supply chain challenges, wholesale energy prices and a shortage of relevant skilled labour, coupled with the huge fiscal stimulus packages that have been introduced during the pandemic, have raised fears that higher inflation may be here to stay for much longer than originally expected. This calls into question the viability of maintaining ultra-loose monetary policy over the medium to long term, and markets have priced in an earlier start to interest rate rises. This has led to short-term rallies in value stocks, as well as increasing bond yields, although growth stocks outperformed again this quarter during the relative uncertainty. These themes, coupled with the speed at which market leadership has changed, and reversed, over very short periods of time, 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 continue to be 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. The trend then reversed in the second quarter and the styles flip-flopped intra-quarter with value outperforming in September. 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. We have increased our conviction in European equities, as the economic data has shown good improvement, the vaccine rollout is progressing much better and monetary policy support is likely to remain for much longer than for other western regions. We continue to prefer Asia, Japan, and UK mid and small caps whilst we continue to 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. We also reaffirmed our views on the individual sub-asset classes with emerging market debt remaining our favoured area, followed by corporate bonds with government bonds being our least favoured asset class.

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 whilst we are still negative on UK commercial property.

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