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Quarterly Investment Review

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Grayside

Quarterly Portfolio Review

April 2022

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

The Russian invasion of Ukraine has come to dominate the geo-political landscape and presents a desperately unfortunate humanitarian crisis to the Ukrainian people. The economic impact is far reaching, not least due to financial sanctions being placed on Russian companies and high-profile individuals. Many governments and supranational bodies have condemned the invasion and withdrawn from trade agreements. Russian participation in global financial markets has been severally restricted and this has triggered the removal of Russian assets from most global equity and fixed income benchmarks, with many financial institutions writing down the value of such assets to zero.

Inflation has been a constant topic of conversation in recent months and markets have begun to price in significantly more aggressive interest rate hikes this year than had previously been expected. If inflation prints continue to read high, there is also a suggestion that central banks will begin to unwind their balance sheets and initiate a programme of quantitative tightening. Not all economies have recovered from the pandemic and some form of lockdown or isolation programme is still in place in many countries. In addition, differing rates of economic recovery and the likelihood of short-term monetary policy divergence has kept financial market volatility high, and this is expected to continue throughout 2022. This growing uncertainty impacted most asset classes during the first quarter, and consequently affected returns.

In equities, the UK proved to be one of the strongest performers on a local currency basis due to the bias towards large cap value areas such as energy, however there was significant dispersal in returns and small and mid-cap stocks continued their recent struggles. Some specialist small and mid-cap indices posted double digit losses as market sentiment remained negative. No other headline equity indices delivered positive returns during the quarter, although this underperformance was cushioned slightly by a general weakening of sterling against most currencies. Growth heavy US markets were down during the quarter, but still offered some of the better returns on a relative basis. Asian and emerging market equities also struggled at index level, driven primarily by fragility in China, but Latin American markets did well alongside Australia. Europe lagged most other regions with only Norway providing some positive returns. The yen was one of the few currencies to weaken against sterling during the quarter, turning a slightly negative local return for Japanese equities into mid-single digit losses for UK investors.

Longer-dated gilts were the worst performing asset within fixed interest, delivering double digit losses. Short-dated gilts performed better on a relative basis, and short dated inflation linked gilts were one of the few areas within bonds to achieve a positive return in the first quarter. US Treasury Bills also produced positive returns for UK investors, but this was primarily a function of currency movements rather underlying strength in the asset. Similarly, some emerging market sovereign debt indices posted flat or slightly negative returns in sterling terms due to currency differentials, but the picture was broadly negative at local level. High yield and global bonds also had a tough quarter.

UK bricks and mortar property had another good quarter following a strong 2021 but returns were mixed for property securities, with European listed REITs struggling. An oil price rally that began in December grew exponentially through Q1 as the Russian invasion of Ukraine progressed. The oil price has come off its most recent highs slightly but remains elevated. A combination of geo-political uncertainty and persistent inflation proved positive for gold; the safe haven asset was one of the best performing assets in early 2022, with silver also doing well.

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 the April 2021 review which became effective from 1st May 2021. 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 March 2022, 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 portfolio produced a negative return and marginally underperformed its composite benchmark but outperformed its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The small underweight to fixed income and overweight to absolute return was positive but the underweight to property was negative. The latest 1-year portfolio volatility figure has increased by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is marginally below that of the benchmark. The portfolio's average 1-yr volatility since launch is just below that of the benchmark.

Having no exposure to conventional UK gilts was very positive for relative performance given their very weak performance, although having a small allocation to UK index-linked bonds was very negative. The performance of global government bonds and corporate bonds was also weak, so the preference for strategic/more flexible funds was generally positive. Specific emerging market debt exposure was negative. From an individual fund perspective there was good outperformance from LeggMason Brandywine Global Fixed Income, Fidelity Short Dated Corporate Bond and Schroder Strategic Credit plus TwentyFour Monument Bond only produced a very small negative return. The main underperformer was Nomura Global Dynamic Bond, which suffered mainly from its exposure to Russian government bonds whose value they wrote down to zero.

The model portfolio has 17% in direct equity funds with an equal focus on UK and international equities. The general performance of active UK equity funds versus the main UK equity index was very disappointing this quarter, as the average fund significantly underperformed, hindered by the underperformance of mid-caps and smaller companies versus the large cap index. Two of the three UK equity funds underperformed the UK All Companies sector average, with the UK Buffettology fund seeing a double-digit negative return and significant underperformance. The Vanguard index fund produced a positive return in keeping with the overall market performance.

Individual performance from the three global equity funds was very mixed and representative of their different investment styles. There was a double-digit negative return and significant underperformance from the quality growth-focused Stewart Investors Worldwide Sustainability fund whilst the value-focused Ninety One Global Special Situations fund, which is a smaller allocation within the portfolio, saw a virtually flat return and significant outperformance.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from Liontrust MA Diversified Real Assets, VT Gravis UK Infrastructure Income and TM Fulcrum Diversified Core Absolute Return with the latter performing particularly strongly.

Balanced Growth Portfolio

The portfolio produced a negative return and underperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The small underweight to fixed income and overweight to absolute return was positive but the underweight to property was negative. The latest 1-year portfolio volatility figure has increased by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is marginally above that of the benchmark. The portfolio’s average 1-yr volatility since launch is just below that of the benchmark.

Having no exposure to conventional UK gilts was very positive for relative performance given their very weak performance, although having a small allocation to UK index-linked bonds was very negative. The performance of global government bonds and corporate bonds was also weak, so the preference for strategic/more flexible funds was generally positive. Specific emerging market debt exposure was negative. From an individual fund perspective there was good outperformance from M&G Global Macro Bond and Fidelity Short Dated Corporate Bond.

The model portfolio has 42% in direct equity funds with an equal focus on UK and international equities. The general performance of active UK equity funds versus the main UK equity index was very disappointing this quarter, as the average fund significantly underperformed, hindered by the underperformance of mid-caps and smaller companies versus the large cap index. Three of the five UK equity funds underperformed the UK All Companies sector average, with the CFP SDL UK Buffettology and Jupiter UK Mid Cap funds seeing double-digit negative returns and significant underperformance. The Vanguard index fund produced a positive return in keeping with the overall market performance and the value-biased Schroder Recovery fund significantly outperformed.

Individual performance from the four global equity funds was very mixed and representative of their different investment styles. There were double-digit negative returns and significant underperformance from the Baillie Gifford International and Stewart Investors Worldwide Sustainability funds whilst the value-focused Ninety One Global Special Situations fund, which is a slightly smaller allocation within the portfolio, saw a virtually flat return and significant outperformance.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from Liontrust MA Diversified Real Assets, VT Gravis UK Infrastructure Income and TM Fulcrum Diversified Core Absolute Return with the latter performing particularly strongly.

Progressive Growth Portfolio

The portfolio produced a negative return and underperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The underweight to fixed income and overweight to absolute return was positive but the underweight to property was negative. The latest 1-year portfolio volatility figure has increased by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is above that of the benchmark. The portfolio's average 1-yr volatility since launch is just above that of the benchmark.

Having no exposure to conventional and index-linked UK gilts was very positive for relative performance given their very weak performance. The performance of global government bonds and corporate bonds was also weak, so the preference for strategic/more flexible funds was generally positive. Specific emerging market debt exposure was negative. From an individual fund perspective there was good outperformance from M&G Global Macro Bond and Fidelity Short Dated Corporate Bond.

The model portfolio has 60% in direct equity funds with an equal focus on UK and international equities. The general performance of active UK equity funds versus the main UK equity index was very disappointing this quarter, as the average fund significantly underperformed, hindered by the underperformance of mid-caps and smaller companies versus the large cap index. Four of the six UK equity funds underperformed the UK All Companies sector average, with the CFP SDL UK Buffettology, Jupiter UK Mid Cap and Premier UK Value Opportunities funds seeing double-digit negative returns and significant underperformance. The Vanguard index fund produced a positive return in keeping with the overall market performance and the value-biased Schroder Recovery fund significantly outperformed.

Individual performance from the three global equity funds was very mixed and representative of their different investment styles. There was a double-digit negative return and significant underperformance from the growth-focused Baillie Gifford International fund whilst the value-focused Ninety One Global Special Situations fund, which is a smaller allocation within the portfolio, saw a virtually flat return and significant outperformance.

Within regional equities Europe was the worst performing region, so only having small exposure was a positive, but the growth-biased Premier Miton European Opportunities fund produced a double-digit negative return and significantly underperformed. Fund selection in Asia and emerging markets was positive overall thanks to a positive return and strong outperformance from Invesco Asian and good outperformance from Vanguard Global Emerging Markets. There was significant underperformance from the growth-biased JPM Japan fund whilst the value-biased Dodge & Cox US Stock fund produced a good positive return and significantly outperformed.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from Liontrust MA Diversified Real Assets, VT Gravis UK Infrastructure Income and TM Fulcrum Diversified Core Absolute Return with the latter performing particularly strongly.

Adventurous Growth

The portfolio produced a negative return and underperformed its composite benchmark and its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The underweight to fixed income and overweight to absolute return was positive but the underweight to property was negative. The latest 1-year portfolio volatility figure has increased by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is above that of the benchmark. The portfolio's average 1-yr volatility since launch is above that of the benchmark.

Having no exposure to conventional and index-linked UK gilts within the small, fixed income element was very positive for relative performance given their very weak performance. The performance of global government bonds and corporate bonds was also weak, so the preference for strategic/more flexible funds was generally positive. There were no notable outperformers or underperformers.

The model portfolio has 81% in direct equity funds with a greater focus on international equities. The general performance of active UK equity funds versus the main UK equity index was very disappointing this quarter, as the average fund significantly underperformed, hindered by the underperformance of mid-caps and smaller companies versus the large cap index. Four of the seven UK equity funds underperformed the UK All Companies sector average, with the CFP SDL UK Buffettology, Jupiter UK Mid Cap and Premier UK Value Opportunities funds seeing double-digit negative returns and significant underperformance. The Vanguard index fund produced a positive return in keeping with the overall market performance and the value-biased Man GLG Undervalued Assets and Schroder Recovery funds significantly outperformed.

Within regional equities Europe was the worst performing region, so only having relatively small exposure was a positive, but the growth-biased BlackRock European Dynamic fund produced a double-digit negative return and significantly underperformed. Fund selection in Asia and emerging markets was mixed with a positive return and strong outperformance from Invesco Asian and good outperformance from Vanguard Global Emerging Markets but larger underperformance from both Baillie Gifford Pacific and JPM Emerging Markets. There was significant underperformance from the growth-biased FSSA Japan Focus and JPM Japan funds whilst the value-biased Dodge & Cox US Stock fund produced a good positive return and significantly outperformed and there was good outperformance from Premier Miton US Opportunities.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from VT Gravis UK Infrastructure Income and TM Fulcrum Diversified Core Absolute Return with the latter performing particularly strongly.

Specialist Growth Portfolio

The portfolio produced a negative return and 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 by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is above that of the benchmark. The portfolio's average 1-yr volatility since launch is above that of the benchmark.

The model portfolio is fully invested in equity funds with a greater focus on international equities. The general performance of active UK equity funds versus the main UK equity index was very disappointing this quarter, as the average fund significantly underperformed, hindered by the underperformance of mid-caps and smaller companies versus the large cap index. Four of the seven UK equity funds underperformed the UK All Companies sector average, with the CFP SDL UK Buffettology, Jupiter UK Mid Cap and Premier UK Value Opportunities funds seeing double-digit negative returns and significant underperformance. The Vanguard index fund produced a positive return in keeping with the overall market performance and the value-biased Man GLG Undervalued Assets and Schroder Recovery funds significantly outperformed.

Within regional equities Europe was the worst performing region, so only having relatively small exposure was a positive, but the growth-biased BlackRock European Dynamic fund produced a double-digit negative return and significantly underperformed. Fund selection in Asia and emerging markets was mixed with a positive return and strong outperformance from Invesco Asian and good outperformance from Vanguard Global Emerging Markets but larger underperformance from both Baillie Gifford Pacific and JPM Emerging Markets. Specific Chinese equity exposure was negative but the Fidelity China Consumer fund did outperform. There was significant underperformance from the growth-biased FSSA Japan Focus and JPM Japan funds whilst the value-biased Dodge & Cox US Stock fund produced a good positive return and significantly outperformed and there was good outperformance from Premier Miton US Opportunities.

Income Portfolios

Portfolio Allocations

The tables below show the current asset allocations of the Income model portfolios, as at the end of March 2022, 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 portfolio produced a negative return but marginally outperformed its composite benchmark and outperformed its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The small underweight to fixed income and overweight to alternative funds was positive but the underweight to property was negative. The latest 1-year portfolio volatility figure has increased by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is marginally below that of the benchmark. The portfolio's

average 1-yr volatility since launch is just below that of the benchmark. The current historic yield is just over 2.8%.
Having no exposure to conventional and index-linked UK gilts was very positive for relative performance given their very weak performance. The performance of global government bonds and corporate bonds was also weak, so the addition of strategic/more flexible funds was generally positive. Specific emerging market debt exposure was negative. From an individual fund perspective there was good outperformance from Invesco Corporate Bond and Royal London Short Duration Credit whilst there was notable underperformance from Janus Henderson Strategic Bond.

The model portfolio has 16% in direct equity funds with an equal focus on UK and international equities. The performance of the average active UK equity income fund was only marginally behind the main UK equity index, helped by the better performance from value and dividend paying stocks. There was mixed performance from the two fund selections with the Threadneedle fund underperforming by a slightly larger margin than the JOHCM fund outperformed by.

Overall performance from the global equity income funds was positive due to strong outperformance from the value-biased Schroder Global Equity Income fund.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from Liontrust MA Diversified Real Assets and VT Gravis UK Infrastructure Income.

Balanced Income Portfolio

The portfolio produced a negative return but marginally outperformed its composite benchmark and outperformed its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The small underweight to fixed income and overweight to alternative funds was positive but the underweight to property was negative. The latest 1-year portfolio volatility figure has increased by a reasonable margin versus the last quarter, which is the same for the composite benchmark, and the latest portfolio figure is marginally above that of the benchmark. The portfolio's average 1-yr volatility since launch is just above that of the benchmark. The current historic yield is just below 3%.

Having no exposure to conventional and index-linked UK gilts was very positive for relative performance given their very weak performance. The performance of global government bonds and corporate bonds was also weak, so the addition of strategic/more flexible funds was generally positive. Specific emerging market debt exposure was negative. From an individual fund perspective there was good outperformance from Invesco Corporate Bond and Royal London Short Duration Credit whilst there was notable underperformance from Janus Henderson Strategic Bond.

The model portfolio has 42% in direct equity funds with an equal focus on UK and international equities. The performance of the average active UK equity income fund was only marginally behind the main UK equity index, helped by the better performance from value and dividend paying stocks. Fund selection was negative as three of the four funds underperformed the sector average with reasonably large underperformance from the Troy and Marlborough funds. The exception was the value-biased JOHCM fund, which performed well.

Overall performance from the global equity income funds was very positive due to strong outperformance from the value-biased Schroder Global Equity Income fund and from Vanguard Global Equity Income.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from Liontrust MA Diversified Real Assets and VT Gravis UK Infrastructure Income.

Progressive Income Portfolio

The portfolio produced a negative return but marginally outperformed its composite benchmark and comfortably outperformed its most comparable IA sector average. The portfolio is marginally overweight equities, which was very negative. The small underweight to fixed income and overweight to alternative funds was positive but the underweight to property was negative. 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 is very marginally above that of the benchmark. The portfolio's average 1-yr volatility since launch is almost identical to that of the benchmark. The current historic yield is just above 3.2%.

Having no exposure to conventional and index-linked UK gilts was very positive for relative performance given their very weak performance. The performance of global government bonds and corporate bonds was also weak, so the addition of strategic/more flexible funds was generally positive. Specific emerging market debt exposure was negative. From an individual fund perspective there was good outperformance from Royal London Short Duration Credit whilst there was notable underperformance from Janus Henderson Strategic Bond.

The model portfolio has 60% in direct equity funds with an equal focus on UK and international equities. The performance of the average active UK equity income fund was only marginally behind the main UK equity index, helped by the better performance from value and dividend paying stocks. Fund selection was very mixed as three of the five funds underperformed the sector average with reasonably large underperformance from the Troy and Marlborough funds. The exceptions were the value-biased JOHCM and Schroder funds, the latter performing particularly well.

Overall performance from the global equity income funds was very positive due to strong outperformance from the value-biased Schroder Global Equity Income fund and from Vanguard Global Equity Income.

Relative to equities and fixed income the returns from the absolute return/alternatives holdings were very positive with all but one of the funds outperforming their respective sector averages. There were positive returns from Liontrust MA Diversified Real Assets and VT Gravis UK Infrastructure Income.

SRI Portfolios

Strategic Asset Allocations

We recommend bringing the equity allocations for the SRI strategic asset allocations into line with the those for the non-SRI strategic asset allocations. This involves a slight reduction within the SRI Balanced and SRI Progressive risk profiles, which will be re-allocated to fixed income. The new 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%	20.00%	29.00%
International Equities	7.50%	20.00%	29.00%
Specialist Equities	0.00%	0.00%	3.00%
Fixed Interest	72.00%	51.00%	32.00%
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 March 2022, and the differences to the previous 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 negative returns with only the SRI Cautious portfolio outperforming its composite benchmark, although all three underperformed their 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 positive. The latest 1-year portfolio volatility figures have increased reasonably significantly versus the previous quarter, more so than was the case for the composite benchmarks. The latest portfolio figure for SRI Cautious Growth is below those of the benchmark whilst the SRI Balanced Growth and SRI Progressive Growth figures are comfortably above, but all the portfolios' average 1-yr volatility since launch figures are either below or only very marginally above those of the benchmarks.

Underlying Fund Performance

Most ethical fixed income funds do not invest in conventional UK gilts, which was a positive for absolute returns this quarter, as they underperformed credit markets, and the lack of any index-linked gilt exposure within these funds was also positive. Fund performance versus the fixed income index in the composite benchmark was very positive overall, as all the funds held across the three portfolios outperformed with particularly strong outperformance from EdenTree Responsible & Sustainable Short Dated Bond and Threadneedle UK Social Bond. Relative to their own sector averages performance was much less positive with only the same two funds outperforming.

The general performance of active UK equity funds versus the main UK equity index was very disappointing this quarter, as the average fund significantly underperformed, hindered by the underperformance of mid-caps and smaller companies versus the large cap index. This was a particularly negative factor for ethical/SRI/sustainable funds and this was further exacerbated by the large underperformance of growth versus value. As a result, all of the funds held across the portfolios underperformed the main UK equity index with double-digit negative returns from ASI UK Ethical Equity, EdenTree Responsible & Sustainable UK Equity, Aegon Ethical Equity and Liontrust SF UK Growth.

The same issues had a negative impact on global equity fund selection and all but one of the funds held across the portfolios underperformed the main global equity index with double-digit negative returns from FP WHEB Sustainability, Pictet Global Environmental Opportunities and Stewart Investors Worldwide Sustainability. The exception was VT Gravis Clean Energy Income, which produced a good positive return and significantly outperformed. Specific emerging markets exposure was negative and fund selection was also negative, as the Stewart Investors Global Emerging Markets Sustainability fund underperformed the IA GEM sector average.

There was a very small positive return from the Troy Trojan Ethical fund and the fund comfortably outperformed its own IA sector average.

Changes

In keeping with our latest asset allocation views (see Summary for more details) we recommend reducing exposure to international equities and increasing the allocation to alternatives. We also recommend matching the new equity overweight/underweight positions from the equivalent non-SRI growth portfolio, which actually means an increase to UK equities. For all three portfolios this will be done through adjusting existing holdings.

Summary

2021 was a strong year for risk assets with most global equity indices achieving strong total returns, albeit with significant underlying volatility. This led to a high starting point for valuations in 2022, providing little downside protection in the face of a turbulent geo-political environment. The Russian invasion of Ukraine acted as a catalyst to dent already fragile investor confidence in a precarious, post-pandemic recovery. Add this to high inflation and downgrades to economic growth forecasts, and the environment looks challenging. China has provided much of the impetus to the global economy in recent years but their current pursuit of a ‘zero Covid’ policy is hampering output, although authorities do have more levers to pull to stimulate growth than most other economies. The US economy, so often a beacon of light in dark times, is also struggling to advance and the situation in Europe is looking dismal. Stagflation is working its way into the public lexicon and many individuals are feeling the pinch at home due to soaring electricity and gas bills.

Inflation is an ever-present theme; the way governments and central banks react will likely determine the course of the economic landscape throughout 2022 and beyond. In the UK, the Bank of England interest rate was increased in December, February, and March, moving from the emergency rate of 0.1% to 0.75%, the highest level since the pandemic hit. Further increases are likely, and the rate may finally increase above 1% for the first time since 2009. The quantitative easing programme may also be put into reverse, and quantitative tightening would place increased pressure on financial markets. The picture is similar elsewhere and there is a risk that such action, coupled with the broader macro-economic environment, will push the global economy into recession. Volatility is unlikely to subside in the short to medium term.

We have introduced a new element to our asset class view framework, an overall view on risk. The inaugural view is slightly negative given that, together with the above challenges faced by global economies and financial markets, valuations look generally unattractive and considerable downside risks remain.

We have downgraded our overall view of equities from slightly positive to slightly negative. This mirrors the move we have made for UK small and mid-cap companies, although we have upgraded UK large cap from neutral to positive. The UK large cap space has a bias towards energy and financials, as well as high quality well diversified global businesses which should do well on a relative basis in the current environment. In contrast, the small and mid-cap space includes companies with higher degrees of idiosyncratic risk as well as having a greater tilt towards growth. Japan remains slightly positive as inflation is less of a concern and monetary support is likely to continue, although there is pressure on the yen due to oil price strength. Asia ex- Japan also remains slightly positive, and the US has been held at neutral. Emerging markets have moved down to slightly negative as, despite some positivity for commodity exporters, food and energy inflation and the possibility of a stronger dollar will detract. Europe moves to negative with a war on its doorstep, falling earnings expectations and a high level of sensitivity to energy price rises.

Our views on fixed interest remain broadly unaltered and we have a negative outlook on the asset class. Rising rates and inflation mean it is challenging for bonds to deliver positive returns in the short to medium term, and the increase in correlation between equities and bonds diminishes their effectiveness at managing risk in portfolios. Emerging market debt stays neutral due to the increased carry and wide opportunity set, global index-linked and investment grade corporate debt are slightly negative. High yield moves down to negative due to the increased risk of recession. Global government bonds and index-linked gilts remain negative with conventional gilts very negative.

We have moved physical property up and property securities down so that both are neutral, in line with our overall view on property. Alternatives now look much more attractive and have moved up to positive. Real assets, such as infrastructure or commodities, is a new inclusion within our framework and enters at positive. These assets typically protect well against inflation and can offer valuable diversification away from equities. Market neutral equity strategies have moved down to slightly positive and multi-asset absolute return is still negative. Despite the potential erosion from inflation, we remain slightly positive on cash.

We continue to believe that a focus on quality and ensuring that portfolios are well diversified and derive returns from multiple sources will be beneficial in a demanding investment landscape.

Stewart Smith, Investment Research Manager
RSMR. April 2022

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