KING & SHAXSON
Asset Management | Rewarding your Values

20 YEARS ANNIVERSARY

Investment Committee
Update/Rebalance Comments

Investment Committee June 2023 - MPS Rebalance

General Overview

Asset/Region	Current Stance	Previous Stance
US Equities	Neutral View	Neutral View
UK Equities	Cautious	Cautious
European Equities	Cautious	Cautious
ROW Equities	Positive View	Neutral View
Fixed Income	Selective Approach	Neutral View
Property	Selective Approach	Selective Approach
Infrastructure	Neutral View	Positive View

It would appear as though we have passed peak inflation with many of its drivers, such as energy prices, reversing alongside the powerful base effects taking hold. We have also seen encouraging comments from companies that previous problems, such as supply chains, have been easing. Expectations in the market are that, as a result, we are near the end of the cycle of central bankers increasing interest rates. But inflationary dangers are not gone. The OPEC+ oil supply cut announced at the start of June was another timely reminder of this.

Whilst headline inflation has been coming down, core inflation has been showing signs of remaining sticky (where prices remain stubbornly high). In recent prints we have actually seen it start to tick up again, moving higher than analysts had been expecting. Trends such as de-globalisation have added to this stickiness, but the continual strength of the labour market is where the focus has been. Despite interest-rate rises and slowing economic activity, tightness has seen the labour remain strong with data often coming in higher than expectations. This being said, recent weeks have seen small cracks begin to appear.

Since the beginning of 2023 we, as an investment committee, have agonised over bond duration. Put simply, this means whether we own the more interest rate sensitive longer-dated bonds, that will reflect the longer-term market view on interest rates; or instead own the less sensitive shorter-dated bonds that reflect the central bank rates.

We have kept duration lower since autumn, mainly because we felt expectations in inflation were too universal and too positive. Whilst we knew the base effects would start to take hold in the headline numbers, and anticipated that the supply chain would ease, we thought this would be countered by higher wages, the pass through of higher corporate taxes and increased economic redundancy as security becomes an issue. We simply felt the market was too optimistic.

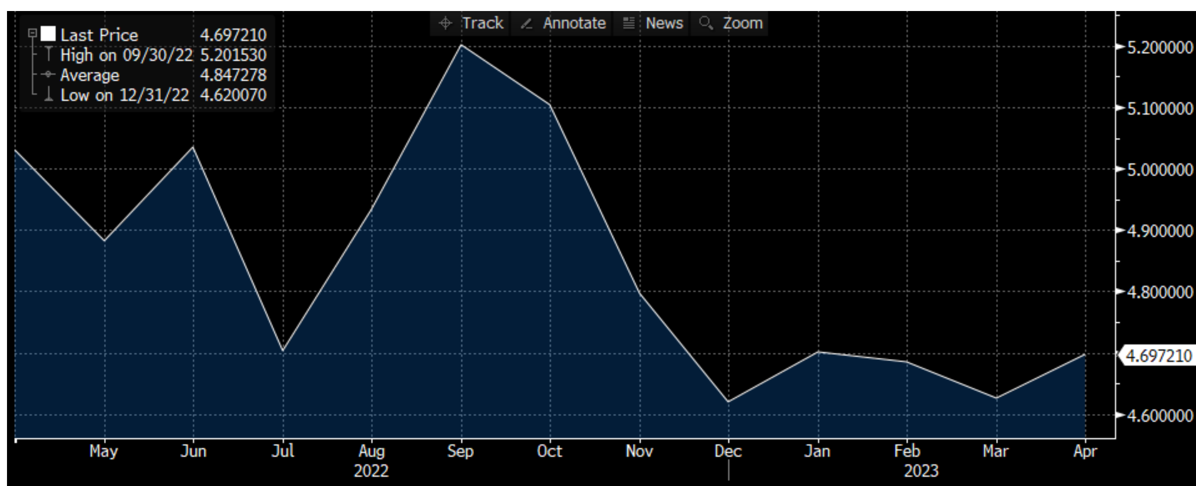
Since the start of the year, we have seen bonds rally and then fall back twice. Since the start of May, bonds have been falling and finally crossed the 4% yield on the UK ten year. May's inflation data in the UK was a catalyst, with the headline falling from over 10% to 8.7%. Whilst in itself this was a large fall, it was less than had been expected by the market. Not only are yields now more attractive, but expectations on inflation and future rates are now more realistic. At these levels, adding to duration is less of a risk, but will be done incrementally, and this forms the biggest change that we have made to portfolios.

In equities, we have been defensively positioned since Autumn sitting near the bottom end of our allocation bands. Given the same logic as extending duration on bonds, where we see expectations on inflation and future rates as now more realistic, we have felt comfortable adding back to equity taking allocations to just below neutral levels. We have focused our additions on impact and growth equities, where cash flows are longer duration and are likely to benefit as the market moves toward thinking about rate cuts.

USA

May was dominated with discussions around the US debt ceiling. Markets were obviously jittery over the path of discussions, with news headlines surrounding progress causing market swings. This episode finally reached its conclusion, with Biden signing legislation that suspended the federal debt ceiling enabling the treasury to resume new debt issuance. This conclusion has reassured markets and it is one less risk to contend with. Some commentators have suggested that the swathes of new debt issuance to come, well in excess of $1 trillion new securities, could drain liquidity from the banking systems and have a similar economic impact to a 25-basis point hike from the central bank.

Uncertainty remains on whether the Federal Reserve (Fed) will pause in its rate hikes or press on with another 25-basis point hike in June. Like elsewhere, sticky inflation is the main cause of concern with the latest reading of US Core PCE (the Fed's preferred measure of US inflation) moving higher as seen below. This was coupled with another robust jobs report, with the number of new people employed surprising strongly to the upside. But the report held diverging messages, and the market's eye was on a surprise rise in the unemployment rate. The Fed may use this to justify a hold to gain more clarity on the economic situation. Whether they hold or not, we agree with market views that they are near their terminal rate.



Source: Bloomberg

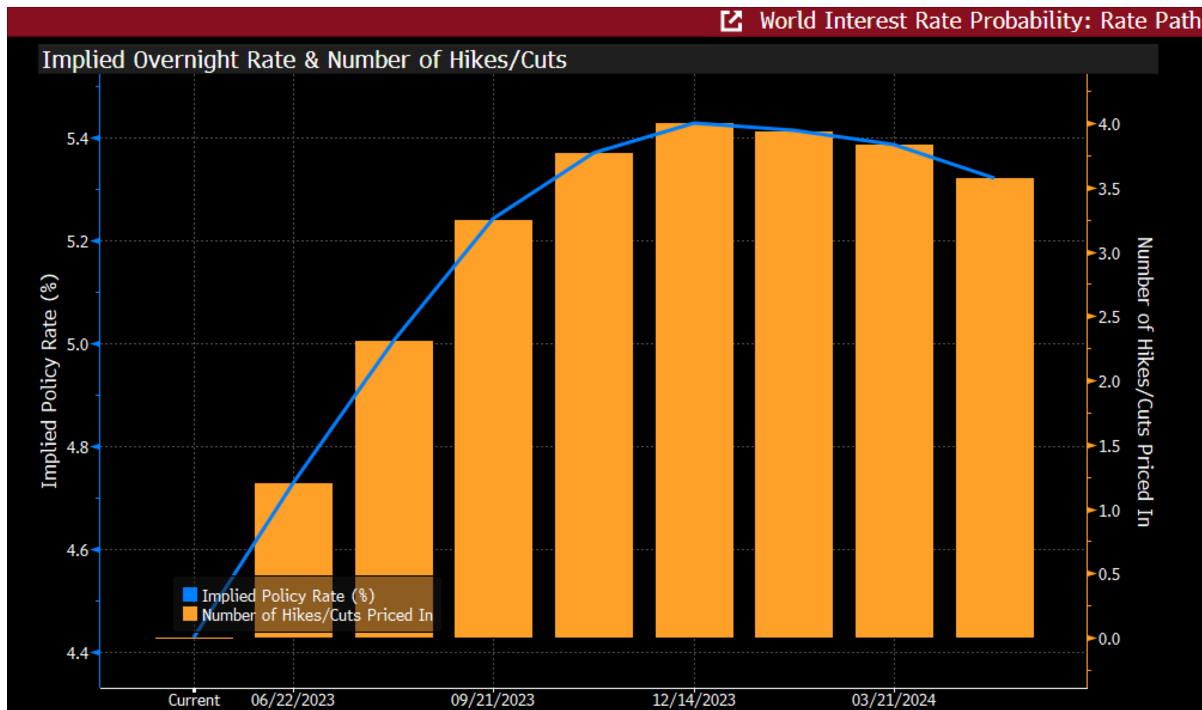
Recently US equity markets have outperformed the UK and Europe, but this has been driven by a handful of large tech names and some have questioned the breadth of this outperformance. Artificial Intelligence has been the driver, which got a boost from comments made by Nvidia. The rally has since fizzled, with some air coming out of big tech as the potential that central banks will keep rates higher for longer than the market currently prices in grows because of stickiness in the inflation data.

The market is currently pricing the first chance of a rate cut in September, but we think that this is too soon. It will likely take a recessionary scenario to start bringing core inflation back down, at which point the Fed will then be more comfortable in starting to cut interest rates. Alongside the idiosyncrasies in the labour market, recent economic releases, such as PMIs, have come in slightly weaker. Furthermore, consumer confidence has also fallen slightly although there has been improving retail sales. Companies have been successful in passing higher costs onto consumers, but there are signs this is beginning to wane with retailers reporting increasing numbers are shopping down as they spend more money on fewer goods.

UK

The UK is the one country that has yet to see a sustained decline in core inflation, and we have another two weeks to wait for the next print (21st June), at which time we will find out whether the horrible April numbers were an aberration or not.

Following that April UK inflation print, the market priced in another 0.5% onto the peak UK rate, so it would seem that we have priced in all the bad news. This would push UK government debt to levels last seen during the chaos brought about by the Liz Truss government's mini-budget. As per below, market pricing suggest rates could increase by nearly another 1%, although we think that this may be overdone and rates won't reach this high. Another bad set of data on the 21st could spell trouble, but any suggestion that that data was an outlier would result in a sharp reversal of that half a percent.



Source: Bloomberg

The British Retail Consortium told us that UK shop price inflation hit a record high in May, leading to calls of 'rip off Britain' around the office as other European countries have seen much greater price declines. Whilst remaining eye-watering high, food price inflation does appear to have peaked. The cynics amongst us suggest that this has conveniently come at a time when political pressure has been mounting on wholesalers.

The UK Chancellor turned heads by suggesting a recession may be necessary to get inflation down, and this is increasingly likely given the rate path trajectory and headwinds in the housing market on the rise. Despite this, the jobs market remains tight with wages continuing to grow and employment numbers remaining strong, although the unemployment rate has been ticking up. Public sector disputes continue as workers strive for fairer compensation, which depending upon how it is resolved could see further wage pressures. The outlook for the consumer has also been improving, with an uptick in consumer confidence and retail sales numbers.

The knock-on effect of yields moving higher was infrastructure and property suffering. We previously commented on the property sector. Here our focus is on closed-ended REITs, either directly or through an open-ended fund. We have seen a number of property deals go through in the last couple of months at large premiums to share prices, which has highlighted the value that is available in the sector once investors look through the noise. We have therefore taken the weakness as an opportunity to increase real estate exposure slightly, seeing it as a growth opportunity at its current level.

Europe

A host of European countries, including France, Germany and Spain, have reported cooling prices, largely as food and energy prices have moved lower, but broad price declines have been seen. Unlike the US and UK, Eurozone core inflation is on a downward trajectory which will be encouraging for the

European Central Bank (ECB). One threat that remains to this however is a wage price spiral, where the latest data saw a jump in wage growth.

On the back of this encouraging inflationary trend, the market believes rate rises will be more limited moving forward and that the ECB doesn't have too much further to go. The market is pricing in one more 0.25% rate hike as very likely with a small chance of another one after that. We see this as a realistic expectation given the encouraging inflation data. The economic data coming out of the eurozone is weak which will also encourage the ECB to pause as soon as they can. Manufacturing and services PMIs both fell at the most recent readings whilst business confidence also tumbled. Recent German data also caught the eye, with factory orders and industrial production comfortably missing expectations.

Rest of the World

Contributing to slowing economic activity and weakening demand has seen a lacklustre recovery in China following their relaxation of Covid restrictions at the end of 2022. May's data release showed that exports fell for the first time in three months, and this fall was much more than had been expected by the market. Other recent data releases have also shown the recovery is losing steam with manufacturing activity contracting and home sales growth slowing.

The beneficiary of the disappointing recovery in China has been India, which has been a standout market in terms of equity returns as investors rotated back to the growth story here. We remain overweight in our exposure to India. Both because we look to limit our exposure to China given government involvement in companies, and because of the growth potential we see in India. Over the last few months, the trend of companies looking to relocate operations away from China in to India has continued. Apple, for example, tripled their production of iPhones in India in the last year as they continue to pivot away from China.

Since the completion of the rebalance, we have seen the central banks of Australia and Canada shock the market by raising rates by 0.25% after a period of pause. These actions have underlined some of the difficulties faced by central banks as they try to slow economic activity and dampen inflation whilst the economy proves to be surprisingly strong. Some have commented on this being a reality check and bonds have fallen on the back of it. It shows some of the risks that remain and hence, as mentioned at the start, we have begun extending duration but only at an incremental pace and have left scope to move further.

Portfolio changes

As mentioned in the introduction, we have increased duration of portfolios at this rebalance. Lowering exposure to short-duration gilts and money market funds and rotating into longer duration corporate bond funds. We have also increased equity exposure to just below our neutral levels by adding to more impact focused equity.

Defensive

In Fixed Income we reduced exposure to the Royal London Short Term FI Fund, the Royal London Short-Dated Gilt fund and the Threadneedle Social Bond fund. We introduced the Wellington Global Impact Bond fund and the BlueBay Impact-Aligned Bond fund taking overall bond exposure to 52%. In Equities we initiated an investment in Impax Environmental Leaders and Pictet Water which increased equity exposure to 19%. Infrastructure/Clean Energy was left unchanged whilst Real Estate exposure was increased to 7%. Cash was reduced to 6%.

Cautious

In Fixed Income we exited the investment in the Royal London Short Term FI and reduced exposure to the Royal London Short-Dated Gilt fund. We introduced the Wellington Global Impact Bond Fund and BlueBay Impact-Aligned bond fund which took overall bond exposure to 40%. In equities we trimmed Janus Henderson UK Responsible Income and added to NinetyOne UK Sustainable. We also added to M&G Positive Impact, Montanaro Better World, Pictet Water, Regnan Global Equity Impact and introduced Impax Environmental Leaders. This increased equity exposure to 35%. Infrastructure/Clean Energy was reduced by 1% whilst Real Estate exposure was increased to 7%. Cash was reduced to 5%.

Income

In Fixed Income we switched the Threadneedle Social Bond Fund for the Wellington Global Impact Bond fund. We left equity and infrastructure/Clean Energy unchanged. Real Estate exposure was increased to 10% whilst cash was reduced to 3%.

Balanced

In Fixed Income we exited the investment in the Royal London Short Term FI and reduced exposure to the Royal London Short-Dated Gilt fund. We introduced the Wellington Global Impact Bond Fund and BlueBay Impact-Aligned bond fund which took overall bond exposure to 31%. In equities we trimmed Janus Henderson UK Responsible Income and added to NinetyOne UK Sustainable. We also added to Montanaro Better World, Regnan Global Equity Impact and introduced Impax Environmental Leaders. This increased equity exposure to 45%. Infrastructure/Clean Energy was left unchanged whilst Real Estate exposure was increased to 7%. Cash was reduced to 5%.

Balanced Growth

In Fixed Income we exited the investment in the Royal London Short Term FI, reduced exposure to the Royal London Short-Dated Gilt fund and trimmed exposure to Threadneedle Social Bond fund. We introduced the Wellington Global Impact Bond Fund and BlueBay Impact-Aligned bond fund which took overall bond exposure to 21%. In equities we trimmed Janus Henderson UK Responsible Income and added to NinetyOne UK Sustainable. As with other portfolios we also added to Montanaro Better World, Regnan Global Equity Impact and introduced Impax Environmental Leaders. This increased equity exposure to 58%. Infrastructure/Clean Energy was left unchanged whilst Real Estate exposure was increased to 5%. Cash was reduced to 5%.

Growth

In Fixed Income we exited the investment in the Royal London Short Term FI and the Royal London Short-Dated Gilt fund. We introduced the Wellington Global Impact Bond Fund and BlueBay Impact-Aligned bond fund which took overall bond exposure to 14%. In equities we trimmed Janus Henderson UK Responsible Income and added to NinetyOne UK Sustainable fund. We also introduced Impax Environmental Leaders which increased equity exposure to 71%. Infrastructure/Clean Energy was left unchanged as was Real Estate. Cash was reduced to 4%.

Adventurous

In Fixed Income we introduced the Wellington Global Impact Bond Fund took overall bond exposure to 3%. In equities we trimmed Janus Henderson UK Responsible Income and added to NinetyOne UK Sustainable. We also Trimmed WHEB Sustainability fund and introduced Impax Environmental Leaders. This increased equity exposure to 89%. Infrastructure/Clean Energy is unchanged whilst we introduced Foresight Sustainable Real Estate fund at 1%. Cash was reduced to 2%.

Cautious Green

In Fixed Income we exited the investment in the Royal London Short Term FI and Rathbone Ethical Bond fund. We reduced exposure to the Royal London Short-Dated Gilt fund and introduced the Wellington Global Impact Bond Fund, BlueBay Impact-Aligned bond fund and the UBS Sustainable Development Bank ETF. This took overall bond exposure to 41%. In equities we exited investments in Aviva, Severn Trent, the US Solar Fund and Vodafone. We added to M&G Positive Impact, Montanaro Better World, Regnan Global Equity Impact and WHEB Sustainability. We introduced Impax Environmental Markets NinetyOne UK Sustainable and L&G Clean Water ETF. This increased equity exposure to 32%. Infrastructure/Clean Energy was reduced to 11.5% whilst Real Estate exposure was reduced to 9.5%. Cash was reduced to 6%.

Light Green

In Fixed Income we exited the investment in the Royal London Short Term FI and Rathbone Ethical Bond fund. We reduced exposure to the Royal London Short-Dated Gilt fund and Edentree Responsible & Sustainable bond fund. We introduced the Wellington Global Impact Bond Fund, BlueBay Impact-Aligned Bond fund and the UBS Sustainable Development Bank ETF. This took overall bond exposure to 36%. In equities we exited investment in Aviva, Severn Trent, Renewi, the US Solar Fund and Vodafone. We added to M&G Positive Impact, Montanaro Better World, Regnan Global Equity Impact and Impax Environmental Markets. We introduced NinetyOne UK Sustainable and L&G Clean Water ETF. This increased equity exposure to 38%. Infrastructure/Clean Energy was reduced to 11% whilst Real Estate exposure was reduced to 9.5%. Cash was reduced to 5.5%.

Mid Green

In Fixed Income we reduced exposure to the Royal London Short-Dated Gilt fund and Threadneedle Social Bond fund. We introduced the Wellington Global Impact Bond Fund, BlueBay Impact-Aligned Bond fund and the UBS Sustainable Development Bank ETF. This took overall bond exposure to 21%. In equities we exited investment in Aviva, Severn Trent, Renewi, the US Solar Fund, MJ Gleeson and Gym Group. We added to Montanaro Better World, Regnan Global Equity Impact and Impax Environmental Markets. We introduced NinetyOne UK Sustainable, L&G Clean Water ETF and Foresight Forestry. This increased equity exposure to 54%. Infrastructure/Clean Energy was reduced to 10.5% whilst Real Estate exposure was reduced to 9.5%. Cash was reduced to 5%.

Dark Green

In Fixed Income we introduced the Wellington Global Impact Bond Fund, BlueBay Impact-Aligned Bond fund and the UBS Sustainable Development Bank ETF. This took overall bond exposure to 7%. In equities we exited investment in Aviva, Severn Trent, Renewi, MJ Gleeson, Gym Group, the US Solar Fund and BSC Social Impact Trust. We added to Montanaro Better World, Regnan Global Equity Impact, Impax Environmental Markets and Foresight Forestry. We introduced NinetyOne UK Sustainable and L&G Clean Water ETF. This increased equity exposure to 69%. Infrastructure/Clean Energy was reduced to 10% whilst Real Estate exposure was reduced to 9.5%. Cash was reduced to 4.5%.

Disclaimer

Please remember that the value of investments and the income arising from them may fall as well as rise and is not guaranteed. All information contained in this document has been prepared by King & Shaxson Ethical Investing. All opinions and estimates constitute our judgement as of the date of publication and do not constitute general or specific investment advice. Nothing in this document

constitutes an offer to buy or sell securities of any type or should be construed as an offer or the solicitation of an offer to purchase or subscribe or sell any investment or to engage in any other transaction. The information contained in this document is for general information purposes only and should not be considered a personal recommendation or specific investment advice.

King and Shaxson Asset Management Ltd. (Reg. No. 3870667) has its registered office at 1st floor, 155 Fenchurch Street, London, EC3M 6AL. The Company is registered in England and Wales and is part of the PhillipCapital Group. King and Shaxson Asset Management Ltd. (FCA Reg. No. 823315) is authorised and regulated by the Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN.