LGT Wealth Management

Phoenix Gaia Quarterly Commentary

April 2024

Market review

- Equity and bond markets moved independently.
- Expectations for interest rate cuts reduced.
- Geopolitics remained a primary concern.

At the start of 2024, investors anticipated significant rate cuts by year-end, pricing in reductions of between 1.50% and 1.75% from the Federal Reserve (Fed). However, throughout Q1, data continued to show US economic resilience, which encouraged markets that the Fed had successfully engineered a 'soft-landing', but gave rise to the possibility of a 'no-landing' scenario. This strong economic backdrop tempered rate cut expectations, pushing the expected date for the first cut further into the year, and reducing the number of anticipated cuts.

Despite interest rates now being expected to stay higher for longer, investor confidence in inflation reaching target levels without a severe recession boosted equities, with the UK being just one of the developed equity markets that reached a record high over Q1. However, the strongest movers were the US and Japanese markets. Within the former, communications services and technology sectors continued to lead the charge, driven by AI optimism and strong corporate earnings. However, Japanese equities enjoyed the most beneficial combination of factors, with the Bank of Japan's shift away from negative interest rates combining with progress on structural reforms to generate increasing optimism over Japan's economy, and very strong increases in equity prices. At the other end of the spectrum, Chinese stocks ended the quarter modestly lower, as foreign investors remained cautious amid ongoing fears about the outlook for the Chinese economy, but showed some signs of life after recovering from their lows of January.

The new Corporate Sustainability Due Diligence Directive (CSDDD) was approved by the European Commission in March. This directive creates a legal liability for companies related to environmental and human rights violations that occur within their supply chains, increasing the potential financial, regulatory, and reputational risks for companies that do not have a robust approach to sustainability management. To look at this more positivley, rather than just through the lens of increased risk, the change strengthens our view that companies addressing their sustainability footprint, including through their supply chains, are reducing risk and placing themselves at a competitive advantage.

Performance review

Given the rise in developed market equities over the quarter, our top performing funds were Janus Henderson Global Sustainable Equity, Alliance Bernstein US Sustainable Thematic Equity, and Lazard Global Sustainable Equity, all of which have significant exposure to the US technology sector, and delivered strong returns of 9.7%, 7.6%, and 6.6% respectively. It was noteable that the outperformance of these funds was seen primarily earlier in the quarter, when much of the focus was on the 'Magnificent 7' companies. However, as the equity rally broadened as the quarter progressed, other styles of fund were able to generate strong returns as well, with our global value funds, Sparinvest Ethical Global Value and Schroder Global Sustainable Value, rising 8.4% and 5.0% respectively. Both funds have significant exposures to financial companies which saw significant gains later in the quarter, as they tend to generate higher profits when interest rates are higher. Therefore, for them, markets moving to price in only three interest rate cuts this year from the seven priced in during December was beneficial.

By contrast, longer-dated bonds and our infrastructure holding had a more difficult start to the year. With fewer interest rate cuts expected now than at the start of the year, prices on both fell, with Foresight Global Real Infrastructure down 7.7% during the quarter, and Vanguard UK Long Duration Gilt Index, L&G All Stocks Gilt Index, and Vanguard US Government Bond Index down 3.5%, 1.8%, and 1.0% respectively.

Portfolio changes

Over the course of the quarter, we made some minor changes to the portfolios.

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Wealth Management

Whilst cash has been a safe place given higher rates, anticipated interest rate cuts will reduce the rates available from deposits. Expectation around the pace of interest rate cuts has reduced, but our core case remains that rates will come down. Therefore, we decided to start reducing the significant cash holdings in Gaia Andante and Gaia Moderato, by 2% initially, channeling the proceeds equally into Trojan Ethical and US Treasuries.

Troy as a fund house, managers of the Trojan fund, are more bearish on current market conditions, which is not unusual for them, as they have had a historically low allocation to equities versus peers. With the rest of the fund made up of inflation-linked bonds, Treasuries, and gold, the fund represents a well-diversified option that should be able to generate positive returns from assets within the portfolio in almost any market environment.

The purchase of more US Tresauries was to take advantage of the softening in the market, adding to our protection against a hard-landing scenario at a cheaper price. However, we maintained our bias towards shorter-dated bonds, as we see more value in that part of the market.

Looking ahead

Investor confidence in inflation reaching target levels without a severe recession was displayed throughout Q1, and was a positive overall for equity markets. However, the possibility of delayed rate cuts could keep borrowing costs higher for longer. In such a scenario, we believe that our preference for quality companies with robust business models, low debt, and positive cash flows will be beneficial.

Geopolitics, upcoming elections, and central bank actions will continue to influence investor sentiment as we move into the second quarter, and indeed throughout 2024. Geopolitics remains an ever-present risk, with continued war in Ukraine and increasing conflict in the Middle East all adding to a long and growing list of concerns for markets. With Joe Biden and Donald Trump now confirmed as their respective party candidates for the upcoming US elections, markets are bracing for a potential round two of Trump, and the heightened tensions this would be likely to bring towards China, and sustainable development within the US. However, whilst a Trump victory would almost certainly create some volatility around prices of sustainable investments, with a lot of loud rhetoric inevitable, we do not see it as changing the investment case for them in any meaningful way.

Overall, the world remains an uncertain place, so we continue to be well diversified, overlaying tactical opportunities where we see asymmetric risks in our favour, so that the portfolios can be robust in a variety of different scenarios.

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