Sustainable Quarterly review

Q1 2024 market review

Overview

- Bond and equity markets moved independently
- Investing for sustainable value creation
- Geopolitics remain a primary concern

Macroeconomic landscape Q1 2024

In the first quarter, bond and equity markets 'decoupled', or moved independently. Data continued to show US economic resilience, and equity markets in developed countries reached record highs, encouraged by the Federal Reserve appearing to engineer a **soft landing**. However, pessimism surrounded China due to concerns over its industrial and property sectors, although recent data suggests the stimulus will help to boost activity.

At the start of 2024, investors anticipated significant rate cuts by year-end, pricing in rate cuts between 1.50% and 1.75%. However, data showing US economic resilience has since tempered these expectations, highlighting the difficulty in reducing inflation to 2%. As the rate of disinflation slowed, markets now anticipate rate cuts to start in June, strategically timed ahead the US election.

Technology stocks, driven by AI optimism, soared, with Meta and Nvidia experiencing historic **market capitalisation** gains. The **rally** extended beyond tech, with broader **indices** like the S&P 500 Equal Weight Index and the Russell 2000 also experiencing gains. Corporate bond markets mirrored this enthusiasm, touching multi-year lows. European stocks, including the EuroStoxx 600 and FTSE 100, also posted strong gains. In the UK, Chancellor Jeremy Hunt's spring budget had minimal impact. With inflation decreasing and projected to approach 2% in the near future, there is potential for the Bank of England to lower rates this summer.

The Bank of Japan shifted from negative interest rates and adjusted its asset purchase program, leading to a weak yen and a surge in local equities. Equities continue to experience a resurgence, with the Nikkei 225 reaching an all-time high in March, surpassing the previous high in 1989. Enthusiasm for stock exchange structural reforms and increased domestic participation helped equities perform strongly in Japan. China's targeted fiscal measures and growth targets failed to fully convince investors, but Chinese equities rebounded in the latter part of the quarter.

Investor confidence in inflation reaching target levels without a severe recession boosted equities and corporate bonds. However, the possibility of delayed rate cuts could keep borrowing costs high, emphasising the preference for quality companies with robust business models, low debt, and positive cash flows. Despite market fluctuations and geopolitical uncertainties, the first quarter of 2024 showcased resilience in equity markets fuelled by technology optimism and positive economic indicators. Central bank actions and geopolitical events will continue to influence investor sentiment and market dynamics as the year progresses.

Investing for sustainable value creation

Written by Ben Palmer, Lead Portfolio Manager

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. This significantly increases the potential financial, regulatory, and reputational risks for companies that do not have a robust approach to sustainability management. The other way of looking at this, is that it strengthens our view that companies addressing their sustainability footprint, including through their supply chains, are reducing risks, and placing themselves at a competitive advantage.

This is the latest in a long list of policy changes over the recent years that is embedding the importance of sustainability management in corporate strategy. Whilst it is difficult to avoid news on the devastation caused by sustainability related disasters, some have been surprised that the events of the last 2 years have not derailed or at least materially decelerated support and action. The answer is not based or reliant on the altruistic good will of policy makers, it is rooted in the economic imperative of taking action.

Whilst the economic model of the last century has resulted in growth and social development it has also caused long term environmental, social, *and* economic challenges. For example, our use of fossil fuels as the primary energy source has altered our global climate and led to an increasing prevalence of extreme weather events, displacing communities, and causing substantial economic damage. In 2023, another record-breaking year for the number of climate related disasters, the OECD estimate that global GDP was reduced by 1% due to extreme weather events, a significant number when compared to the 2.9% growth that was achieved. The realisation of the flaws in the current model, and the fact that the negative impacts are not for future generations to bear but are manifesting themselves today is leading to sustained action. Political, social and market forces are creating an environment where the importance of a healthy environment and society in delivering sustainable growth is not just acknowledged but behaviours that support this are rewarded and behaviours that do not are penalised, driving the evolution towards a more sustainable economic model.

We believe you can both contribute to and benefit from this through focusing on a broader, more holistic assessment of 'sustainable value creation' (SVC), which considers how value can be generated for all stakeholders including shareholders, society, and the environment, and importantly how using this wider lens can lead to better long term financial outcomes. Central to a more sustainable economic model is creating healthier societies and cleaner economies. A healthy society is not just about effectively treating disease, it is also about keeping people safe and healthy, creating strong inclusive cultures, and providing economic opportunities. A cleaner economy means moving our power to less polluting sources, and re-engineering our production and consumption habits so that we don't just constantly deplete the earth's resources. If we can work towards these objectives, we will create a more resilient and productive world that is equipped to support continuing development and long-term economic growth. Within these two structural mega trends we utilise four investment pillars which have been core to our process since launching our sustainable proposition in 2018- 'Inclusion and equity', 'Health and wellbeing', 'Environmental action', 'Circular economy'. These help identify desirable and undesirable activities, considering 'what' a company does and 'how' it does it.

Whilst markets will be impacted by shorter-term cyclical factors, we believe the evolution of the economic model is underway and with it the emphasis on building healthier societies and cleaner economies. Through investing for sustainable value creation within our pilar framework we believe our portfolios are well positioned to contribute to a more resilient and productive world and deliver on client's long term investment objectives.

Further reading material

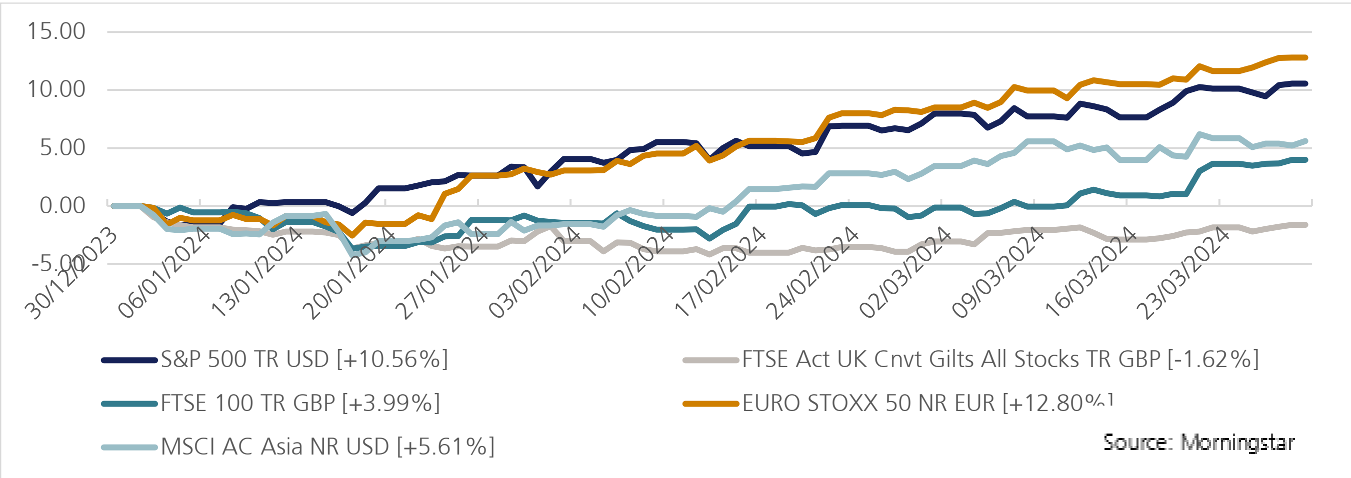
Take a deeper dive into the Q1 2024 investment landscape with key members of the LGT Intermediary Investment Services team.

Click here

Watch Phoebe Stone, Head of Intermediary Investment Services and Head of Sustainable Investing, discuss the first quarter of 2024 in a five-minute quarterly roundup.

Click here

Q1 2024 index performance (%)



Model portfolio performance as at 31 March 2024

Portfolio	3 months	6 months	1 year	3 years
Defensive	1.48	6.70	6.20	1.92
Cautious	2.45	8.02	7.72	4.35
Balanced	3.21	9.12	8.63	7.06
Growth	4.03	11.06	9.68	7.88
Adventurous	4.61	11.87	9.62	8.01

Source: Morningstar

Performance is gross of 0.30% AMC and net of underlying charges

Past performance is not a reliable indicator of future performance; and the value of investments, as well as the income from them can go down as well as up, and investors may get back less than the original amount invested.

12-month rolling performance

Portfolio	01/04/2019 - 31/03/2020	01/04/2020 - 31/03/2021	01/04/2021 - 31/03/2022	01/04/2022 - 31/03/2023	01/04/2023 - 31/03/2024
Defensive	0.25	11.56	0.98	-4.96	6.20
Cautious	-1.00	17.22	1.71	-4.77	7.72
Balanced	-2.88	25.89	2.93	-4.25	8.63
Growth	-3.17	33.88	3.48	-4.95	9.68
Adventurous	-4.17	39.00	3.14	-4.46	9.62

Source: Morningstar

Performance is gross of 0.30% AMC and net of underlying charges

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Performance of sustainable funds in Q1 2024

Janus Henderson Global Sustainable Equity
+9.69%

Sparinvest Ethical Global Value
+8.39%

Alliance Bernstein Sustainable US Equity
+7.64%

Liontrust Sustainable Future Global Growth
+7.40%

Lazard Global Sustainable Equity
+6.60%

Foresight Global Real Infrastructure
-7.73%

Source: Morningstar

Given the rise in developed market equities over the quarter, the portfolios saw progressive gains from the global equity funds. Resilient economies along with momentum across a broad selection of equity markets had led to growth leaning companies to perform well. The top performing funds, Janus Henderson Global Sustainable Equity (+9.69%), Alliance Bernstein Sustainable Equity (+7.64%) and Lazard Global Sustainable Equity (+6.60%) have significant exposure to the US technology sector which has been very favourable given AI optimism. The outperformance of these funds was primarily seen earlier within the quarter.

Our global value funds saw comfortable gains with Sparinvest Ethical Global Value and Schroder Global Sustainable Value returning 8.39% and 5.01% respectively. While at the start of the year, much of the focus had been on the Magnificent 7 companies, towards the end of the quarter the equity rally broadened, boosting returns for value strategies. Both funds have exposures to financial companies such as ING Groep, which saw a significant gain in March and therefore, supporting performance. As markets have moved to price in only three interest rate cuts this year from the seven priced in during December, financial companies such as banks and insurers which have typically performed better when interest rates are higher, have been beneficiaries.

Foresight Global Real Infrastructure fund (-7.73%) lagged across the quarter. The longer dated bonds and our infrastructure holding have had a more difficult start to the year, as higher-than-expected inflation data and resilient labour market data prompted investors to lower their expectation for interest rate cuts over the next 12 months. With fewer interest rate cuts expected now than at the start of the year, this led to both government bond prices (which move inversely to interest rates) and infrastructure holdings which are sensitive to interest rates to fall.

Portfolio changes and rationale

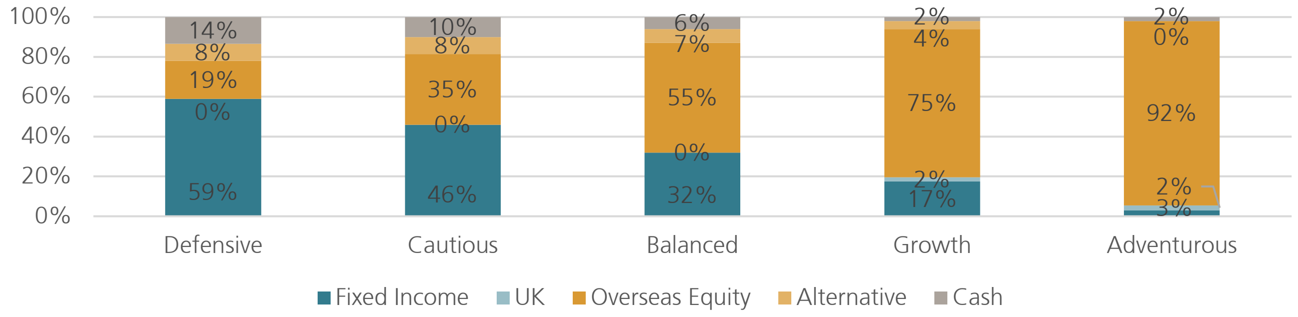
Rebalancing equity and fixed income exposures

- While cash has been a safe place given higher rates, anticipated interest rate cuts will reduce the rates for cash.
- Given our sizeable cash allocations in lower risk profiles, we decided to start reducing cash by 2% across Defensive and Cautious and channeling these proceeds equally into **Trojan Ethical** and **US treasuries**.
- **Trojan Ethical** – Trojan as a fund house are more bearish on current market conditions with a historically low allocation to equities. With the rest of the fund comprising of inflation linked bonds, treasuries and gold, the fund should capture a degree of any market upside while also benefitting from rate cuts on the bond and equities. Their government bond exposure also insulates the fund against recessionary risk and the gold exposure provides additional diversification.
- **US treasuries** – US treasuries have benefitted from higher rates following Fed push back at the start of the year, any cuts to interest rates will be beneficial regardless of whether soft or hard landing based.

Reducing cash in Defensive and Cautious Models

- We have rebalanced our equity and fixed income exposure across risk profiles. This does not result in significant structural changes but instead re-dresses balance between position sizes and the role of the funds within the overall mandate.

Portfolio positioning



Source: Morningstar

Glossary of terms

Bonds	Bonds are debt securities issued by governments and corporations to raise money. Similar to an IOU, the investor lends money with the agreement that it will be paid back by a specific date, and they will receive periodic interest payments along the way. Bonds come under the umbrella of '**fixed income**' investments.
Defensive	Defensive positioning means prioritising asset protection during market turbulence by favouring stable sectors like utilities, consumer staples, and healthcare.
Earnings season	The period during which publicly traded companies release their quarterly financial results to the public.
Growth vs Value	Most stocks are classified as either value stocks or growth stocks. Generally speaking, a value stock trades for a cheaper price than its financial performance and fundamentals suggest it's worth. A growth stock is a company which comes at a higher price however, its profits are expected to grow significantly in the coming years as the company develops – this is typical for technology firms.
High conviction	An investment portfolio with a small number of carefully chosen securities, reflecting the manager's strong confidence in their selections
Index / indices	A benchmark that tracks the performance of a specific group of assets, such as stocks or bonds
Index linked bond	A type of bond whose interest payments and principal value are tied to a specific index, such as inflation or a stock market index.
Magnificent Seven	A group of high-performing technology companies considered industry leaders, including Apple, Amazon, Alphabet, Microsoft, Meta, Tesla, and Nvidia.
Quality	A quality stock is one from a financially sound company with stable earnings, consistent growth, and strong management.
Rally	A market rally is a sustained increase in stock prices driven by positive investor sentiment and economic conditions.
Sentiment	Market sentiment is the overarching attitude or outlook of investors towards a particular security, sector of the market or economy as a whole.
Soft vs hard landing	A soft landing refers to a gradual economic slowdown or adjustment, usually avoiding a recession, while a hard landing is a sudden and severe economic downturn often leading to a recession.
Market capitalisation / mega-caps	Market 'cap' is the market value of a company based on its current share price and total number of shares. Ultra-large cap companies have the largest market capitalisation. The largest companies by market cap are currently Apple, Microsoft, Alphabet (Google), Amazon, Nvidia and Meta (Facebook).
Yield	The income you receive on an investment, such as dividends from shares or interest from bonds.
Yield curve	The yield curve is like a snapshot of how interest rates are right now for different types of loans or bonds. It shows how much you'd earn if you invested your money for a short time, like a few months, versus if you invested it for a longer time, like several years.
Volatility	Volatility refers to the degree of fluctuation in a security's price or a market's performance over time. A highly volatile share experiences larger price changes compared to more stable investments, indicating higher risk.

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