Active MPS 2024 Review

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For Professional Advisers Only

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Introduction

The aim of this review is to consider how we performed during 2024, our thoughts on where the Active MPS is currently positioned and how we view the year ahead. Equities outperformed bonds over the year as inflation continued to moderate and interest rates were cut by the major central banks. The US market once again led the charge, driven by AI related tech stocks. However, inflation is proving to be stickier than anticipated and led to the anticipation of further meaningful interest reductions being more muted. This was a major headwind for the performance of sovereign bonds.

As a reminder, our philosophy since launch has been to provide a series of risk targeted portfolios that result in a service similar to that which our firm's private clients receive. We do this by adopting a 'whole of market' approach that includes investment companies and passives alongside open ended funds to gain access to as many asset classes as possible through the most appropriate structure.

Reflecting on 2024

We entered the year once again fully invested, with an underweight allocation to cash but overweight all other asset classes, namely equities, bonds and alternatives. The overweight to bonds was almost entirely explained by a maximum overweight to government bonds that was built up throughout 2023. The alternatives overweight was explained by the portfolios having a range of exposures to property, hedge funds and infrastructure, all of which we believe provide important portfolio diversification. Within the equity allocation we were fractionally underweight the UK and Japan but overweight Europe and North America. Finally, we were overweight Asia and Emerging Markets in the lower risk models and underweight in the higher risk ones.

The year began with ongoing conflict in the Middle East and Ukraine, which some feared could disrupt trade and oil and negatively impact stock markets. Investors had concerns about general elections too, with some 40 countries heading to the polls. Oil prices remained stable, even falling throughout the year, and the disruptions did not spread to the wider global economy. The elections, particularly in the US, proceeded without significant disruption or cause geopolitical destabilisation. In India and Japan poll results were much tighter, while there were repercussions following the European elections halfway through the year.

The delicate task of curbing inflation remained a key focus for many central banks except for Japan's central bank, the Bank of Japan, which pivoted away from its zero-interest rate policy. It meant Japan saw its first interest rate rise in 17 years[1] from -0.1% to a range of 0% to 0.1%. This was driven by signs of moderate economic recovery, wage increases and a rise in inflation. There were expectations for interest rates to fall globally, particularly in the UK, US and Europe. Cuts were expected to begin in the US in March but were slower to materialise than expected. Europe was one of the first movers, with the European Central Bank cutting rates for the first time in five years reducing its main lending rate from 4% to 3.75%. More cuts followed, with the rate now at 3%. The Bank of England (BoE) reduced interest rates for the second time in November from 5% to 4.75% but held them there, citing concerns over persistent inflation. The US Federal Reserve mirrored the BoE with a second interest rate cut in November by 25 basis points to a range of 4.25% to 4.5%. It was smaller than the 50 basis points cut in September due to similar concerns the over inflation.

The UK election resulted in a landslide win for Sir Keir Starmer's Labour party with the largest government majority in parliament since 1832, and the worst performance of the Conservative party in modern history. It was a successful night for other parties too including the Liberal Democrats and the Reform party led by Nigel Farage. Since then, headlines have been largely dominated by the state of the nation's finances, with the new government suggesting their fiscal inheritance was worse than they had expected. Chancellor Rachel Reeves delivered the Autumn Budget on 30th October, accompanied by a fiscal and economic forecast from the Office for Budget Responsibility. Despite the budget and bleak outlook painted by the government, we remain constructive on UK equities as they look relatively cheap, both compared to their own history and the rest of the world.

The US stock market started the year with caution and optimism having delivered significant gains in 2023. However, some areas of the market were getting more expensive and valuations stretched but this was offset by optimism that the US economy was continuing to grow, and inflation would fall. The latter view won out and the US market, which has been exceptional over the past decade as it has constantly outperformed its global peers, continued to deliver. Recently this performance has been primarily driven by the so-called 'Magnificent Seven' tech stocks and having led much of the recent rally in the US there were expectations these stocks would pull back and allow the wider US market to take up the lead. Although we saw more performance from the wider market, the Magnificent Seven continued to dominate for much of 2024. The backdrop of the US election, the peacefully accepted results, and the expectation that Donald Trump's policies will favour equities has sparked renewed interest in the stock market. Looking ahead, 2025 could again be positive for US equities. Despite some volatility, the overall trajectory for the US market is predicted to be upward. There are still risks to consider, such as high valuations and market concentration. Together, the Magnificent Seven account for a near record 33% of the S&P500 market cap. If the AI theme fails to deliver, then tech stocks could drag down overall US equity performance. America's debt also continues to accumulate at an alarming rate. With further tax cuts coming from Trump this could rise even faster

Japan's performance for 2024 has been mixed. At the beginning of the year, the Nikkei 225 surged to a new all-time high,2 34 years after its last peak. This resurgence was partly due to corporate governance reforms led by the government and the Tokyo Stock Exchange, which boosted shareholder value. The yen fell significantly in 2024 before a sharp recovery following the surprise rise in interest rates. Since this event, the currency has weakened, but remains off its recent lows, while the stock market has been slowly recovering. In late October Japan had a general election following the resignation of its Prime Minister, Fumio Kishida, due to low popularity ratings. The ruling Liberal Democratic Party and coalition partner, Komeito, lost their parliamentary majority for the first time since 2009. This didn't impact markets this year but does raise concerns for 2025 and beyond.

Europe also saw mixed performance in 2024. European stock markets initially participated in the rally of the first half of the year as semi-conductor stocks led the way. Markets became more volatile as they gave way to concerns about the far right gaining seats in the European Parliament while a shock election in France raised further uncertainty. However, at the end of 2024 political instability remains an issue in some parts following the collapse of France's government due to a budget crisis and political gridlock. In Germany, the political landscape does not look any clearer. While the world watched the US election unfold Germany was entering political meltdown. Chancellor Olaf Scholz fired his Finance Minister Christian Lindner, leader of one of the three coalition parties. Two of Lindner's colleagues in cabinet also quit. Scholz called a vote of confidence on 16th December, which he lost - paving the way for an election in early 2025. Despite the political uncertainty Germany's DAX 40 has remained buoyant and even hit new record highs this month. France on the other had has seen its stock market slump over the second half of the year which resulted in Europe ex UK being the worst performing of the major regions in 2024.

Chinese financial markets faced significant challenges in 2024, including slowing economic growth, a declining property market, and subdued consumer confidence. To address these issues, the People's Bank of China (PBOC) introduced a comprehensive economic stimulus package in September. Stimulus measures include a reduction of key interest rates and reserve requirements for banks to increase liquidity and encourage lending, as well as targeted measures to stabilise the property sector. The markets reacted positively but the effectiveness of the stimulus package is still being evaluated, with some experts expressing concerns about its timing and sufficiency. The year saw India's fortunes transform with the country outpacing other major economies. Investors are attracted by its favourable demographics, potential for further growth due partly because of its rising middle class, political stability and high-quality stock market by emerging market standards.

But there are still some risks to take note of. The government performed poorly in the general elections in June, failing to win a majority, which could hamper further economic reforms. Consumption also started to slow and in the latter half of 2024 the country's gross domestic product (GDP) reduced to 5.4% from last year's 8.1%3.

The gold price surged past $2,400 per troy ounce in April, driven by escalating geopolitical risks, concerns over budget deficits, and increased central bank demand. Usually, gold's performance doesn't correlate with US equities. However, investors have been drawn to gold for its risk protection benefits as geopolitical tensions continue. This trend could continue into 2025.

In 2023 bonds regained some appeal as a viable investment option in anticipation of interest rate cuts in 2024. Frustratingly, enthusiasm for UK gilts and US treasuries remained subdued last year as although interest rates have been falling, cuts began later than expected and the trajectory of that fall has been slower. Inflation remained sticky whilst growth, particularly in the US, has been stronger than expected. This led to more volatility in the government bond market in 2024 as investors constantly re-evaluated their expectations.

In terms of overall performance, all six portfolios made positive ground, ranging from 5.2% for Defensive and 12.3% for Growth. Four (Defensive, Defensive Income, Balanced Income and Balanced Growth) of the six portfolios outperformed their MSCI Dynamic Planner benchmark over the year, with Growth and Dynamic Growth lagging by less than 0.75% 4.

[1] BBC.co.uk, Japan raises interest rates for the first time in 17 years, 19th March 2024
[2] FT.com, Japan's Nikkei 225 index eclipses record high after 34 years, 22nd February 2024
[3] CFO.com, India's GDP Growth slows to 5.4% in Q2, lowest in 7 quarters, 30th November 2024
[4] Facstet 31.12.24

What did the team get up to in 2024?

We executed just two rebalances during the course of the year, in February and May. We hope that our investors do not view this lack of turnover as laziness! In truth it was a reflection of us believing that our stance heading into the second half of the year did not require adjusting. Perhaps of most significance was our decision not to try to predict the outcome of the US presidential election and position the portfolios accordingly. This was predicated on the view that we had zero insight as to who would win what was most likely to be a tight race. With hindsight this was exactly the correct course of action.

The February rebalance was primarily driven by the annual update made to the Dynamic Planner asset allocation framework. Since early 2023 we have steadily increased not only the weighting to conventional government bonds across the risk profiles but also the duration within the allocation. We continued this in February, bringing the models to a maximum overweight exposure as government bonds remained a compelling investment proposition, offering the combined benefits of attractive real yields as well as a level of portfolio insurance were a growth shock to occur. A new position in the iShares Up To 10 Years Gilts Index, a passive fund, was introduced in the two lowest risk models to help manage our duration exposure.

Equity exposure was decreased in the two lowest risk models as well as Dynamic Growth, but increased in the other three, although all moves were marginal. The one area of consistent reduction was to the UK where, despite attractive valuations, we saw greater macro-economic headwinds and less exposure to the growth theme that has been driving markets for the past year or so. We retained an overweight to equities in all six models as corporations continued to enjoy strong pricing power as consumer confidence remained robust, labour markets were tight and economic activity remained surprisingly buoyant, especially in the US. In the higher risk half of the range, we remained underweight Asia and Emerging Markets which have continued to struggle on a relative basis for the past few years, principally due to a deteriorating picture in China. In the Dynamic Growth model, we initiated a position in Baillie Gifford Emerging Markets Leading Companies which is unashamedly growth focused and will benefit from any improved outlook and market sentiment.

The May rebalance was driven by several factors, namely two fund switches, reinvestment of cash from a corporate action and lastly to take advantage of discounts to NAV in the alternative investment company holdings. Fund switches were carried out within the US and Emerging Markets equity allocations. We exited JPMorgan US Equity Income and reinvested into BNY Mellon US Equity Income primarily based on a preference for the process of the team at BNY. However, we were also able to benefit from access to an attractively priced share class that led to an overall OCF saving. Hermes Global Emerging Markets was also exited from all portfolios bar Dynamic Growth, where it was reduced significantly, and reinvested into Baillie Gifford Emerging Markets Leading Companies.

At the start of April, Troy Income & Growth Trust completed its merger with another investment trust and as part of the transaction we opted to receive cash rather than rolling into the combined entity. We therefore put some of this back into the UK equity market in the Balanced Income, Balanced Growth and Growth portfolios. Japan was also added to in all portfolios bar Dynamic Growth as we believed the outlook for Japanese companies was compelling, buoyed by huge corporate governance reforms as well as a currency that was as weak as it has been for decades. This took all portfolios overweight Japan, bar Defensive.

Finally, within the three lower risk portfolios, we sought to take advantage of persistently wide discounts in the property, infrastructure and hedge fund names. We believe the discounts that have persisted in these areas of the investment companies space for the past eighteen months are unsustainable. Any change in sentiment, either because of a change in the outlook for interest rates or because of a change to the penal cost disclosure regime that these companies are currently subject to could see a significant narrowing of discounts and the possibility of very attractive returns.

What investments were the team most pleased to hold and what didn't work so well during the year?

The UK equity allocation added significant outperformance. Within the list, Artemis UK Select (+25.7%) topped the leaderboard for the second consecutive year. Redwheel UK Equity Income (+21.2%) and Premier Miton UK Multi Cap Income (+13.5%) also performed extremely well, the latter meriting particular mention as it has a significant bias to smaller companies which do not appear on the radar of any financial commentator currently. This gives us hope that we are in a more suitable environment for active managers in the UK to reassert themselves after a very few tough years. Whilst all our positions here made positive gains the notable laggard was BlackRock Smaller Companies (+2.2%).

For the second year in a row, the allocation to developed market equities was a relative drag on performance, principally due to the US positions. In a year where the market was dominated by only a handful of names, it was very difficult for active managers to outperform. That said, our best performing holding was GQG US Equity (+28.4%) with its very focused portfolio that is currently quite tech heavy. Vanguard US Equity Index (+25.8%) demonstrated the strength of the overall market as did the fact that all of our holdings here made double digit returns, with Monks (+19.2%) making a notable contribution. BlackRock Gold & General (+17.2%) benefitted from the continued strength of the gold price, although lagged the return of gold bullion. We believe that the outlook for gold equities is extremely positive and the profitability of the underlying companies should be exciting with the metal price at all-time highs. Our Japan holdings were mixed, with JPMorgan Japan (+17.8%) outperforming by some margin, but Jupiter Japan Income (+5.5%) and Baillie Gifford Japan (+1.9%) being more pedestrian. Our European exposure was once again a pleasing positive driver, with all three names outperforming. However, the slightly more muted returns from BlackRock European Dynamic (+3.6%), Janus Henderson European Focus (+3.2%) and BlackRock Continental European Income (+3.0%) reflect the headwinds that Europe faced over the year.

The biggest relative performance detractor was the exposure to Asia and Emerging Markets which unwound its outperformance in 2023. A number of our Asia Pacific ex Japan holdings struggled relatively, although Hermes Asia ex Japan (+13.4%) and Schroder Asian Total Return Investment Company (+12.6%) outperformed. Fidelity Asia (+11.1%) also made solid positive returns but Pinebridge Asia ex Japan Small Cap (+2.8%) was the most significant laggard. Within the broader emerging markets allocation, India has for some time been the biggest beneficiary of investor wariness of China's macro and governance outlook and it once again turned in a leading role, with our holding in Goldman Sachs India (+23.1%) being the biggest outperformer. It was however ably supported by BlackRock Frontiers (+16.0%). Utilico Emerging Markets (-3.1%) and BlackRock Emerging Markets Equity Strategies (-0.0%) were the only negative performers, although we would highlight that this second fund has outperformed by a significant margin over the past three years.

The bond allocation was also a positive driver of relative performance across the board, although absolute returns were far more unexciting than for equities. The key, as has been the case over the past couple of years, was to retain a short duration stance. AXA US Short Duration High Yield (+6.0%) led the way although there was also a significant contribution from M&G Emerging Markets Bond (+5.5%), which benefitted from the strength of the dollar, as well as Artemis Corporate Bond (+3.2%), The returns from government bonds were less impressive with most making little headway over the year, although Vanguard UK Inflation Linked Gilt (-8.7%) was a disappointment due to its longer duration.

Alternatives were a real mixed bag. Both NB Uncorrelated Strategies (+6.7%) and BH Macro (+10.6%) produced returns ahead of our bond positions, the latter helped by its discount to net asset value narrowing. Unfortunately, the property and infrastructure names were weak as inflation and interest rate expectations whip-sawed the asset class throughout the year. Empiric Student Property (-8.5%), Picton Property Income (-7.5%) and INPP (-5.8%) all trade at historically wide discounts to net asset value and offer highly attractive dividend yields. At some point the situation will rectify itself and we would expect major moves up from current levels. In the meantime, shareholders are getting paid a significant income stream.

Source: Morningstar, Factset as at 31.12.24.

How is the MPS currently positioned as we begin a new year?

The portfolios remain fully invested, with an underweight allocation to cash and bonds but overweight equities and alternatives. Within the bond allocation we are maximum overweight government bonds but underweight corporate, international and index-linked bonds. The alternatives overweight is explained by the portfolios having a range of exposures to property, hedge funds and infrastructure, all of which we believe provide crucial portfolio diversification.

Within the equity allocation we are generally neutral on the UK, slightly underweight Europe but overweight Japan and North America. The North America allocation also includes the holding of BlackRock Gold & General which is the only thematic play in the portfolios. Finally, we are overweight Asia and Emerging Markets in the lower risk models and underweight in the medium and higher risk ones.

What is the outlook for markets in 2025?

Equities have had a mixed performance since the US presidential election on 5th November. US stock returns have risen compared to global equities (ex US) in sterling terms. This divergence can broadly be explained by investors' anticipation of tax cuts and deregulation from the incoming Trump administration, as well as ongoing solid US economic fundamentals. In contrast, UK chancellor Rachel Reeves' tax raising budget did little to boost the domestic stock market. Elsewhere, European stocks appear in the crosshairs of potential tariff hikes under president-elect Trump, while the collapse of the German governing coalition has not helped either. Investors can expect political uncertainty in the largest European economy until elections are held on 23rd February.

We see four key themes for this year:

1. Global equities over bonds: There is significant momentum behind stocks and there are expectations of further interest rate cuts this year that should support the equity story.

2. Exceptional US equities: Stronger EPS projections and better capital deployment mean we favour US equities. Donald Trump's deregulation programme should also prove to be a significant support.

3. Gilts over treasuries: Trump's policies are likely to be more expansionary compared with the UK. Gilts look relatively cheap compared to US treasuries given growth and inflation dynamics.

4. Joining the gold rush: Gold is backed by structural central bank demand and offers portfolio diversification benefits although near term US dollar appreciation is a risk.

Since the launch of the Active MPS in September 2012 we have extolled the virtues of investment companies and their use in diversified portfolios. However, the past few years have been an incredibly frustrating period for investors in these vehicles, such as ourselves, as they have struggled due to their discounts to NAV, for various reasons, widening out and remaining there. The biggest drag that the sector has faced has been PRIIPs and associated EU Law regarding the cost disclosure requirements of PRIIPs and associated MiFID regulations. The investment company sector has suffered massively from this double counting of over-inflated PRIIPs costs as it has led to widespread selling from big multi-asset funds of many investment companies with high costs and reduced demand despite the attractive discounts available. This has been most pronounced in the alternative assets sectors such as infrastructure, renewables and private equity. The retail disclosure framework for Consumer Composite Investment (CCI) is expected to come into force in the first half of 2025 and the consultation phase has just begun. The anticipation is for it to provide much more clarity on what investors are actually paying for and to be much more bespoke depending on the investment vehicle concerned. This is all undoubtedly good news for the investment companies sector which has really struggled with these regulatory headwinds in recent years.

Conclusion

Despite some geopolitical risks, both economic and company fundamentals remain strong. The 'soft landing' increasingly looks the likely path for the US economy, and Trump's suggested policy agenda of tax-cuts and deregulation should prove a tailwind for equities. US exceptionalism once again won out in 2024 and is hard to ignore, but investors must bear in mind that this has been supported by gains in the technology sector driven by growth in AI. There are still concerns that America's fiscal deficit, incoming tariffs, and sector concentration could pose further risk for investors. Over-reliance on one sector could prove to be a mistake and diversification remains a crucial strategy for any investor. While 2024 presented various economic hurdles there is potential for further growth in 2025

We thank all of you again for your support over the past twelve months and we look forward to staying in regular communication with you throughout the year.

Cumulative performance to 31 December 2024

	1 year	5 years	Since Launch
Active MPS Defensive Portfolio	**5.19%**	**10.23%**	**79.29%**
IA 0-35% Shares	4.36%	5.99%	41.93%
Active MPS Defensive Income Portfolio	**7.08%**	**17.77%**	**113.16%**
IA 20-60% Shares	6.18%	12.78%	67.43%
Active MPS Balanced Income Portfolio	**9.90%**	**28.56%**	**146.78%**
IA 40-85% Shares	8.88%	24.02%	112.74%
Active MPS Balanced Growth Portfolio	**10.86%**	**31.26%**	**174.31%**
IA 40-85% Shares	8.88%	24.02%	112.74%
Active MPS Growth Portfolio	**12.31%**	**32.45%**	**190.09%**
IA Flexible	9.14%	26.84%	118.20%
Active MPS Dynamic Growth Portfolio	**10.33%**	**25.17%**	**175.12%**
IA Global	12.84%	52.22%	237.62%

Past performance is not a guide to future performance. Capital at Risk. The value of investments and the income from them can fall as well as rise and you may not receive back the original amount invested. The portfolio's performance is shown above after the effects of all charges made by the underlying holdings but before accounting for Evelyn Partner's investment management charge, and any platform fees and adviser charges. The effect of these additional fees and charges would be to reduce the returns shown. IA = Investment Association. Source: Factset as at 31.12.24.

By necessity, this briefing can only provide a short overview and it is essential to seek professional advice before applying the contents of this article. This briefing does not constitute advice nor a recommendation relating to the acquisition or disposal of investments. No responsibility can be taken for any loss arising from action taken or refrained from on the basis of this publication. Details correct at time of writing.

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Past performance is not a guide to future performance.

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