Quarterly report
Sustainable Model Portfolio Service

Q2 2024 market review

Overview

- US equity markets continued to rally and hit record highs
- Central banks' rate cutting regimes began to pick up pace
- Market participants keep a close eye on global election results

Macroeconomic landscape

Q2 2024

After a slight pullback in May, US equity markets continued to **rally** and hit record highs, lifted by Nvidia, Apple and Microsoft, with Nvidia briefly overtaking Microsoft in June to become the world's most valuable company. The narrowness of the markets was even more pronounced this quarter, as Nvidia rose 37% while the S&P 500 **Index** gained 4.3%. Nvidia is responsible for some 35% of the S&P 500's gains since the start of this year. In comparison, the equal weighted S&P 500 Index fell 2.6% in the quarter, clearly indicating a handful of companies continue to drive the indices.

Government **bonds** fell slightly throughout the quarter as market participants weighed up the outlook for inflation and economic growth. Investment Grade and High Yield bonds showed resilience, benefiting from the strong economic growth outlook and the tailwind provided by their high-income component.

Markets have fluctuated between anticipating one or two Federal Reserve (Fed) rate cuts this year. However, due to persistent price pressures and a robust job market, the Fed is unlikely to rush to cut rates. Meanwhile, the Bank of England (BoE) indicated in June it is more comfortable cutting rates and will likely start in August. While the European Central Bank (ECB) lowering interest rates by 0.25% (to 3.75%) in its June meeting was expected, it is noteworthy that interest rate cutting regimes are picking up pace with central banks in Sweden, Switzerland and Canada all cutting rates.

Following an unexpected rise in April, the US Consumer Price Index (CPI) showed signs of moderation, suggesting inflation is heading in the right direction. Bond yields followed suit, with 10-year Treasuries reaching 4.7% early in the quarter before falling to 4.4% by quarter-end.

On the political front, Rishi Sunak's decision to bring forward the UK general election to 4th July stunned market participants. Labour won the election by a landslide, but markets showed limited reaction to the news as polls had predicted the Labour victory for months. Given that fiscal headroom remains limited, policy changes are likely to be marginal despite the huge electoral swing.

In the US, the first presidential debate brought forth fresh concerns over President Joe Biden's health and former President Trump continues to lead key swing states. In early June, the European Parliamentary elections showed surging support for right-leaning parties, with President Emmanuel Macron calling a snap national election in France. The French CAC 40 fell over 6% following Macron's announcement and the difference in the amount of interest that French bonds pay over German Bunds reached levels not seen since 2017. However, following the second round of voting, France now faces gridlock as none of the three main parties secured a majority.

Harnessing the power of data

Written by Ben Palmer, Lead Portfolio Manager

Financial data has long been a cornerstone of traditional investment analysis, and over recent years we have seen corresponding growth in the use of sustainability data to help inform sustainable analysis. The drive towards data is not without its challenges, not least due to the lack of corporate disclosures, and the inherent question on how you place a metric on areas like corporate culture. We fully acknowledge these challenges and are very clear on data's limitations. However, we also believe it can play an important role in our analysis, monitoring and reporting. The emphasis on integrating high quality data is strengthening. We have seen governments and regulatory bodies across the world implementing stricter requirements on what can be defined as 'sustainable' and how this can be evidenced to enhance transparency and accountability.

Data providers

The market for third-party sustainability data providers is concentrated on several key players. MSCI ESG Research for example, offers a comprehensive range of ESG company ratings, carbon data and ongoing controversy coverage. Similarly, ISS ESG, a division of Institutional Shareholder Services, also provides a detailed range of ESG company ratings and norms-based screening. Both data providers have spent years developing their own methodologies to encompass a wide range of ESG factors, to assess company performance and progress. Given that sustainability is rather broad, there is a lack of consistency in measuring sustainability amongst these providers. The CFA institute for example found that the correlations across ESG ratings of major data providers ranged from 7% to 65%.

CFA Institute (2021)

	MSCI	S&P	Sustainalytics	CDP	ISS	Bloomberg
MSCI	x	36%	35%	16%	33%	37%
S&P	36%	x	65%	35%	14%	74%
Sustainalytics	35%	65%	x	29%	22%	58%
CDP	16%	35%	29%	x	7%	44%
ISS	33%	14%	22%	7%	x	21%
Bloomberg	37%	74%	58%	44%	21%	x

Note: CDP is the Carbon Disclosure Project Score.

Source: CFA Institute

This is relatively low if ESG ratings are supposed to measure the same attributes of a company. However, what we find is that this does not indicate that one particular data provider is wrong, but that there is a difference in what is being measured. Reflecting on our earlier examples, MSCI's ESG company ratings focuses predominately on a company's exposure and management to operational ESG risks and opportunities. ISS on the other hand, focuses on the company's revenue contribution or obstruction towards the UN Sustainable Development Goals (UN SDGs).

Our in-house sustainability tools

As we found that third-party data providers have different measures to sustainability, we developed our own in-house sustainability tool which utilises several data providers (including MSCI and ISS) to gain a holistic view within our investments. This comes with several advantages:

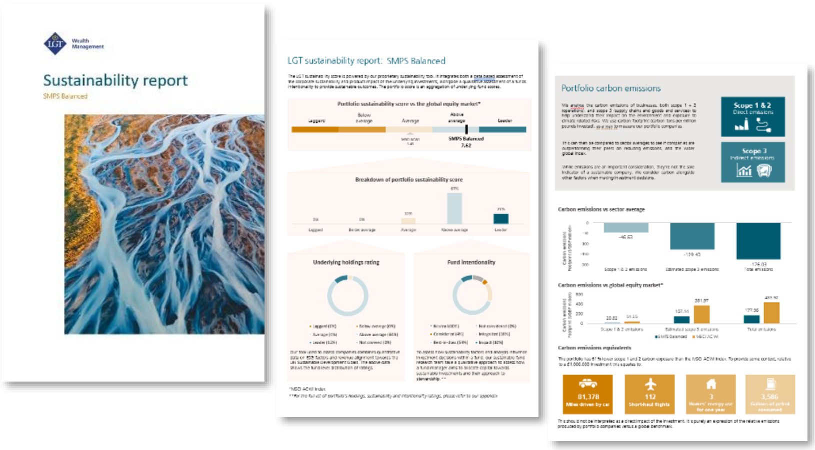
Firstly, this allows us to align the assessment of sustainability metrics with our own objectives. For instance, we believe understanding a company's operational risk and opportunity as well as the impact of their products and services are both important. Therefore, our in-house sustainability tool combines data from both MSCI and ISS data to formulate a company rating.

Secondly, with the dynamism of new data being available, having in-house sustainability tools gives us the flexibility to continuously innovate our understanding of sustainability and integrate this within our systems. For instance, while carbon emissions data can be a good indicator of a company's exposure to climate risk and opportunity, it does not necessarily paint the full picture. We are currently developing our climate solutions tool which identifies a company's contribution to mitigation of climate change and a net zero alignment tool to verify a company's decarbonisation targets against a global net zero ambition pathway. Combining these developments with our existing carbon emissions data will give us a much more nuanced look into a company's climate risk and opportunity.

Finally, with the need for transparency and sustainable disclosures increasing at a rapid pace, it is important to have systems in place to respond to ongoing regulation. For example, the recent Task Force for Nature Related Disclosures (TCFD), and any upcoming requirements as a result of the FCA Sustainability Disclosure requirements (SDR). With in-house data infrastructures, we are well equipped to deliver.

Our new sustainability report

As we continue to develop our proposition, we want to start sharing some of the informative insights we generate on our portfolios through our tools. With this in mind, we are launching our new quarterly sustainability report. In addition to the data driven insights we also include information on our stewardship efforts and qualitative based case studies and over time we can evolve the report to account for new insights or regulations. We believe this new report is a great tool for advisers and clients as we continue to harness the increasing power of data within our in depth qualitative led process, supporting us in delivering long term sustainable value creation.



Source: LGT Wealth Management

For more information on our sustainability report, please get in contact with a member of the team.

Further material

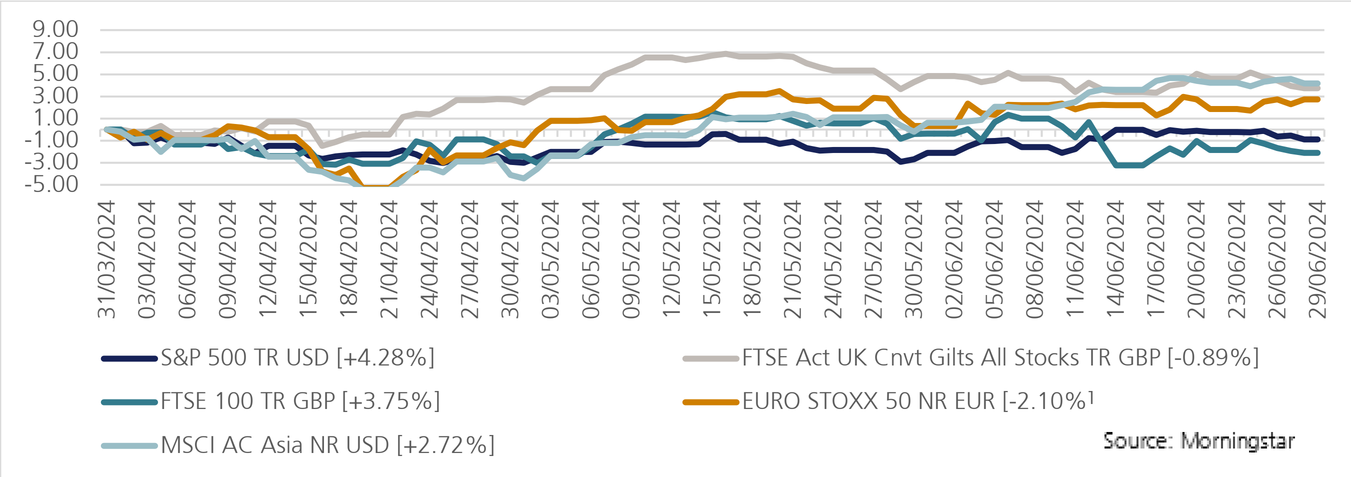
Take a deeper dive into the Q2 2024 investment landscape with key members of the LGT Intermediary Investment Services team.

Click here

Watch Ben Palmer, Lead Sustainable Portfolio Manager, discuss the second quarter of 2024 in a five-minute quarterly roundup.

Click here

Q2 2024 index performance (%)



Model portfolio performance as at 30th June 2024

Portfolio	3 months	6 months	1 year	3 years	Since inception (01.11.2018)
Defensive	0.71	2.20	7.02	-0.34	18.11
Cautious	0.75	3.22	8.11	1.24	25.88
Balanced	0.91	4.14	8.86	2.86	36.75
Growth	0.91	4.98	9.58	2.87	46.47
Adventurous	0.98	5.64	9.54	2.67	50.83

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	01/07/2019 – 30/06/2020	01/07/2020 - 30/06/2021	01/07/2021 - 30/06/2022	01/07/2022 - 30/06/2023	01/07/2023 - 30/06/2024
Defensive	3.22	7.93	-8.23	1.47	7.02
Cautious	3.31	12.21	-9.42	3.38	8.11
Balanced	3.58	18.32	-10.43	5.49	8.86
Growth	5.66	22.44	-12.31	7.05	9.58
Adventurous	6.12	25.09	-13.61	8.50	9.54

Sources: Morningstar

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.

Performance of LGT WM funds in Q2 2024

Stewart Asia Pacific Sustainable Leaders
+5.93%

HC Cadira Sustainable Japan Equity
-6.29%

Polar Capital EM Stars
+5.05%

Janus Henderson Global Sustainable Equity
+4.14%

Foresight Global Real Infrastructure
+3.95%

Impax Asia Environmental Markets
+2.60%

Source: Morningstar

The second quarter of the year saw positive market performance within Asia, particularly in Asia Emerging markets. Stewart Asia Pacific Sustainable Leaders, Polar Capital EM Stars rose by 5.93% and 5.05% respectively. Within the region, positive macroeconomic data, signs of government stimulus, and attractive valuations have turned investor **sentiment** more favourable, leading to strong performance and promising prospects for continued growth.

Janus Henderson Global Sustainable Equity (+4.14%) also saw considerable gains with the US leading the charge with momentum and **mega-cap** tech stocks propelling markets. Investor attention remained focused on the '**Magnificent 7**' with Nvidia seeing significant stock price appreciation and accounting for c. 33% of the S&P 500 performance in the first half of the year. Nvidia accounts for approximately 7.5% of Janus Henderson Global Sustainable Equity.

Foresight Global Real Infrastructure (+3.95%) saw positive gains this quarter, showcasing a small bounce back from its poorer performance in Q1. As the market begins to price in lower fund rates across the long term, we saw the negative drag of the fund which has a significant exposure to long duration assets ease slightly for the quarter. Additionally, we saw stock specific gains from Foresight Global Real Infrastructure with Brookfield Renewable Partners (BEP) announcing a 10.5 GW framework agreement with Microsoft to develop renewable energy projects within the next 4 years. On the day of announcement, the stock saw a c. 30% increase in price.

HC Cadira Sustainable Japan Equity (-6.29%) saw a decline over the quarter as the yen continued to depreciate and we saw conservative earnings forecast for Japanese companies. We added HC Cadira Sustainable Japan Equity to the higher risk models in May, bypassing the majority of the quarterly decline and with the Bank of Japan showing signs of proactive interest rate hikes indicating a commitment to stabilising the economy, this could pave the way for future recovery and growth.

For fixed income, we witnessed central bank divergence as some had begun their easing cycle, most notably the ECB while the Fed and BoE remain on hold. Even though evidence shows that inflation is returning to the 2% target there was continued uncertainty around the timing of the Fed's first rate cut. In this environment, it was short duration and high yield bond funds that benefitted given their lower sensitivity to interest rates. The Vontobel TwentyFour Sustainable Short Term Bond fund returned +1.1% in Q2.

Portfolio changes and rationale

Adding into Japan from EM

- Given at the start of the quarter where we saw recent market strength in Asia Emerging markets, we took this opportunity to trim some of our exposure by reducing our position in Impax Asia Environmental Markets across our Growth and Adventurous models by 1.5% and 2% respectively. While we still hold a relative overweight to the region, trimming our position has allowed us to take advantage of recent market uplift while balancing our geographical exposures.
- We added HC Cadira Japan Sustainable Equity to our approved list, a fundamentally driven fund with strong ESG and sustainable credentials focusing on investing in high quality Japanese companies.
- Structural reform in Japanese markets have provided attractive opportunity for investors as corporate governance reforms prompt increased shareholder-friendly initiatives and government support for markets resilience. As opposed to our other Asia funds which provide minority Japan exposure, having Cadira as a dedicated Japanese fund within our range strengthens our ability to capitalise on Japanese market tailwinds.

Reducing cash in Defensive, Cautious and Balanced Models

- Whilst cash has been an attractive asset over the last one to two years, as interest rates start to come down this will diminish. The macro landscape has not shifted significantly of late however the general economic picture is relatively robust and corporate forward-looking expectations in aggregate are also supportive.
- We have been considering opportunities to reduce our cash allocation in our more defensive portfolios (where we have retained larger exposures) for the past few months and believe that increasing our core global equity bucket and US holding is a prudent approach at this time, providing broader market exposure.
- We also propose increasing the Trojan Ethical weighting to 10% in Defensive and Cautious, this further increases a degree of market exposure (c.20% equity allocation), whilst providing some exposure to government bonds where **yields** look attractive and gold as a further diversifier.

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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