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M&G wealth

MODEL PORTFOLIO SERVICE
QUARTERLY INVESTMENT UPDATE
April 2024

Introduction

Welcome to the quarterly M&G Wealth Model Portfolio Service Investment Update. In this report, we discuss our current market views, recent changes to investments and the outlook for each of the asset classes in the models. We also cover portfolio performance and provide information on our portfolio risk ratings, platform availability and costs at the end.

Section	What's in it?
What moved markets in Q1 2024	Here we explain why markets have started the year positively.
Our views and what we're watching	This has our views on the overall economy, including inflation, economic growth and financial markets.
In focus: regions and asset classes	This goes into more detail on equities in specific regions (e.g. Europe, UK) and types of bonds (government bonds, emerging market bonds).
Performance	This shows the performance of our models and highlights some of the key things that drove these outcomes.
Costs	This shows the investment management fee and ongoing charging figures (OCFs) for the portfolios.
Risk Ratings	This shows the risk ratings from third party providers for the portfolios.
Platform Availability	This shows the platforms where portfolios are available.

What moved markets in Q1 2024

Markets have started the year on the front-foot, with resilient economic data and strong earnings reports leading stock markets higher. The global stock index rose 9.12% in Q1 with US and Japan stocks leading the way. In contrast the dramatic fall in government bond yields towards the end of last year has been partially reversed[1]. The yield on a 10 year US government bond rose from 3.94% to 4.32% and the return on the global bond index for the quarter was -0.1%. Corporate bonds and emerging market bonds outperformed government bonds.

Resilient US Economy

The resilience of the US economy during 2023 caused economists to repeatedly push back calls for a recession to a later date. Today, the consensus is now for a scenario where growth moderates but doesn't contract.

The data released so far this year largely confirmed this expectation; the US economy has continued to add jobs and fourth-quarter US GDP growth was 3.3%. GDP is a backward looking figure but 'live' monitoring tools for GDP suggest growth is still running at 2.9%[2] for the first quarter - a picture of resilience.

Companies continue to grow earnings

Each quarter, companies listed on stock exchanges publish reports on their sales, profits, assets held and other financial metrics. This information lets investors test if the 'views' of the economy are accurate and if the story this quarter was a positive one. The projected revenues of US companies for the current quarter exceeded what was expected. A handful of large companies generated all the growth in earnings for the US market. We expect this to broaden across more companies as the year progresses.

Update on Inflation

US inflation measured on a year-on-year basis has sat at 3% since mid-2023. In the UK, inflation has stayed at 3 to 4% in recent months. Wage growth, a key component of assessing the path for UK prices, has continued to slow but remains high at 5.6%. UK gilts have suffered and are down -1.62% this quarter.

1. yield relates to the coupon you receive from a bond relative to the price
2. Atlanta Fed GDP Now tracker

Our views and what we're watching

Inflation is slowing

Inflation and interest rates are constantly in the headlines. Estimates change frequently for when and by how much central banks will cut interest rates. Our view, which we've held since last year--is that inflation will remain higher than central bank target level of 2%. Right now, it's at 3.2% in the US, 3.4% in the UK at 3-4% and 2.6% in the Eurozone. For equities, we believe economic growth, productivity and innovation are the important driving forces for returns. Companies continue to earn profits because they have been able to raise prices and/or reduce costs. Consumers continue to spend money, as their wages have risen. The US economy remains strong and US companies are earning higher profits relative to those in other parts of the world. We've recently added more US equities to the portfolios.

Interest rates: paths diverge?

There is an expectation that the US Federal Reserve will reduce interest rates in 2024. However, if the US economy is growing, unemployment stays low and inflation stays steady there is a chance that interest rates stay elevated. The fall in inflation has mostly been driven by falling goods and energy prices. Inflation from service sectors still remains high. In contrast, the Eurozone economy is slowing faster. Europe could head towards lower growth and lower inflation sooner than the US, and might start reducing interest rates sooner. If this happens, the returns from Europe and US bonds would diverge. At the moment, we have less in US and European bonds as we think the backdrop is more positive for equities than bonds.

US equities: Looking beyond the technology companies

In Q1 2024, US companies reported better than expected earnings for the second successive quarter. The bulk of earnings growth was driven by a few companies Netflix, Meta, Google, Amazon and NVIDIA. The potential for artificial intelligence (AI) to increase productivity remains a key focus. We think this trend will continue in coming months, and we expect other sectors to deliver better growth such as manufacturing and healthcare. Some of these sectors appear undervalued, particularly considering the strength of the US economy and government investment. We are watching for other parts of the US equity market beyond tech and consumer sectors that will broaden returns for US investors this year.

Japan is embarking on a new journey

There are two key factors influencing Japanese equities: improving corporate governance and the shift to a healthy level of inflation. There is an initiative by the Tokyo Stock Exchange to boost shareholder returns through improved corporate governance, such as having independent company directors, paying higher dividends and being more efficient with the capital held by companies. For active shareholders in Japan this presents a fantastic opportunity to add value as outlined by M&G's team in Japan.

Last month the Bank of Japan ended an era of negative interest rates, raising borrowing costs for the first time since 2007. This is part of a shifting mindset in Japan from a scenario of low growth to one of 'healthy' growth and inflation. With a change in mindset, we expect changes in consumption, investment, and savings patterns that will have significant ramifications for the equity market and the broader economy over the long term. Within equities we continue to favour Japan.

In focus: Regions and Asset Classes

UK Equities

We have a neutral weight to UK equities. UK equities are not compelling from a growth perspective. Over the last 10-years, UK company earnings have grown at an annual rate of 3.9% compared to US companies which have grown earnings at 7%. We see little reason why this trend will change. The value of the UK equity market has gradually fallen over the last 10 years and is now 40% cheaper than global equities (measured on a price to earnings basis). However, the multiple is low for a reason; company profits do not grow as fast, the equity market itself is shrinking as fewer companies list in the UK and the size of companies is smaller at a time when large cap stocks are more favoured by market participants. Contrary to many investors, we don't believe there is a 'UK discount', global companies listed in the UK such as Shell and Unilever are not expected to grow as fast as global peers in their respective sectors.

US Equities

We have more in US equities in the near-term. The US economy remains in better shape than other advanced economies driven by President Biden's economic policies over the last 3 years with high levels of spending under the Infrastructure Investment and Jobs Act, the CHIPS Act and the Inflation Reduction Act. We think these policies will remain in play and continue to support the economy during the election year. In addition, expectations for S&P 500 earnings growth for 2024 have been revised up, with the technology sector expected to account for half of this year's S&P 500 earnings. Markets reward an improvement in profits and this is a key factor behind the momentum in US stocks which we think will continue.

Europe Equities

Analysts expectations of profits for European companies are lower than the US and Japan. There's a couple of reasons for this. Firstly, Germany – Europe's powerhouse - continues to struggle economically. Secondly growth in China, where a number of European companies in the luxury, automotive and mining sectors have a lot of exposure, continues to be lacklustre. However, similar to the US, one needs to be aware of how the market is structured - the companies that dominate the European equity index and have accounted for most of the recent positive performance are global companies listed in Europe. These companies remain in a good place and continue to generate good profits.

Japan Equities

We are overweight Japan equities. Our views are summarised in the outlook section on page 6 - in summary solid corporate earnings and a recovery in wages and inflation after decades of poor growth means we think the backdrop for Japan stocks is positive in the near-term. Structurally, we also think shareholder-friendly reforms and policies are very positive for the Japanese equity market.

Asian and emerging Market Equities

China stocks have lagged again this quarter which has been a drag on emerging market equity returns. The market continues to battle deflation and a very weak property market which is contributing to lacklustre consumer spending. Profitability and earnings have now missed analysts' expectations for 9 straight quarters so despite the fact the stock market is cheap, it is likely to remain so until some good evidence can convince investors otherwise. Taiwan stocks have performed very well with leading semi-conductor manufacturers boosted by AI demand. India has also continued to outperform. While valuations are too expensive in some areas, the secular trends – rising foreign direct investment and expanding labour market - remain strong. The upcoming election is only a tail risk as a Modi government win looks very likely.

Market Views and Outlook - Bonds

Government bonds

We are cautious on bonds and expect equities to outperform bonds over this year. We have been, and remain constructive on the U.S. economic outlook and expect growth this year to once again be above potential, preventing inflation from moving clearly toward the Fed’s 2% target rate by year end. Investors have gradually readjusted their expected path for interest rates this year but still expect 3 cuts to interest rates which we think is optimistic. We think it is more likely the European Central Bank will reduce rates but this is already priced into European bonds. Geopolitics remains a potential wildcard and a reason to hold government bonds. Although in the case of the US elections, we think the policies floated by former president Donald Trump wouldn’t be positive for bond markets.

Corporate Bonds

We have less in European corporate bonds. Valuations are stretched as credit spreads are near their tightest levels historically. Investors remain focussed on all-in yields rather than credit spreads (the premium investors get paid over government bonds for the risk that companies default on their borrowing) at the moment. We have less in Europe bonds specifically because these bonds are less sensitive to interest rates than UK and US bonds and we acknowledge there is a possibility rates are cut in the US and Europe this year.

Similar to investment grade corporate bonds, high yield bond valuations are stretched leaving little room for downside. There is a bit more headroom in European high yield bonds where growth is more uncertain. We expect the European Central Bank to cut interest rates before the US Federal Reserve which could alleviate some of the refinancing pressures on the more heavily indebted European borrowers.

Emerging Market Bonds

We hold a positive view on emerging market bonds due to the higher levels of interest on offer and improving economic outlook. We believe inflation in these markets will continue to decrease, providing central banks with further scope to reduce interest rates, which would lead to an increase in bond prices. The expected differential in real GDP growth between emerging and developed markets is set to hit an 8-year peak in 2024, according to the IMF. Historically, this level of growth differential has been an important predictor of emerging market bond performance. Emerging market countries have also reduced their reliance on short-term foreign capital and increased currency reserves, enhancing their ability to manage and repay debt.

Passive Portfolio Performance

Absolute and relative to IA sector peers

	Q1 2024	1 Year	3 Years*	5 Years*
MPS Passive 1	**0.85**	**6.15**	**1.04**	**6.49**
Rel to IA 0-35%	-0.65	0.30	1.25	0.39
MPS Passive 2	**1.83**	**7.59**	**2.64**	**7.25**
Rel to IA 20-60%	-0.66	-0.12	0.89	0.28
MPS Passive 3	**2.49**	**8.43**	**3.94**	**7.88**
Rel to IA 20-60%	0	0.72	2.19	0.91
MPS Passive 4	**3.88**	**10.14**	**5.38**	**8.75**
Rel to IA 40-85%	-0.29	-0.02	1.95	0.39
MPS Passive 5	**4.50**	**10.86**	**6.08**	**9.28**
Rel to IA 40-85%	0.33	0.70	2.65	0.92

*annualised performance to 31/03/2024

Hybrid Portfolio Performance

Absolute and relative to IA sector peers

	Q1 2024	1 Year	3 Years*	5 Years*
MPS Hybrid 1	**0.90**	**6.19**	**1.13**	**6.63**
Rel to IA 0-35%	-0.60	0.34	1.34	0.53
MPS Hybrid 2	**1.89**	**7.53**	**2.54**	**7.49**
Rel to IA 20-60%	-0.60	-0.18	0.79	0.52
MPS Hybrid 3	**2.47**	**8.12**	**3.44**	**8.16**
Rel to IA 20-60%	-0.02	0.41	1.69	1.19
MPS Hybrid 4	**3.77**	**9.25**	**4.17**	**9.12**
Rel to IA 40-85%	-0.40	-0.91	0.74	0.76
MPS Hybrid 5	**4.42**	**9.56**	**4.30**	**9.91**
Rel to IA 40-85%	0.25	-0.60	0.87	1.55

Source: FE Fund Info data to 31/03/2024

*annualised performance to 31/03/2024

Performance notes:

The performance figures are meant to assist advisers with their due diligence process. While M&G Wealth Investments LLP (M&GWI) has taken reasonable steps in the preparation of them, we can't accept responsibility for any errors, omissions, actions taken or advice provided by Advisers based on the information.

The value of investments will fluctuate, which will cause values to fall as well as rise and investors may not get back the original amount invested. The figures refer to the past and past performance is not a reliable indicator of future results. The performance figures are calculated in FE Analytics based on a standard model and may not reflect the performance of individual customer portfolios. The calculation includes the investment management fee and all underlying fund charges. The platform, wrapper and advice fees are excluded.

2024 Performance Highlights

The **Passive and Hybrid** models returned between +0.9% and +4.5% in Q1 with higher risk models performing better than lower risk models.

Performance was marginally weaker than multi-asset peers in lower risk models and better than peers in higher risk models. Our models have more in Asia and emerging market equities which didn't perform as well as US equities. Having more in Japan equities helped. The M&G models have more in corporate bonds and emerging market bonds which performed better than government bonds.

Holding more in high yield bonds and emerging market bonds benefited the portfolios in 2023 and that continued in Q1. The global high yield index returned +2.6% compared to UK gilts which fell -1.6%. The high yield fund we hold lagged the benchmark returning +1.6%. The fund has a structural overweight to higher rated high yield bonds (BB) which has contributed the most to underperformance, where bonds with a worse credit rating have performed better as credit spreads on these bonds have tightened by more.

The absolute return fund in the models has performed well recently. This is a fund we hold to achieve true diversification from equities and bonds where the manager is able to invest in a wider range of asset-classes and can sell asset-classes short. Recently long positions in US and Japan equities have added to performance as well as investing in commodities. Within currencies, the fund is positioned for diverging policy and growth prospects between the US and Euro area and is short euro which has also helped. The long Yen position has detracted.

Global ESG Themes Portfolio Performance

Absolute and relative to IA sector peers

	Q1 2024	1 Year	3 Years	5 Years
MPS GESGT 1	**1.27**	**6.64**	**N/A**	**N/A**
Rel to IA 0-35%	-0.23	0.79	N/A	N/A
MPS GESGT 2	**2.14**	**7.39**	**N/A**	**N/A**
Rel to IA 20-60%	-0.35	-0.32	N/A	N/A
MPS GESGT 3	**2.62**	**7.76**	**N/A**	**N/A**
Rel to IA 20-60%	0.13	0.05	N/A	N/A
MPS GESGT 4	**3.14**	**8.05**	**N/A**	**N/A**
Rel to IA 40-85%	-1.03	-2.11	N/A	N/A
MPS GESGT 5	**3.69**	**8.43**	**N/A**	**N/A**
Rel to IA 40-85%	-0.48	-1.73	N/A	N/A

Source: FE Fund Info data to 31/03/2024

Performance notes:

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The value of investments will fluctuate, which will cause values to fall as well as rise and investors may not get back the original amount invested. The figures refer to the past and past performance is not a reliable indicator of future results. The performance figures are calculated in FE Analytics based on a standard model and may not reflect the performance of individual customer portfolios. The calculation includes the investment management fee and all underlying fund charges. The platform, wrapper and advice fees are excluded.

2024 Performance Highlights

The **Global ESG Themes** models returned between +1.3% and +3.7% in Q1.
Performance was very similar to multi-asset peers. The thematic funds in the models that hold more large-cap companies performed well such as the gender and diversity fund and the thematic opportunities fund. Those holding more mid-sized companies such as the clean energy fund performed worse.

Costs

Total costs (OCFs at 31/03/2024) (varies by platform)

Please note the impact of transaction costs and share class availability may mean illustrations from platforms show different (higher or lower) total costs. Costs are quoted in the percentage per annum.

Costs %pa Risk Level	Fee	Est. underlying OCF	Total
Passive 1	0.15	0.17	0.32
Passive 2	0.15	0.17	0.32
Passive 3	0.15	0.16	0.31
Passive 4	0.15	0.14	0.29
Passive 5	0.15	0.13	0.28
Hybrid 1	0.15	0.36	0.51
Hybrid 2	0.15	0.39	0.54
Hybrid 3	0.15	0.41	0.56
Hybrid 4	0.15	0.44	0.59
Hybrid 5	0.15	0.45	0.60
Global ESG Themes 1	0.15	0.49	0.64
Global ESG Themes 2	0.15	0.52	0.67
Global ESG Themes 3	0.15	0.53	0.68
Global ESG Themes 4	0.15	0.54	0.69
Global ESG Themes 5	0.15	0.55	0.70

Source: FE Fund Info as at 31/03/2024

Current fact sheets are here:
https://www.mandg.com/wealth/adviser-services/investment-solutions/mps/support/factsheets

Model Risk Ratings

Passive Portfolios

	Dynamic Planner	defaqto	EValue	FinaMetrica	Oxford Risk
Passive 1	3	2	2	Best Fit 24-45	2
Passive 2	4	3	5	Best Fit 46-54	3
Passive 3	5	4	6	Best Fit 55-65	4
Passive 4	6	6	8	Best Fit 66-76	5
Passive 5	7	8	9	Best Fit 77-100	6

Hybrid Portfolios

	Dynamic Planner	defaqto	EValue	FinaMetrica	Oxford Risk
Hybrid 1	4	2	3	Best Fit 23-45	2
Hybrid 2	5	3	5	Best Fit 46-54	3
Hybrid 3	5	4	6	Best Fit 55-65	4
Hybrid 4	6	6	9	Best Fit 66-76	5
Hybrid 5	7	8	10	Best Fit 77-100	6

Global ESG Themes Portfolios

	Dynamic Planner	defaqto	EValue	FinaMetrica	Oxford Risk
GESGT 1	N/A	2	3	N/A	3
GESGT 2	N/A	3	5	N/A	3
GESGT 3	N/A	4	6	N/A	4
GESGT 4	N/A	5	8	N/A	5
GESGT 5	N/A	6	9	N/A	5

EValue ratings are on 1-10 scale, with a 15-year time horizon. Oxford Risk ratings are on a 1-7 scale.

The reports from each risk rating agency are available at:
https://www.mandg.com/wealth/adviser-services/investment-solutions/mps/support

Platform Availability

The Passive, Hybrid and Global ESG Themes portfolios are available on these platforms:

Platform	Passive	Hybrid	Global ESG Themes
abrdn	LIVE	LIVE	
Aegon Retirement Choices (ARC)	LIVE	LIVE	
Aegon Platform (previously Cofunds)	LIVE	LIVE	
Aviva	LIVE	LIVE	LIVE
Fidelity	LIVE	LIVE	
M&G Wealth	LIVE	LIVE	LIVE
Novia	LIVE	LIVE	
Nucleus	LIVE	LIVE	LIVE
Platform One	LIVE		
Quilter Wealth (Old Mutual)	LIVE	LIVE	
Scottish Widows (previously Embark)	LIVE	LIVE	LIVE
Transact	LIVE	LIVE	

Source: M&G Wealth

Where can I find more information:	
Defaqto	https://www.defaqto.com/advisers/
Selectapension	https://www.selectapension.com/
Langcat Analyser	https://analyser.thelangcat.com
Synaptic Software	https://www.synaptic.co.uk
Morningstar	https://www.morningstar.com

Key Risks

Investing comes with risk. The value of your client's investment can go down as well as up and they may not get back what they put in.

The portfolios may invest in bonds. Changes in interest rates are likely to affect the value of bonds. In general, as interest rates rise, the price of a fixed interest bond will fall and vice versa. The value of the bonds may fall if the companies or governments who have issued the bonds deteriorate in quality, or become insolvent.

The portfolios may invest in equities. Equity prices fluctuate daily, based on many factors including economic, industry or company news. The portfolio invests in shares of companies that manage and develop property. Property may be difficult to sell and can experience significant declines in value due to changes in economic conditions and interest rates.

The portfolios may contain bonds and equities from emerging markets. The impact of economic, political and regulatory factors can be significant for companies and governments in emerging markets. Investments in emerging markets can experience significant declines in value over extended periods of time.

The portfolios may have exposure to investments that are not denominated in UK pound sterling (£). These investments may be affected by changes in currency exchange rates, which is known as ‘currency risk’. There is also a risk that it may be difficult to sell some investments (or sell them without making a loss) due to an insufficient number of buyers in the market. This is known as ‘liquidity risk’.

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M&G wealth