MAY REVIEW

INVESTMENT UPDATE

Chartered Financial Planners and Wealth Managers

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What happened in markets?

It was a strong month for risk assets with global equities returning 4%. US equities were led higher by the 'Magnificent 7', a group of dominant technology stocks which includes Microsoft, Alphabet and Nvidia. The sector outperformed the wider US market after reporting strong first quarter earnings. Oil price weakness weighed on the energy sector.

The ongoing recovery of UK mid-cap stocks continued in May. A combination of positive economic surprises, lower inflation, cheap valuations, strong company results and a flurry of bids for UK listed companies have rejuvenated interest in domestic stocks. Consumer confidence has also picked up in response to rising real incomes.

Sterling and UK government bond yields were largely unmoved after the announcement of a General Election in early July. The timing took some by surprise, but the incumbent government possibly took the view that things are unlikely to improve materially in the short term. Markets expect a decisive Labour victory given their consistent lead in the polls over the last few months, and a new government should also bring some stability and certainty to policy making.

UK inflation once again registered a significant decline, falling to 2.3% compared to 3.2% in March, although this was a little higher than expected. Wage growth also remains stubbornly high. A July election means the Bank of England are unlikely to cut interest rates in June, with August now in focus. Providing some relief to markets, US inflation was in-line with expectations at 3.4%.

What did we do in the funds?

It was a busy month of activity as we added dedicated emerging market and high yield fixed income exposure across the VT Esprit fund range. The HSBC Global Emerging Market Government Bond Index invests in US dollar denominated sovereign debt issued by countries across emerging market regions, including Latin America, Africa & the Middle East and Asia. The largest country exposure is to Mexico, China, and Indonesia. Bonds issued by such countries typically come with a higher yield than developed markets to compensate investors for the higher risks involved.

The iShares Broad $ High Yield Corporate Bond ETF offers cost effective exposure to an index of US dollar denominated high yield corporate bonds. As the name suggests, these bonds offer higher yields than government and investment grade corporate bonds given the extra risks of owning debt issued by companies deemed to be less creditworthy than such entities. However, credit quality has improved in recent years and the low duration nature of the asset class means high yield bonds are less sensitive to changes in interest rates. Yields are also relatively attractive at c. 8%.

Within VT Esprit Careful Growth, we added two actively managed equity funds which are held elsewhere in the fund range. Lightman European invests in a concentrated portfolio of European equites and exhibits a strong value bias, meaning the fund has significant exposure to sectors including energy, mining, and financials which the manager deems to be undervalued. The Sanlam Global Artificial Intelligence complements the Lightman fund given that its investment approach is the polar opposite. It seeks to own companies at the forefront of artificial intelligence with a large proportion of the fund invested in US domiciled technology companies.

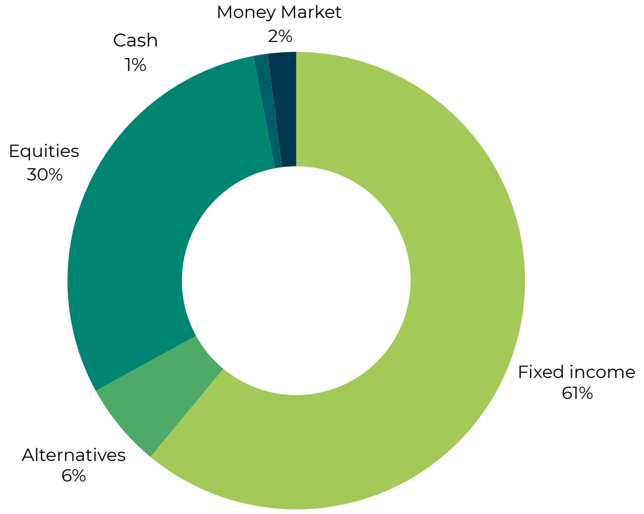
With European economic data starting to bottom out, and with the European Central Bank set to cut interest rates in June, we introduced the HSBC European Index fund in VT Esprit Tactical Balanced, Growth and Alpha Plus to broaden out our equity sector exposure in the region. European equites trade at relatively attractive valuations and corporate earnings may improve as the year progresses.

We exited the position in the AXA Global Strategic Bond fund in VT Esprit Tactical Alpha Plus in order to accommodate the purchase of emerging market and high yield bonds, and we have started reducing the position in the VT Esprit Tactical Growth fund also.

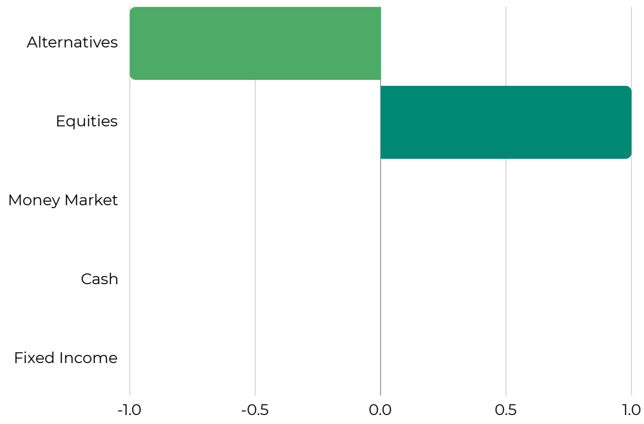
Finally, we switched out of the Fidelity US Index Fund into the SPDR S&P 500 ETF in the remainder of the VT Esprit Fund range, having completed this exercise in VT Esprit Tactical Alpha Plus in April. The SPDR ETF tracks the same US Index as the Fidelity fund but at a lower cost for investors.

Asset allocation

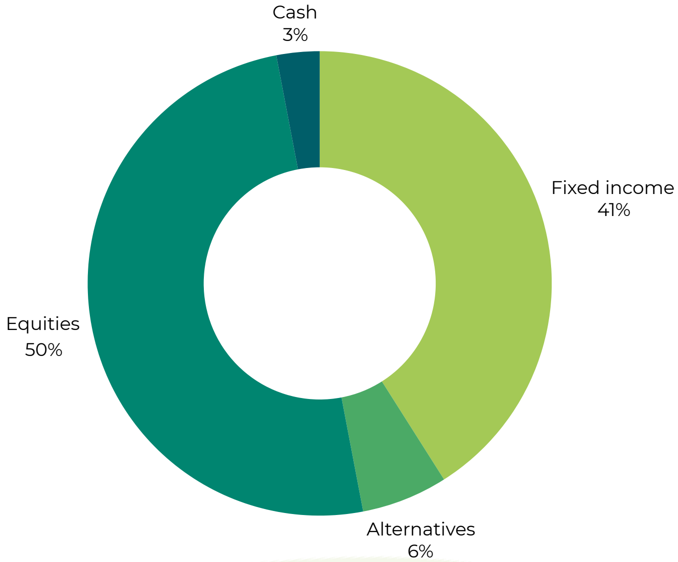
VT Esprit Careful Growth



Portfolio changes



VT Esprit Tactical Balanced



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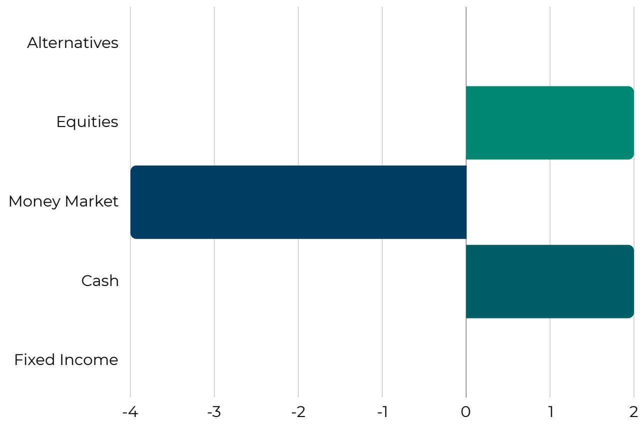
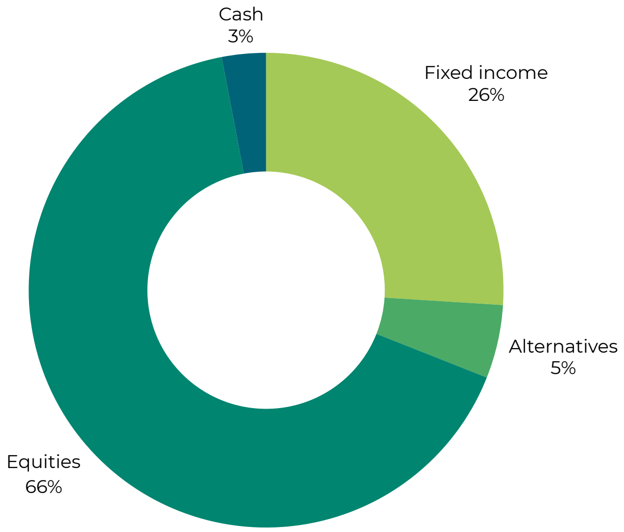


VT Esprit Tactical Growth



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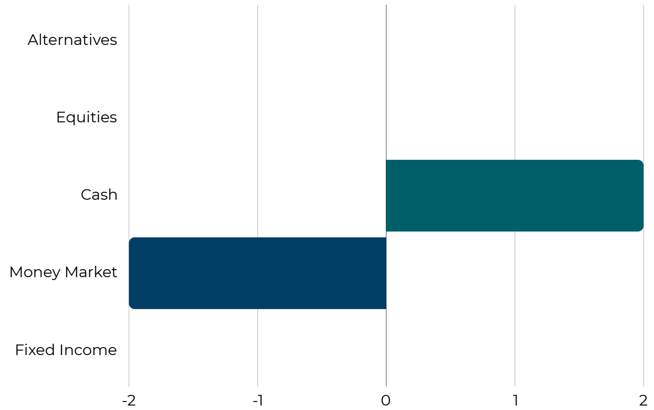
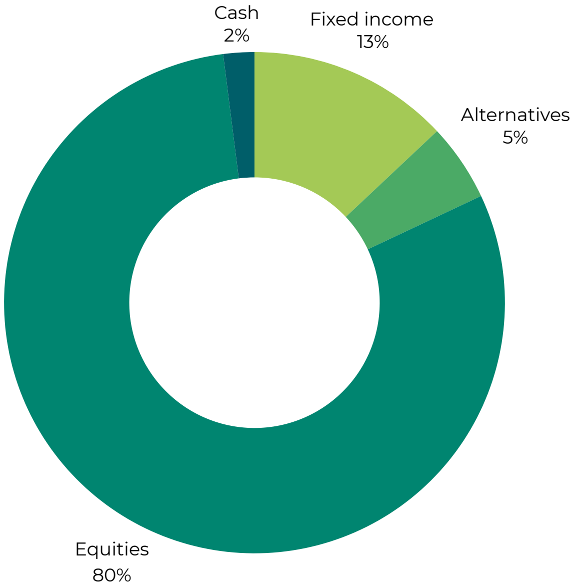


VT Esprit Tactical Alpha Plus



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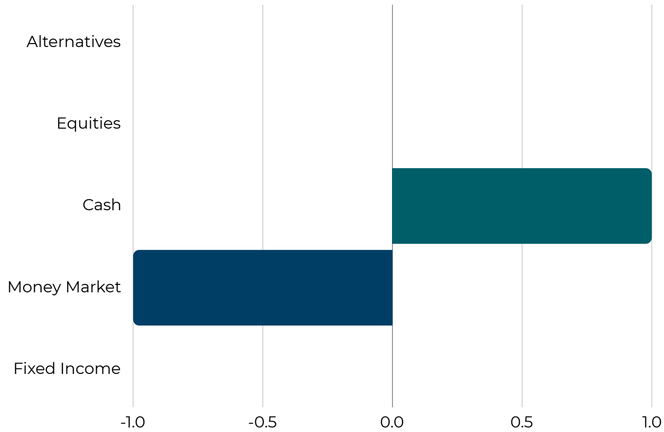
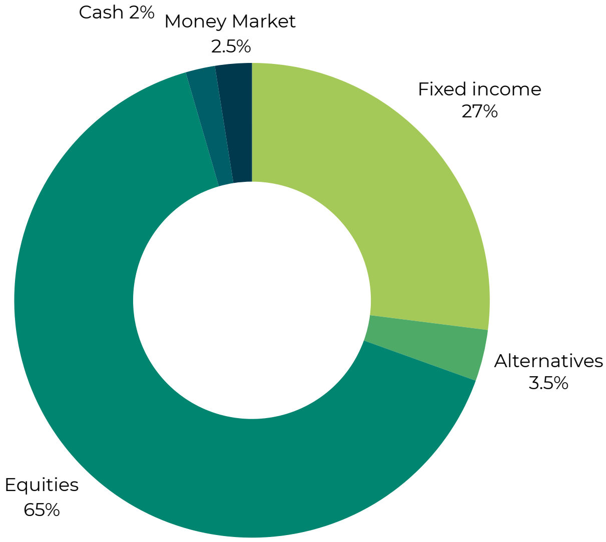


VT Esprit Sustainable Growth



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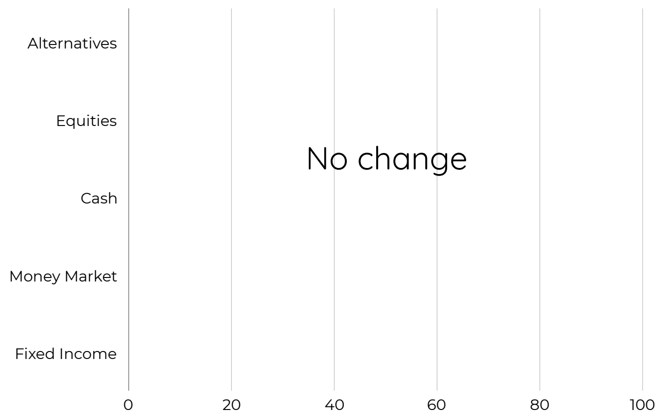

What is the outlook?

The US economy continues to show signs of gradual cooling, and investors are betting that the Federal Reserve begins a rate cutting cycle in September, ahead of the November election. Oil prices have fallen sharply in recent weeks, taking the steam out of global bond yields, and providing some relief at the pump ahead of the US summer driving season.

We expect the positive momentum behind UK equities to persist in the run-up to July's election, with a comfortable Labour victory likely to provide an additional incentive for investors to pick up relatively cheap UK assets. The potential feel-good factor will also be helped by warmer weather and the start of the European Football Championship, which is being hosted in Germany, especially with England amongst the tournament favourites.

The UK has been shunned by domestic and international investors alike since the Brexit result, but there are tentative signs that the UK is back on the radar of both. Strong wage growth and high services inflation means the Monetary Policy Committee will probably wait until August to reduce the base rate, but as ever, much will depend on the data between now and then. Two or three rate cuts may be enough to stimulate a meaningful pickup in consumer activity.

With interest rates at decade highs, the market will likely interpret any soft patch in US economic growth as an opportunity for the Federal Reserve to cut interest rates and enable other central banks to follow suit. This should mean any equity weakness proves short-lived. Such an environment would also provide a boost to fixed income returns as lower yields push up bond prices