

Conventional Managed Portfolio Service - Portfolio 4

Quarterly Update - Q3 2021



This document is issued by the discretionary investment management area of abrdrn, which has a separate legal entity, abrdrn Capital Limited.

In brief

- Despite a sell-off in September, US, UK and European equities advanced during the quarter despite concerns over slowing growth, supply bottlenecks and an uptick in inflation.
- Asia was mixed with a broad sell off in Asian bourses but with strong returns from the Tokyo Stock Price Index.
- In China, slowing growth, ongoing regulatory intervention and heavy indebtedness at property developer Evergrande dampened emerging market performance.
- Talk of tapering and rising inflation saw yields rise on conventional bonds.
- Portfolios posted solid gains with the exception of the lowest-risk model which was somewhat softer over the quarter as yields picked up and dampened fixed income returns

Market Commentary

Oscar Wilde most famously quipped that conversing about it was the last refuge of the unimaginative, while in more recent times Bill Bryson noted that its most striking characteristic is that there isn't much of it. However, recent research carried out by the BBC shows that 94% of Britons admit to having talked about the weather in the past six hours, while 38% have mentioned it in the past hour or less.

Of course, several features of the UK's geography make our climate overtly unique, often changeable but always wholly unpredictable. Firstly, there's the Gulf Stream, raising temperatures to above where they should be at this latitude, coupled with the fact that the UK is made up of islands, resulting in a lot more moisture in the air. Collectively, this can make for fairly erratic weather.

Forecasting in the UK is no easy occupation, weather or otherwise, something that the Bank of England (BoE) has come to realise only too well over the years, especially after the gale force-like headwinds brought about by a global pandemic. Even outgoing chief economist Andy Haldane protested earlier this year that the BoE is too gloomy in its outlook for the UK economy.

The (supposedly) sunnier skies of July provided something of a port in storm on domestic shores, a culmination of a more successful Covid-19 vaccine rollout than anticipated, allowing the government to usher in 'freedom day' on 19 July. Despite warnings from both scientists and advisory groups over the growing Delta variant, a persistent cloud on the horizon of a post-pandemic UK, the government saw it fit to remove nearly all social distancing rules. Although peaking mid-month, the new variant went on to disrupt supply chains and lead to staff shortages throughout the summer as companies struggled to fill job vacancies.

Meanwhile, the US seemed to be making hay while the sun shone. With lawmakers working to pass a major infrastructure spending bill amid a wave of positive economic updates, any worries about the sharp rise in Covid cases were far outweighed, with all US stock market indices, much like the thermometers in the country's western states, regularly hitting record highs.

With an economic bounce back much more pronounced than most commentators had predicted, data showed that US inflation went on to strike a new high of 5.4% in July. However, Federal Reserve Chairman Jerome Powell, much like his central bank counterparts around the world, deemed that such a spike was likely to be transitory, reiterating the 'lower for longer' outlook for interest rates. However, as the economy continued to recover, the Fed went on to use increasingly hawkish language in relation to its bond purchasing programme.

It was very much a case of sunshine after the rain for Japanese equities. A notable laggard during the early summer months, August saw the land of the rising sun post some of the strongest gains among developed markets. After a shambolic vaccine rollout and tumultuous build-up to hosting the already delayed Olympic Games, Prime Minister Yoshihide Suga's approval rating fell to an all-time low, prompting an announcement that he was stepping down and hopes of a snap election to reinvigorate the economy, possibly as early as October.

It was European markets that were in gold medal position during August however, buoyed by a combination of improving economic data and recovering corporate earnings. In fact, the proportion of companies beating analysts' forecasts on the continent hit its highest level in five years, as the bloc's vaccine rollout gathered pace, even overtaking the US in terms of percentage of second vaccines administered.

September also saw the European Central Bank start to introduce the notion that it would taper its asset purchasing programme. Although inflation data showed that prices rose at their fastest pace in 10 years, the central bank was quick to reassure investors that any moves in interest rates would be well telegraphed and the taps could be turned back on if needed.

While the end of September saw many Britons queuing at their local petrol station, many Germans were queuing outside their local polling station, as the winds of political change blew through the Eurozone's largest economy. The last weekend of the quarter saw Angela Merkel,



German Chancellor for 16 years, stepping down and waving auf wiedersehen to the country's Bundestag for the final time. Although the EU has lost the presence of a great diplomat who was central to holding the bloc together during various crises during her tenure, other developments soothed markets. In a surge reflective of gas prices during the month, the incredibly strong rise of Olaf Scholz's Social Democratic Party was well received by financial markets as a poor showing from the far left party, Die Linke, meant that a fully left leaning coalition for Germany was out of the question.

With European markets proving to be hot property throughout the quarter, in China, it was the property market that was proving to be too hot. They say that when it rains, it pours, and for China's second largest property company, September saw that old adage ring true. A fall in property prices, triggered by a growing reluctance on both the part of the Chinese consumer to move house and the government to support the sector, left Evergrande Group unable to sell properties and other assets quickly enough to service its US\$300 billion obligations. Famously now the world's most indebted company, Evergrande has seen its shares tumble by up to 75% this year, sparking fears of contagion that spread through China's financial system and reverberated around global markets.

Portfolio Commentary

Strategic asset allocation (SAA) delivered positive returns across the spectrum during the third quarter with lower-risk mandates delivering lower returns than higher-risk ones.

The quarter was reminiscent of the first quarter of 2021, with the imbalance between supply and demand for goods, services, materials and labour shaping the views of central bankers and market expectations for growth, inflation and monetary policy.

The economic outlook broadly deteriorated as the Delta variant of Covid-19 affected the speed at which economies could reopen. Economic expansion is expected to remain well ahead of the trend seen in the years preceding the pandemic, albeit we are likely past the peak with much of the rebound from the lows of 2020 behind us.

Supply chain issues have left many businesses unable to fulfil orders, while demand has continued to increase, leading to both higher input and output costs. This, in turn, has led to the highest inflation levels in more than a decade.

Central bankers have been keen to reiterate that this is largely transitory. Although their tone is largely reassuring, their plans for reducing monetary stimulus and increasing interest rates have undoubtedly been brought forward.

As a result, nominal bond returns suffered during the second half of the third quarter with gilts bearing the brunt of this sell-off. Global bonds excluding the UK and UK inflation-linked bonds fared somewhat better. The implied inflation increase more than offset the expectation of higher interest rate and these assets delivered healthy returns during the quarter. Within credit, all maturities of UK investment grade (IG) corporate bonds faced losses due to their sensitivity to rising interest rates. Short duration UK IG bonds were less affected by this move, although they still ended the quarter with modest losses. Global high yield bonds are less sensitive to interest

rates and were more robust than their IG peers, although a noticeable increase in spreads ensured they made a reasonably modest return. It was a mixed quarter for emerging market debt. The hard currency, hedged to sterling, allocation within mandates was negatively affected by the rise in US treasury yields, leading to marginal losses. The local currency bond allocation also delivered a small loss over the quarter, though sterling weakening against a broad basket of EM currencies helped to negate this.

Equity markets returns diverged considerably. Developed market equities were largely positive albeit the journey to achieve these varied. US, UK and European bourses performed reasonably in line (up 3.05%, 2.23% and 0.76% respectively) with a strong showing until the end of August. At that point, higher and more persistent levels of inflation in some geographies made central banks (the US Federal Reserve and Bank of England in particular) turn more hawkish on their policy stance. That led to a spike in government bond yields and, as a result of these higher rates, equities took fright and there was a reasonably broad-based sell-off throughout September. The developed market that took a decidedly different path was Japan. Japanese equities lagged western markets during July and August as its zero tolerance Covid policy coupled with relatively low vaccination rates meant that a national lockdown was enforced over the summer months, albeit the Olympic Games were allowed to take place. Following Prime Minister Yoshihide Suga's popularity plummeting in the polls and his surprise resignation in early September, Japanese equities rebounded amid the prospect of a large fiscal package being announced before the year-end. This saw the Japanese market handsomely outperform during September and end the quarter up 7.34%. Further afield, Asian and emerging markets lost ground, however. Difficult environments from a Covid perspective combined with a raft of Chinese government regulation across the education, healthcare and technology sectors and latterly the interruption to energy supplies in some provinces negatively affected these markets, which fell 6.06% and 5.71%, respectively. A difficult regulatory and macroeconomic backdrop deteriorated even further in China with the news that Evergrande, China's second largest property developer, was on the brink of defaulting on a proportion of its US\$300 billion debt.

Moving on to alternatives and there was a strong showing from both real estate investment trusts and infrastructure assets. Uncertainty remains over the timescale and overall size of the infrastructure bill to be passed by the US government, rumoured to be between US\$2 trillion and US\$3.5 trillion, but there continues to be strong demand for infrastructure assets among investors who recognise the benefits of holding real assets.

Tactical asset allocation (TAA) made a positive contribution to performance across CMPS mandates during the quarter, with the impact being larger within lower-risk than higher-risk mandates.

The CMPS 4 mandates benefited from an underweight position in cash. This underweight helped to fund overweight positions in emerging market debt (EMD) in both hard (hedged to sterling) and local currency, as well as equities in our preferred regions of the US, UK, Asia ex-Japan and emerging markets (EM). The increased allocation to EMD, both hard and local, Asian and EM equities



detracted from performance, while the overweight to both US and UK equities proved beneficial.

We made a change to the long-term SAA during the quarter with the objective of attaining the best risk-reward trade off across asset classes and to future proof the portfolios for the market conditions that we anticipate. The new SAA increases the weighting to equity funds, global listed infrastructure, absolute return multi-asset and emerging market debt (hard and local currency). At the same time, exposure to money market funds and conventional fixed income has been reduced as we expect higher inflation and rising bond yields to prove a headwind.

As the weighting to global listed infrastructure increased under the new SAA, we diversified our fund holdings. We blended the incumbent First Sentier Global Listed Infrastructure Fund with the Legg Mason ClearBridge Infrastructure Value Fund and the Legal & General Global Infrastructure Index Fund, which also helps to lower the overall cost of this new basket. As part of this reappraisal of alternative investments, we reduced the weighting to global real estate investment trusts across all of the models and sold the iShares Global Property Securities Equity Index Fund.

We also introduced the Barings Emerging Markets Sovereign Debt Fund (sterling hedged), which has an excellent long-term track record. We secured access to a new share class at a very keen price.

We increased the cyclical exposure within our European equity basket, funded by the removal of the Schroder European Fund. We introduced the Invesco European Smaller Companies Fund to complement the Barings Europe Select Trust, Fidelity European and BlackRock European Dynamic Funds.

In UK equities, the JPM UK Equity Core and JOHCM UK Dynamic Funds outperformed the FTSE All-Share Index. The Lazard UK Omega Fund underperformed. Although the TM Tellworth UK Smaller Companies Fund has outperformed its index handsomely in the year to date, performance was a little softer during the quarter.

US equities have been one of the strongest performers this year, but choppiness during the third quarter favoured defensive growth companies. As a result, the mega cap S&P 500 outperformed the Vanguard US Equity Index Fund, which has broader exposure to small and mid-sized companies as well as mega and large caps.

Slowing growth in China, ongoing regulatory intervention and deep indebtedness at property developer Evergrande dampened the performance of Asian and emerging markets (EM). The Fidelity Asia Fund underperformed in this environment. In contrast, Japanese equities were particularly strong. While the Invesco Japanese Equity Advantage Fund posted solid returns, it lagged the Tokyo Stock Price Index.

Within our emerging markets (EM) equity paring, RWC Global Emerging Markets underperformed while Artemis SmartGARP Global Emerging Markets not only outperformed but posted a strong positive return in a negative quarter for EM equities.

Outlook

Despite the setbacks brought about by the emergence of the Delta variant of Covid-19 throughout the summer, we believe the investment barometer still points to 'fine'. The clouds that dominated the horizon at the beginning of the year continue to part, with the inclement weather many had feared during lockdown yet to materialise.

The synchronised accommodative central bank policy and increasing vaccination rates imply a mainly sunny outlook with sporadic showers. The spread of the Delta variant continues to present challenges to company supply chains and logistics and future variants pose unknown threats, at least until the world is fully vaccinated. However, we have transitioned to 'living with Covid', the new normal, and the outlook for many companies seems to be stabilising, albeit they face higher costs.

Perhaps the largest challenge for central banks is forecasting just how robust their economies are in the face of forthcoming interest rate increases. Our base case remains for central banks to hike rates in 2022 at the earliest, with several recent hawkish statements from various central banks only reaffirming this view. The coming months, just like those in the previous quarter, could well be characterised by the debate on whether inflation is here to stay or will merely blow on through.

On a corporate level, we expect earnings momentum evidenced by recent investor updates to continue apace, especially in developed markets. However, we are now more cognisant of potential pockets of low pressure as Covid-induced supply shortages take their toll. With the US having potentially reached peak growth, we look towards Europe and the UK to take up the mantle of those nations emerging from the pandemic with a brighter outlook.

Performance

Portfolio performance is based on abrtn MPS hosted on the abrtn WRAP platform.

Please note: portfolio constituents and performance may vary on other platforms.

The portfolio has not been available on all platforms since inception.

Performance figures are net of the abrtn Discretionary Management Charge. However they do not include the deduction of product and adviser specific charges. The effect of these charges would be to reduce the performance levels shown. In addition, MPS portfolios are subject to fund level annual management charges, which vary over time in line with the composition of the portfolio. Please refer to the relevant Managed Portfolio Service Annual Charges Summary for more information on charges.

ARC Private client indices ARC private client indices are based on actual client portfolio returns provided by various investment management companies. These portfolio returns are allocated to one of four categories based on the volatility of their returns relative to world equities, and an average return is calculated for each category. Grouping portfolios by their volatility differs from the traditional approach, which compares portfolios which have similar asset allocations. Instead, investment managers may use whatever asset allocation they consider appropriate to achieve the desired levels of return and volatility.

Performance: Conventional MPS Portfolio 4

	Performance (%) 3rd Quarter 2021	Performance (%) 3 years	Performance (%) Since Inception ¹	Volatility Since Inception (%)
Conventional MPS Portfolio 4	1.14	24.39	71.92	10.38
ARC £ Steady Growth	0.66	18.90	50.66	8.66

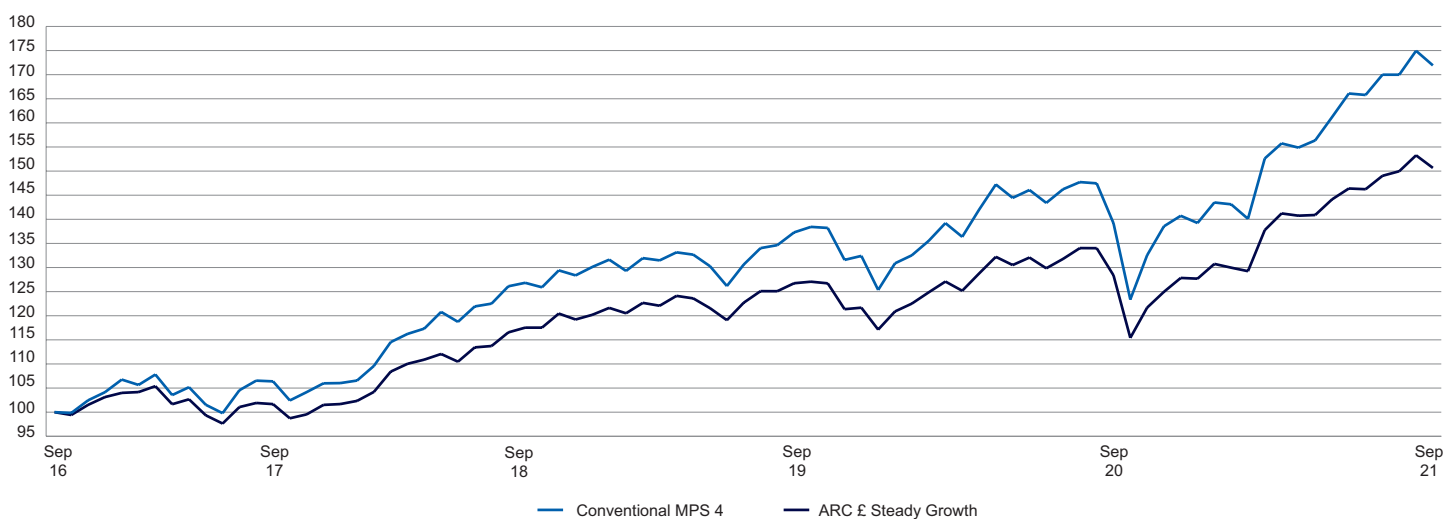
The performance figures may vary due to product specific charges and should be viewed on an indicative basis.

¹30/11/2014 - 30/09/2021

Volatility calculated using monthly returns. Any holdings referred to relate to the abrtn MPS hosted on the abrtn WRAP platform.

Differences in holdings may occur on other platforms due to fund and shareclass availability.

Performance: Conventional MPS Portfolio 4 Inception to end Q3 2021



Asset allocation: Conventional MPS Portfolio 4

Asset allocation	MPS Model Strategy 4 as at end Jun 2021* (%)	MPS Model Strategy 4 as at end Sep 2021* (%)	Change +/-
Global High-Yield Bonds	5.8%	4.8%	-1.0%
EM Debt Hard Currency	4.0%	3.9%	-0.1%
EM Debt Local Currency	3.9%	4.0%	+0.1%
UK Equities	20.3%	22.0%	+1.7%
North American Equities	32.6%	34.8%	+2.2%
European Equities	7.1%	7.2%	+0.1%
Developed Asian Equities	4.3%	4.1%	-0.2%
Japanese Equities	3.9%	3.5%	-0.4%
European Equities	-	7.2%	+7.2%
Emerging Market Equities	1.5%	1.5%	0.0%
Global REITs	6.1%	-	-6.1%
Global Infrastructure	2.7%	8.0%	+5.3%
Absolute Return Funds	7.3%	5.5%	-1.8%
Cash	0.5%	0.5%	0.0%
Total	100.0%	100.0%	

Portfolio performance is based on abrtn MPS hosted on the abrtn WRAP platform.

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The Portfolio has not been available on all Platforms since inception.

*The data is rounded to 1dp and small variances to totals may occur.

This data is based on the abrtn MPS hosted on the abrtn WRAP platform.

The figures shown here refer to the past. Past performance is not a reliable guide to future performance. As with any investment, the value of your fund can go down as well as up and may be worth less than you invested.

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