Fund Manager Second Quarter Report – June 2025.

by Harry Thompson

Trump's 'Liberation' day seems a long way off, with equity markets recovering from the sharp sell-off to now trade at or above the prior highs. An ETF tracking a global basket of stocks returned +11.42% in the second quarter in US dollar terms, although the return in sterling terms of +5.05% reflects the weakness we have seen in the US dollar year to date. A key theme so far this year has been a movement of capital away from the US, and the debate around whether this is the end of so called 'US exceptionalism'. We witnessed a global re-weighting away from the US, and the dollar weakness has played a significant role in the divergence of returns for UK investors.

However, US large cap growth equities, led by the MAG7 and renewed AI enthusiasm, saw a large recovery to be a strong performer on the quarter, with value stocks lagging behind. In Europe and the UK, there was limited divergence in growth over value but large caps struggled on the quarter, returning low single digits in local currency, whilst smaller caps posted double digit gains. Europe has benefitted from the diversification of investment away from the US, with European stocks outperforming US stocks by the biggest margin on record in the first half of the year in dollar terms. This is despite the strong performance of US large cap growth since the end of April. It is important to note that a strong driver of these European returns have been investment into harmful armaments, an area excluded by our model portfolios.

The portfolios held up relatively well during the downturn, given our risk off stance following the rebalance in February where equity exposure was reduced in favour of fixed income. Whilst relative performance lagged slightly in the recovery, a number of sustainable investments have performed better in the first quarter, so despite dominance by stocks such as the MAG7, which we have more limited exposure to, 2025 has been a good year so far. Infrastructure and property also staged recoveries, benefiting portfolios.

Healthcare and Energy sectors were the only two in the red for the quarter. Healthcare has come under extreme pressure and has been described by some as being 'on its knees'. US policy risk has been a major headwind but there a number of factors which point to a relatively attractive sector, given the long-term secular growth drivers.

The acceleration in Middle East tensions which added volatility to the oil price, initially spiking and raising inflation concerns, but dropping back to prior levels as tensions eased. Renewable energy, coming off a sustained period of weakness, was in focus given Trump's tax bill and the impact this had on renewable tax credits. The outcome has been mixed, with certain technologies, such as residential solar taking the brunt of the pain. Electricity demand is set to rise for the first time in decades, led by the growth in datacentres, so renewables growth is still likely to be supported, albeit divergence between technologies. The changes in legislation provide much needed clarity and whilst certain technologies will suffer, others will continue their growth trajectory particularly given the cost competitive nature compared to fossil fuel generation.

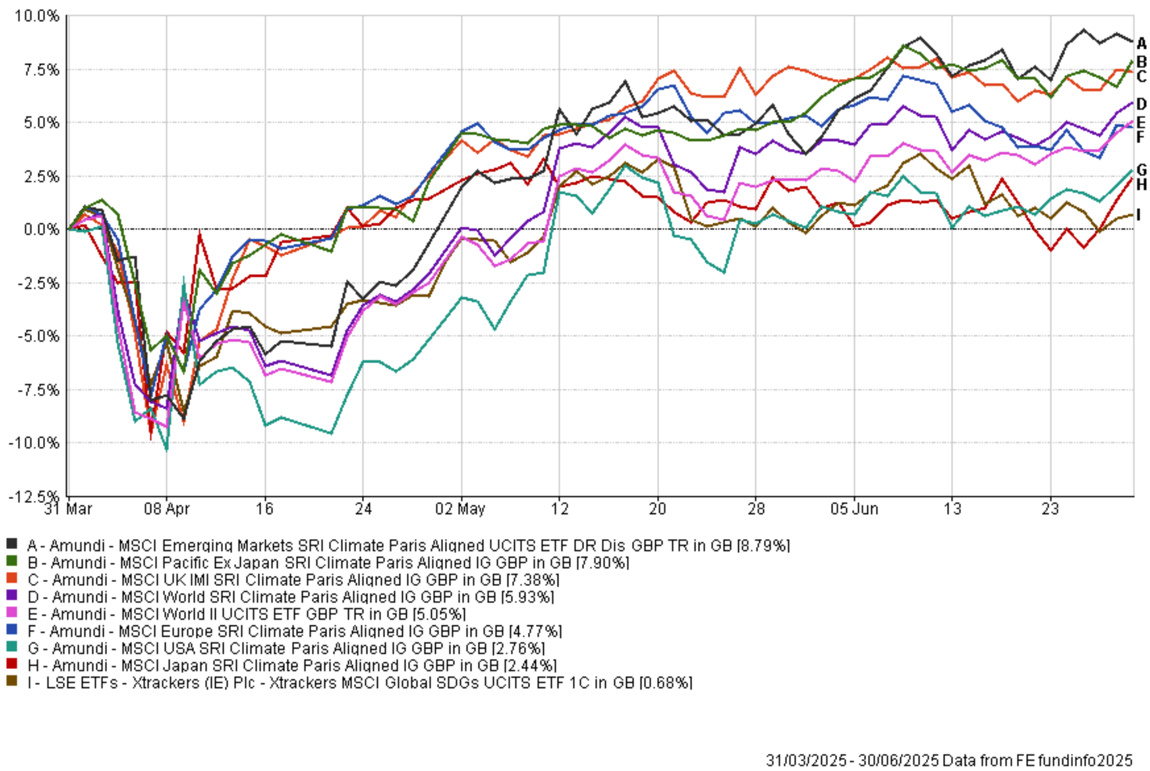
Companies exposed to the broader electrification and energy transition theme have had a strong quarter, supported by renewed optimism around AI. Short covering (buying shares to cover an investor's short position) has played a key role in some of these moves, particularly in the alternative energy universe. However, reassurances around AI capex have supported those companies exposed to datacentre build outs, such as Schnieder Electric, whilst easing trade tensions has supported the semiconductor universe, amongst others.

Front and centre for much of the quarter, geo-political tensions have eased, from the aversion of a full-scale trade war to easing tensions in the middle east. Nonetheless, these issues have had real world impacts on business and investment given the uncertainty that has been created.

Within fixed income, yield curves steepened, with the front end supported by a growing expectation for easing interest rates, whilst government deficits have had investors wary of holding long dated debt. Whilst being under the spotlight, it has become increasingly obvious that governments are struggling to reign in their outgoings, particularly given the increased commitment to defence.

This comes as Trumps "Big Beautiful Bill" will add trillions to the deficit, whilst Kier Starmer and the Chancellor have an uphill battle given the backlash to issues such as welfare reform. It's widely expected that Rachel Reeves will be back asking the UK taxpayer for more money at the next budget. Given these concerns, within our fixed income allocation, we have favoured shorter duration assets.

Core Allocation Review

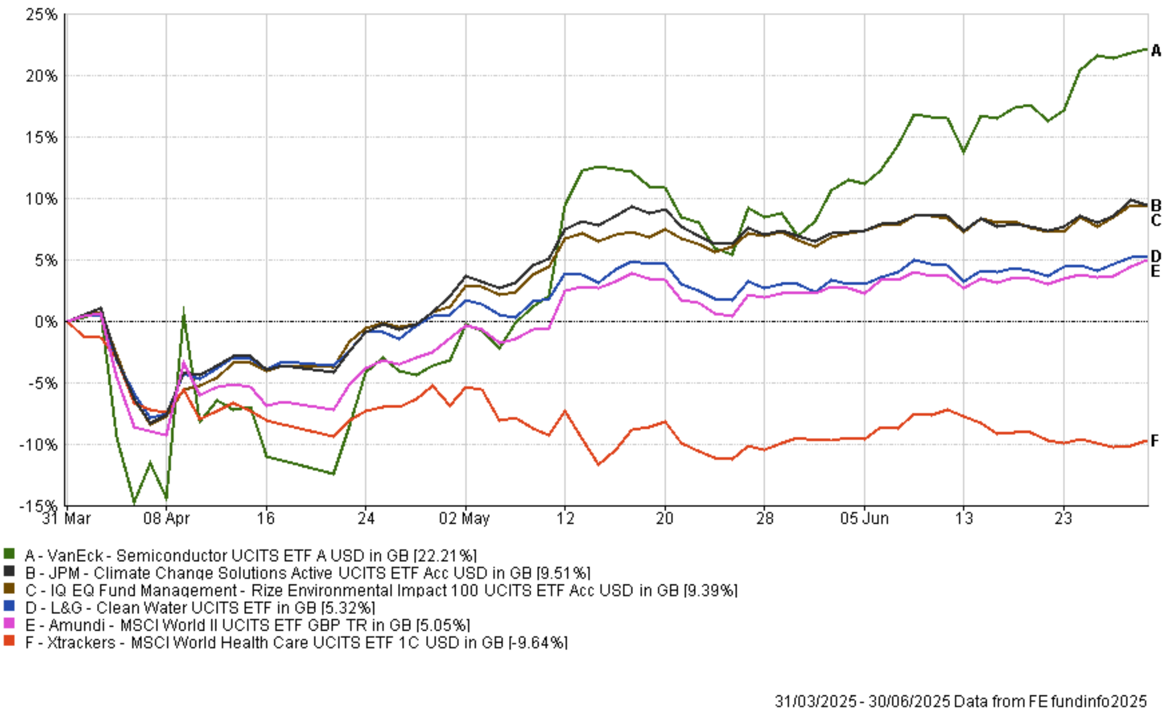


Whilst not held, the pink line represents the unscreened MSCI World ETF from Amundi, which rose 5.05% in the quarter. Portfolios World SRI screened version outperformed, rising 5.93%. The rotation out of the US benefited a number of regions, such as the UK and Europe. Europe has attracted capital flows, but a lot of this has been focused on sectors screened from portfolios such as defence, so the Europe SRI exposure has lagged the non-screened equivalent, whilst Q2 was more subdued given the outperformance in Q1. Our higher weight to the UK relative to a global equity allocation has been beneficial.

Portfolios Asia/Emerging Markets exposure was a strong contributor to performance, particularly in the higher risk portfolios given the higher allocation. Portfolios MSCI USA SRI exposure underperformed other regions given the capital flows previously mentioned. This did lag the unscreened equivalent given the rally back in some of the larger tech names not held within portfolios.

Making up a smaller part of the core allocation, the global Sustainable Development Goals ETF lagged. Underlying holding returns in this impact ETF were very mixed on the quarter, with Equinix (datacentres) dropping after weak guidance, whilst healthcare and EV exposure lagged the market rally, whilst certain renewables struggled, such as Enphase Energy given is focus on US residential solar.

Satellite thematic allocation review



The thematic sleeve of portfolios was largely a positive contributor to performance during the quarter, outperforming the Amundi MSCI World ETF (in pink), with the exception of global healthcare. The rationale for these returns has been discussed already in the first part of this document (easing trade tensions, AI enthusiasm etc). The standout being the VanEck Semiconductor ETF which returned +22.21%, whilst the JPM Climate Change Solutions ETF and the Rize Environmental 100 returned +9.51% and +9.39% respectively.

We commented on the healthcare sector in our IMC rebalance minutes in June, which can be found below:

> *The sector has seen a significant pullback with sentiment being at all-time lows and "peak fear" near. This is in line with two other periods over the last 35 years which then led to a bull market.*

•Headwinds include US policy risk but a lot of this has been built into the price. JFK has been a major headwind, alongside US policy in general with the likes of Elon Musk also creating uncertainty with his DOGE focus.

•Widespread changes to US healthcare are unlikely, as per previous years of concerns such as Clinton in the early 90s (failed with reforms) & Obama in 2010. We are now on the long-term support level that the sector has used over the years to bounce from.

Outlook

Geopolitics is impacting the market less as it becomes desensitised to political noise from world leaders, whilst accepting the significant shifts in global dynamics. The disruption has caused investors to look beyond the US, shaking the market from its alarming complacency around US exceptionalism.

The recent policy environment has increased uncertainty which is a poisonous word in business, and how companies have weathered the last few months as well as any changes in their outlook will be pivotal for equity valuations. In mid-July the second quarter reporting season begins in the US, starting with the US banks, these will be the first meaningful reports in the post liberation day world and an essential guide for expectations.

We reduced risk (predominantly in February) in our last two rebalances given our concerns over deteriorating outlooks, slowing growth, as well as the increased uncertainty. With deficits remaining a major issue, we still see no benefit or justification in adding unnecessary risk by extending fixed income duration. We have duration risk through a part of our equity sleeve given the bias to more future focused companies. With equity slightly below neutral, we have room to add into any weakness.

In the meantime, capital continues to flow to meet environmental and social issues, and this has become a global phenomenon that we expect will accelerate as rates ease and equity returns continue to broaden. Climate change, energy security, health, food security and knowledge remain important concerns.

limited exposure to some key sectors of stock markets and a higher exposure to a number of positive themes. It is therefore important to understand that both performance and the risks associated can differ versus a portfolio that does not include ethical exclusions. As the portfolios are housed on number of platforms there will be some variances in cost and performance depending on the platforms ability to hold certain share classes and their policy on execution, and the data is to provide a guide but each platform will vary.