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Ethical MPS Quarterly Report

prepared by King & Shaxson Asset Management

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by Wayne Bishop

Politics and Economics

This quarter will be remembered as the quarter that finally delivered as the eagerly awaited interest rate cuts in the UK and the US finally happened. It is hard to believe that it was just under a year ago, in October 2023, that market expectations for interest rates finally pivoted from rates still rising a little more to them having peaked, and maybe even beginning to fall.

The chain-reaction in the market from that pivot led to expectations that ebbed and flowed until the end of the first quarter of 2024, and over the last six months these expectations have turned into the final reality. This has had the expected positive effect on portfolio performance, and we will look at this in more detail later in the report. As we enter the last quarter of 2024 we are confronted with significant political events, a little more economic uncertainty and a more mixed corporate outlook.

Taking each of these points in turn, in November we have the last big election of this jumbo political year with the US presidential election. Some months ago, it looked like a certain Trump victory, but the rise of Kamala Harris following Biden stepping aside has created an element of uncertainty. You could argue that her support in some key states has swung the pendulum back into the Democrats favour, but it is still a very close call and a month is an eternity in politics. The geo-political implication of this election cannot be understated.

Closer to home the new UK government has not started well. Poor communication and concerns over the agenda have not helped. The budget on October 30th is expected to have significant ramifications for investors; pension allowances, inheritance tax, capital gains tax and investment decisions are all open to uncertainty, and the UK bond market is paying the price. We would expect any fiscal tightening to maybe accelerate monetary easing (in layman terms, higher taxation may mean lower interest rates).

This leads to the economic outlook. The US economy continues to perform strongly and drive global growth, whilst Europe, Japan and the UK continue to struggle along and China has remained a source of concern, not growing as fast as it has been as real estate issues drag on the economy. India continues to emerge and remains the focus for growth in a large global economy and its financial markets continue to slowly open up and gain more of international attention.

China has recently made some strong efforts to rekindle its economic growth and this will demand a great deal of global market attention in the short term. Dumping in certain sectors, such as solar (which ended this quarter) and in steel have serious consequences for their sectors and well as adding more complexity to geo-political tensions. This will be a key issue should Trump come back into office.

The fate of the US, UK and EU economies in particular will dictate market expectations on interest rates over the coming quarter, and especially in November as Central Banks meet again.

The final point is corporate results, at the time of writing the strikes at Boeing, railways and ports in the US are having ramifications on the economy and the companies and supply chains concerned. We expect results to become more mixed.

Two very hot sectors, the Magnificent Seven stocks that drove the equity rally of 2023 has slowed, but their results will still be eagerly watched in Mid-October. At the same time large pharmaceutical companies that benefited from the anti-obesity drug rally have also seen some profit taking as expectations and competition rises. All eyes will be on corporate reporting in October (mainly US) and the CEO outlooks.

Investments

For our Ethical MPS, it's been a good quarter, building on the improvement we have increasingly seen since the large rally at the end of 2023. In fact, looking over the last twelve months, the first half (September 23 to March 24) was mixed, but since March 24 we have seen a more sustained recovery. Two factors lay behind this, firstly interest rates, including the pivot, the final reality of falling interest rates, and more importantly interest rate expectations; and secondly, the broadening of market buying from just a small number of stocks (notably the M7, defence and banks) to a much broader rally across the whole market. Global small caps outperformed large caps on the quarter, with one leading index highlighting a divergence of around 4%.

Whilst increasing fixed income exposure over the last eighteen months, and incrementally adding to duration over the last few quarters, we have been hesitant increase the interest rate risk dramatically. The rationale is based around deficits, supply and demand of bonds and the ability of governments to control debt. The UK bond market has suffered as a result of budget postering, with spreads verses other government bond markets widening significantly. Shorter dated bonds have been far less volatile, but yielding more, and these have performed the function we want from bonds. Green and sustainable bonds, where we have more exposure, have outperformed UK corporate bonds. An ETF tracking the leading green bond index returned 4.08% for the quarter, versus sustainable UK corporate bond funds returning around 2-2.5%. At our rebalance in July, we added the Aegon Global Sovereign Bond fund, given our desire to improve credit quality within the portfolios and this returned 4.27% over the quarter, or 2.62% since inclusion.

Falling interest rate expectations really benefited the portfolio's infrastructure exposure. These investments actually continued to perform well as interest rates increased in the first half of 2022. We continued to hold then as most of them had fixed or hedged their interest rate exposure and were not excessively leveraged. The "Black Swan" event was the Liz Truss budget in September 2022 which really damaged these investments, effectively killing all development pipelines and creating a surge to safer assets. At the time short term T-Bills were offering in excess of 6% and effectively destroying any new investment case in infrastructure.

As closed ended investments, the market price was determined by market forces and not the company's valuation. The discount between the two was too wide and over time felt this would narrow. This has happened over the last six months leading to a strong but varied recovery in property and infrastructure-based investments. Foresight UK Infrastructure returned 6.53% in the third quarter. In most cases, this still feels like a partial recovery, as interest rates fall further, and the political and supply chain concerns around infrastructure abate, there still remains further recovery potential. The need for renewable energy remains stronger than before.

Whilst renewable energy infrastructure enjoyed a recovery the fortunes of the equities in the sector have been more mixed. July and August's returns where largely mixed for companies exposed to the energy transition theme, but a stronger recovery in September following the Fed rate cut pushed a number of funds into positive territory for the quarter, where a leading clean energy index returned 2.97% for the quarter.

Longer term, the performance of renewable energy equities remains comparable to the oil and gas sector. A leading clean energy index has returned 96% over 10 years almost exactly the same as global oil and gas, but the journey over the last ten years has been very different and renewable energy is still down from its 2021 peak[i]. Even though the outlook for renewable energy remains positive (with no fears of stranded assets) geopolitics continues to play a role, and 2024 was impacted by tariffs and dumping in the solar sector that China dominates. Previously this had been a negative on US based Solar producers until the practice ended in May.

Healthcare took a tumble in September, with Polar Capital Healthcare Opportunities returning -4.69%. However, we had taken some profit on this back in July, and despite this fall, the fund is one of the better performing in the sector year to date, returning 13.93% in 2024 (to the end of September). Meanwhile, portfolios water and waste exposure returned a modest low single digit for the quarter after a particularly strong month in July and then mixed fortunes for the remainder of the period, which is largely in line with leading indices exposed to this theme.

Following the bout of Chinese stimulus, equities exposed to the region where buoyed. Major Chinese equity indices hit bull market territory, returning over 20% in the quarter. However, if you take out the last week of the quarter, returns were only in the very low single digits, highlighting the wave of money that moved into Chinese equities in the last few days. Over the last few re-balances, we had been incrementally adding to our Chines equity exposure, so portfolios did benefit from this move. A new fund addition in July was Aikya Global Emerging Markets fund, which was more exposed to China, and this returned 6.95% in September.

Conclusion

The last year has seen a change in the dynamics for more positive investments as the interest rate scenario and market dynamics have moved back in their favour. More is expected from Central Banks around the world. The immediate pinch point for all portfolios and markets in general remains the end of October and start of November, with the UK budget and the US election presenting very different, but potentially material, risks and uncertainty.

Q3 2024 Performance

Portfolio	Q3 2024
King & Shaxson Ethical Adventurous	1.86%
King & Shaxson Ethical Balanced	2.84%
King & Shaxson Ethical BalancedGrowth	2.63%
King & Shaxson Ethical Cautious	2.73%
King & Shaxson Ethical Defensive	2.84%
King & Shaxson Ethical Growth	2.23%
King & Shaxson Ethical Income	3.89%

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[i] Comparing the total Sterling return of the iShares Clean Energy ETF against the MSCI Oil and Gas consumption index, both returned ca 96% over the ten years to 30th September 2024.