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Multi-Asset

May 2024

Looking forward with optimism

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We believe there are many opportunities in global financial markets today. Our degree of positivity is reflected in the current tactical asset allocation (TAA) score of four out of five, on a scale of one to five in which the latter is the most bullish. While we are pro-risk on a tactical, 12 to 18-month basis versus our underlying strategic asset allocation (SAA), we believe there is still scope for more optimism.

The Liontrust Multi-Asset team is positive about nine of the 22 asset types we assess, with most of the remainder scoring a neutral three. At present, the decision is more about where we decide not to invest rather than where we can do so. The rallies in equity markets over the past few months have pointed to growing confidence. It has also been encouraging that the US rally has broadened beyond the Magnificent Seven stocks that have dominated the market for so long.

The once-feared hard economic landing is looking less likely, as seen in the strong data emerging from the world's largest economy, the US. The worst of the inflationary spikes appear to be behind us too, with the impact from the main moves up in prices – caused by the recovery from the Covid pandemic and the Ukraine conflict – now largely over.

Positive on equities

We are biased towards being overweight in equities, especially those in the UK, Japan, Asia ex-Japan and emerging markets. The economic environment and outlook are positive for equities. They are still generally cheap, under-owned and there is a lot of cash waiting on the sidelines. A strengthening global economy or further improvements in investor sentiment would give a major boost to them.

In the UK, expectations for the first quarter of 2024 were for a positive GDP coming out of the very mild recession we saw at the end of last year. But the GDP growth of 0.6% was actually ahead of expectations. In addition, if you dig into the numbers, there is see some interesting data. For example, services are performing well and as inflationary pressures are easing the UK, there is a greater propensity to consume. This all means the UK has so far avoided the depth of recession that the consensus expected over the past 12 to 18 months.

Past performance does not predict future

Earlier this year, we added US small caps to our overweight list above. The Magnificent Seven behemoths have dominated headlines for some time, while their smaller counterparts in the US have been overlooked. US small caps have underperformed amid the monetary tightening seen in the last two years and we believe they offer good value now. This is against a current backdrop that sees the US economy heading in the right direction, and they are likely to do well if interest rates fall this year.

We remain broadly neutral on fixed income, although we continue to be positive regarding investment grade corporate bonds. Credit spreads in corporate debt are not particularly high but the overall levels of yields remain attractive because of the high levels of sovereign rates. High-quality businesses are offering nominal yields that we consider to be good value. Thanks to a good combination of credit quality and yield, we believe that investment grade credit represents a good diversifier, offering better risk-adjusted returns than high yield bonds and emerging market debt.

More generally, we believe that bond yields should form a range around current levels and we maintain exposure to fixed income for its long-term diversification to equities, some level of inflation protection and, latterly, strong income.

Risks lie ahead

But risks remain, of course. Even with the equity gains in the first quarter – the second successive quarter of positive returns - there was always a risk that the significant rallies could trigger a pullback. This release of pressure materialised in mid-April, when some markets, including the US, dipped. Given our optimism highlighted earlier, we regard such pullbacks as opportunities to add to tactical allocations. Indeed, the UK stock market has subsequently breached its all-time high.

Buying stocks at the wrong price is a risk, but this is always the case, even at the best of times. In our view, most major stock markets look fairly priced, if not quite cheap in several cases. The exception is the US, which looks expensive on many measures, although outside the Magnificent Seven mega caps, there is value available.

Investors also face potential risks from continued geopolitical conflicts and tensions and the fall in inflation has not been as quick as previously anticipated. This is impacting on the path of interest rates. When we started 2024, there was an expectation of around six or seven interest rate cuts in the UK during this year, most notably in the second half of 2024. Yet, as things stand today, the implied pricing in the markets is only for a couple of interest rate cuts in the second half of the year such has been the stickiness of inflation.

On the one hand, this brings more uncertainty that can be reflected in asset prices. On the other, the higher sustained inflation is symptomatic of an economy that is doing fairly well. Unemployment remains low and the economy is growing. Were unemployment to go up or the economy slow, this would very quickly ease inflationary pressures.

Clearly, geopolitics and inflation are linked, particularly through the oil price. Should we see continued nervousness around the Middle East and disruption of the oil supply pushing prices up, this would bring a secondary, inflationary impact. It is something to keep in mind and look at closely.

Positive direction of travel

Markets have started to price in a shallower and slower path of interest rate cuts, the trajectory of which might look more like Table Mountain than the Matterhorn. Market participants' focus on the minutiae of central bank minutes and the timing of rate cuts will likely create some uncertainty in the short term.

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As long-term investors, such minutiae are of little relevance to us. The precise timing of rate cuts is less important to us than the broad direction of travel. We see a global economy that is in reasonable shape, companies generating good revenues, low unemployment and real wage growth. If market uncertainties mean that financial assets can be purchased at reasonable value, then we see this as good news with a long-term view, diversified investments and a rigorous investment process that has been tried and tested over many years.

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

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Key Risks

Past performance does not predict future returns. You may get back less than you originally invested.

The Funds and Model Portfolios managed by the Multi-Asset Team may be exposed to the following risks:

Credit Risk: There is a risk that an investment will fail to make required payments and this may reduce the income paid to the fund, or its capital value. The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay;

Counterparty Risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss;

Liquidity Risk: If underlying funds suspend or defer the payment of redemption proceeds, the Fund's ability to meet redemption requests may also be affected;

Interest Rate Risk: Fluctuations in interest rates may affect the value of the Fund and your investment. Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;

Derivatives Risk: Some of the underlying funds may invest in derivatives, which can, in some circumstances, create wider fluctuations in their prices over time;

Emerging Markets: The Fund may invest in less economically developed markets (emerging markets) which can involve greater risks than well developed economies;

Currency Risk: The Fund invests in overseas markets and the value of the Fund may fall or rise as a result of changes in exchange rates.

Index Tracking Risk: The performance of any passive funds used may not exactly track that of their Indices.

Any performance shown in respect of the Model Portfolios are periodically restructured and/or rebalanced. Actual returns may vary from the model returns.

The risks detailed above are reflective of the full range of Funds managed by the Multi-Asset Team and not all of the risks listed are applicable to each individual Fund. For the risks associated with an individual Fund, please refer to its Key Investor Information Document (KIID)/PRIIP KID.

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