MPS investment update

March 2025 (written 7 March 2025)

Portfolio asset allocation

	Risk profile 3	Risk profile 4	Risk profile 5	Risk profile 6	Risk profile 7
Debt and fixed interest	**59.51**	**46.93**	**32.19**	**17.33**	**0.00**
Emerging Markets	2.95	2.92	1.97	0.00	0.00
International	10.80	11.71	8.70	4.97	0.00
Government	21.93	13.35	8.54	4.06	0.00
Corporate	23.83	18.94	12.98	8.29	0.00
Equities	**20.59**	**40.59**	**60.34**	**80.16**	**97.09**
Emerging Markets	1.01	2.00	1.97	2.67	2.91
Far East	0.93	1.86	2.04	3.56	4.43
Japan	1.00	1.07	1.87	2.43	2.94
North America	4.74	9.62	14.49	19.45	24.00
Thematic	2.25	4.07	6.77	8.13	8.40
United Kingdom	3.16	7.91	12.64	18.47	21.78
International	7.50	14.06	20.56	25.46	32.63
Alternative investments	**14.68**	**9.96**	**4.96**	**0.00**	**0.00**
UCITS funds	12.68	7.99	2.91	0.00	0.00
Commodities	2.00	1.97	2.05	0.00	0.00
Cash	**5.22**	**2.53**	**2.52**	**2.51**	**2.91**

Data as at 28 February 2025

Core inputs to our asset allocation framework

The economy

There's been a change of pace from the past few years, as the previously omnipotent US economy has started to slow. We expect a gradual softening, rather than a major downturn, driven by uncertainty over parts of the Trump agenda. Any pro-growth policies in the pipeline are unlikely to offset any weaknesses before this happens.

Europe remains stagnant – no change there. A big question is whether recent announcements on defence spending and infrastructure will be sufficient to spur Europe out of its lethargy. We keenly keep watch.

China recently committed to its previously stated growth projections of around 5% annual GDP growth. Data from the country is often questionable, but there certainly are signs of a tentative improvement in concrete economic data.

Overall, we expect the global economy to experience a period of low growth, with a recession still unlikely. However, both upside and downside scenarios are still plausible.

Inflation

Inflation rates have stalled in the last few months, with rates across the US and UK slightly above 3%, and at a high 2% in Europe. Further progress is proving difficult and we suspect this will persist in 2025. As with economic growth, there are both upside and downside risks to medium-term inflation rates. Our expectation is that inflation will be persistently higher than we saw in the last decade, but we are not expecting a major spike in the short-to-medium term. Inflation expectations have risen in recent weeks, as markets become concerned about inflation uncertainty.

Interest rates

Interest rate expectations are moving in a volatile way, reflecting the pervasive uncertainty around economic growth, inflation and global geopolitical events. With concerns rising over a US economic slowdown, there has been a major shift in US rate expectations, with four cuts now expected in the next year. Is this realistic? Possibly. Could it change again quickly? Absolutely.

We still believe that the next move in US rates will be lower and that two rate cuts are likely this year. In the UK, investors are also expecting two rate cuts, which is justified by the miserable growth outlook of the UK economy, but debatable in the context of persistent inflationary pressures. The UK is in a tough place and doubts remain over what the Bank of England can do to ease the pressure.

Corporate earnings

The recent corporate earnings season reflected a global economy and corporate sector that was doing very well at the end of 2024. There was broad strength across all sectors, apart from energy. The technology sector's growth was once again a feature, notably this success was expected and did not lead to further outperformance. At an index level in the US, earnings rose at a 14% year over year growth rate, surpassing the 8% rate that was expected. Expectations for the year ahead remain lofty and can probably only be achieved with further margin expansion and a positive economic backdrop. We need to closely analyse both factors throughout 2025, before we can have total confidence that high expectations will be met.

Valuation and positioning

There's been a fascinating reversal across global markets to start 2025. The previous leaders are now lagging, while those that trailed in 2023–2024 are leading. 2025's star performers have been European equities and some of the large international companies listed in the UK, while the US market has relatively underperformed. The technology sector has temporarily fallen out of favour and we are starting to see much better performance from healthcare, consumer staples and areas of utilities.

Although two months is not long enough to declare a real trend change, there are reasons that recent performance dynamics could persist, as valuations of the new leaders are sensible and sentiment had previously been poor towards them. Bond markets are also interesting currently. We are seeing real pressure on government bond prices in Europe and the UK, while US government bonds have performed relatively well, with yields relatively calm. We might use recent market movements as an opportunity to increase exposure to UK gilts. Credit markets are calm and there remains a healthy appetite across investors for corporate bonds and global credit.

Key subject of the month: 'The fast and the furious – has 2025's volatility forced us to change our views for the year already?'

- It has been an extraordinary start to the year in geopolitics, economics and markets
- Markets have followed the path that we expected for 2025 so far: positive returns in equities and bonds, plenty of volatility, but a very different shape and distribution of returns compared to 2024
- So far this year, US equities have underperformed with a flat return, while Europe, the UK and Asia have boomed; we view this as justifiable and deserved, as valuations in those markets were far cheaper and sentiment was extremely poor
- As 2025 progresses, we expect the US market to regain favour among investors, though there is a strong case for cheaper markets around the world to outperform
- It has been a noisy start to the year, but we have not yet seen anything to truly weaken our mildly constructive view on equities – politics are unhelpful and create nerves, but need to be assessed through a different lens when thinking about investments
- As anticipated, fixed interest markets have started 2025 well with many of our favoured investments performing strongly
- Inflation-linked investments are benefitting from the frantic start to 2025 and rising in value as investors fret over possible inflation in the future – this insurance is helping our portfolio outcomes
- Our concerns over the UK's fiscal situation have led to strong performance in US treasuries over UK gilts, there's an opportunity to rotate some of our client's assets into the UK
- Credit investments have built on a super 2024 and started the year well as the backdrop is supportive and demand for fixed interest investments is very high.

In short, it has been a fast and furious start to the year, but portfolios have behaved as we expected and market trends explainable. We have not shifted our constructive views, even if we still expect plenty of volatility, which we hope to use to our advantage.

Key asset allocation positioning

- We are still neutral in all asset classes at a 'headline level', reflecting our view that most asset classes are offering a fair balance between risk and reward
- This view has now been constant through the last 17 months and while we believe it remains appropriate for 2025, we stay open-minded about what is likely to be an unpredictable year
- We persist with a moderate underweight stance towards the US, large cap tech and growth themes in equity markets, although we have moderated that underweight stance
- We still admire the value opportunities in regions like Asia, Europe, and the UK, although we do not have an extreme positional skew
- While our equity allocation is neutral, we believe that we are well placed for potential economic slowdown, as we have increased focus on those companies that should have dependable business models and profit streams in a slower economic environment
- We remain underweight UK gilts and interest rate duration in fixed interest investments but have moderated our previous positioning and are expecting to increase interest rate sensitivity further
- We remain comfortable taking corporate credit risk, even if there are pockets of complacency in those markets that we are actively avoiding and believe 'compensation' through yields is fair
- As with equities, we have moved up in quality in fixed interest in expectation of trickier times ahead and will likely continue this progress
- Alternatives can add value in volatile markets, as 'relative value' trades help, but we can now find better opportunities elsewhere in fixed interest and equity markets
- As stated repeatedly through the last few years, our key stance is to remain balanced, diversified and operating with a 'flexible mindset'.

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