MODEL PORTFOLIO SERVICE
MONTHLY COMMENTARY

SUCCESSION
MODEL PORTFOLIOS
POWERED BY
7IM

JUNE 2022

Portfolio Performance

At 7IM, we believe that taking a long-term view is essential when investing. We can't always avoid the short-term bumps and shocks that the financial world has in store, but a well-diversified portfolio goes a long way towards smoothing out some of the journey. The long-term nature of our strategic and tactical process is a good complement to the Succession Matrix Expected Parameters.

	Q2/2017 - Q2/2018	Q2/2018 - Q2/2019	Q2/2019 - Q2/2020	Q2/2020 - Q2/2021	Q2/2021 - Q2/2022	3 Year Ann. Return	5 Year Ann. Return	Succession Matrix Expected Parameters – Ann. Return
Defensive	1.4%	2.8%	3.4%	4.6%	-6.0%	0.6%	1.2%	3.0 – 4.5%
Cautious	1.8%	2.5%	2.7%	8.4%	-5.5%	1.7%	1.9%	4.5 - 6.0%
Balanced	3.3%	2.1%	2.0%	12.9%	-5.1%	3.0%	2.9%	5.2 – 7.5%
Moderately Adventurous	4.9%	1.6%	0.4%	17.1%	-4.3%	4.0%	3.7%	6.0 – 8.0%
Adventurous	6.1%	1.5%	-1.0%	20.1%	-3.8%	4.6%	4.3%	7.0 - 10.0%
Income	1.6%	5.4%	-2.6%	12.0%	-4.9%	1.2%	2.1%	

Source: 7IM/FE. Annualised return is defined as 'Ann. Return' in the performance table above and is as at end June 2022. The extreme COVID-19 related drawdown at the start of 2020 means performance should continue be viewed with caution. Portfolios are towards the lower end of their ranges for the five-year returns, with the more defensive end struggling a little in the face of low interest rates.

Market and Portfolio Review

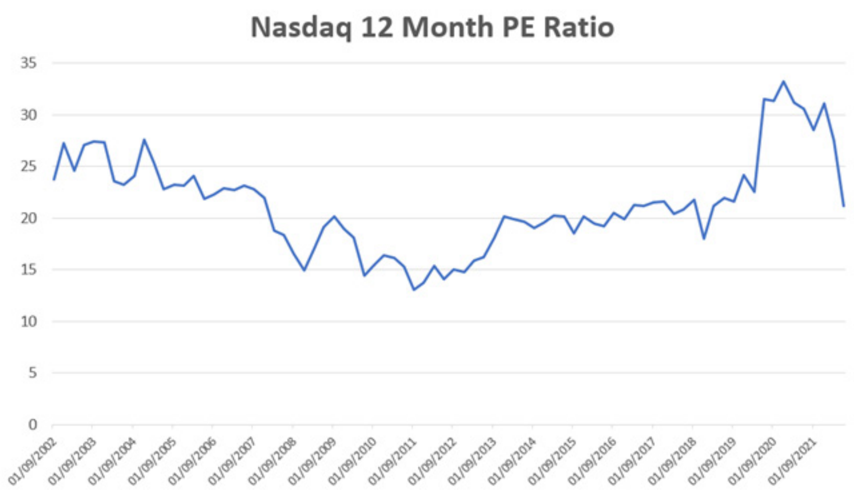
The first six months of this year have been *tough* with pretty much all markets, other than commodities and energy, down sharply. The MSCI World is down over 20%, and bonds around the world have seen double-digit losses. June offered no respite from the sell-off. The S&P fell almost 8% over the month, and bond yields continued to rise.

Market sell-offs are often the most interesting (and stressful) times for investors, particularly multi-asset investors like us. The lay of the land changes. Markets that investors considered expensive can become cheap and momentum can shift quickly.

During the Covid drawdown, many investors latched onto the phrase 'buy the dip', and echoes of this seem to be coming back. At a high level, buying the dip worked after Covid. There was a short, sharp sell-off, then markets rallied for the best part of two years. So, what would a devout buy-the-dipper do now, and why should you take care when buying the biggest dips?

If you are looking to buy the biggest dip, you'd be looking at growth stocks and US tech right now. Eye-watering valuations and duration exposure has meant that these stocks have suffered most in the risk-off, high inflation environment we have seen so far this year.

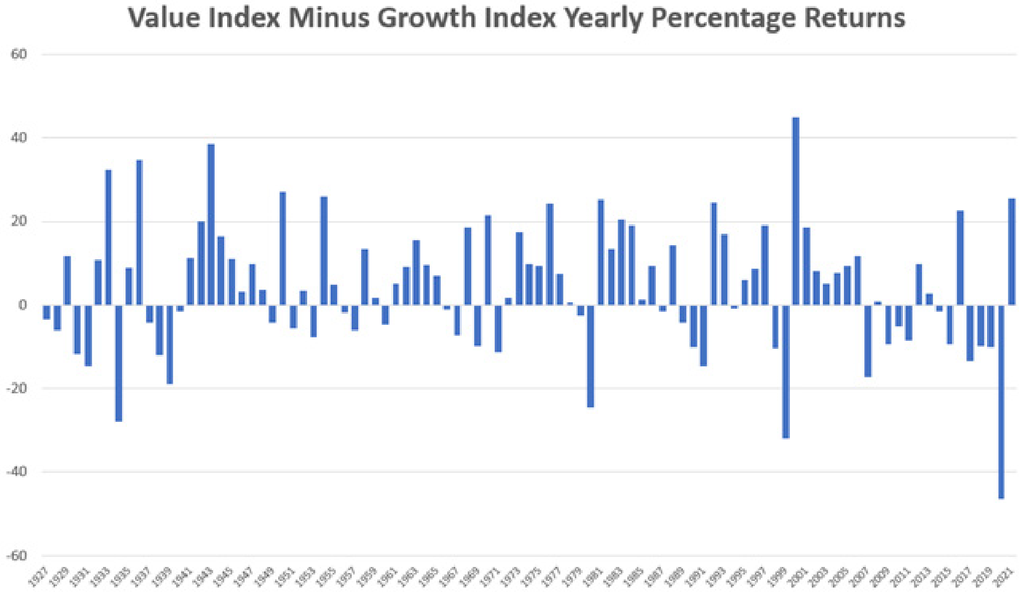
Let's start by looking at how much US tech valuations have dropped off:



Source: Bloomberg Finance L.P.

The chart on the previous page shows the price-to-earnings ratio of the Nasdaq over time, a standard measure of value. We think it's clear that, relative to history, these stocks aren't screamingly cheap in Price-to-earnings terms. They've been considerably cheaper for large parts of the past 20 years and it wouldn't be surprising if the ratio fell further.

Something else worth looking at is what usually happens when the tide changes from growth to value or vice-versa:



Source: Ken French Dartmouth MBA Faculty

This chart shows the percentage returns of a value index minus the percentage returns for a growth index each year since 1927. So, a positive number is value outperforming and a negative one is growth outperforming. What you can see is that when value starts outperforming, it tends to do so for a number of years – there are clusters of positive bars.

Piling back into growthy tech stocks – buying the biggest dip – could be a risky strategy as the relative outperformance of value is unlikely to have run its course.

Portfolio Positioning and Changes

During June, no changes were made to the Succession model portfolios. They will be rebalanced in line with our quarterly schedule in August.

Core views

At 7IM, we have a number of long-term core views that help to guide our investment decisions and allocations within portfolios.

We expect equity markets to go sideways... as the world normalises, manufacturing will slow, and services will recovery. How deep will the slowdown be? How long will it last? Will services be able to take up the slack?

These questions will be on investors' minds for a while. Without a clear direction for the economy, equity markets will struggle to move meaningfully higher as investors question both valuations and future earnings streams. *Put selling and higher credit allocations should do well in this world.*

Bond yields have more symmetry now... inflation is the other uncertainty hanging over investors. When will inflation come down? How low will it go? What will the Fed do next? This uncertainty has led to the volatility we have seen so far. The flip-side of that volatility is that it doesn't pay to be as underweight. Bond yields, at these levels, have more symmetry. *Adding government and corporate bonds looks sensible.*

Remain diversified... the lack of direction will have an impact across different markets. Will a particular factor (growth/value) work out? Should we favour defensives or cyclical stocks? Are there obvious sector winners? The market is not providing us with opportunities to pick a side right now. *So, we remain diversified... properly diversified. Our portfolio of diversified holdings across asset classes, time horizons and alternatives should do well.*

Detailed asset allocation

	Defensive	Cautious	Balanced	Moderately Adventurous	Adventurous	Income
UK Equities	3.0%	5.5%	13.0%	15.5%	19.0%	18.0%
US Equities	4.0%	5.0%	10.0%	10.5%	13.0%	8.5%
European Equities	2.0%	2.5%	4.0%	8.5%	9.0%	5.0%
Japan Equities	1.5%	2.5%	3.5%	8.0%	9.0%	3.5%
Emerging Markets Equities	4.0%	6.5%	8.5%	11.5%	16.5%	8.5%
Global Equities	5.0%	8.5%	13.0%	17.5%	22.0%	5.0%
Global Government Bonds	20.0%	9.5%	3.5%	0.0%	0.0%	5.0%
Gilts*	7.0%	1.0%	1.0%	0.0%	0.0%	1.0%
Global Inflation Linked Bonds	6.0%	3.0%	0.0%	0.0%	0.0%	0.0%
Global Corporate Bonds	6.5%	12.0%	5.0%	0.0%	0.0%	7.0%
UK Corporate	0.0%	3.5%	0.0%	0.0%	0.0%	2.0%
Global High Yield Bonds	10.0%	10.0%	10.0%	3.5%	0.0%	14.0%
Emerging Markets Bonds	3.0%	6.0%	7.0%	7.0%	0.0%	11.0%
Real Estate***	0.0%	2.5%	2.5%	3.5%	3.5%	6.0%
Alternatives/Hedge Funds	21.0%	18.0%	16.5%	12.0%	6.0%	0.0%
Cash	7.0%	4.0%	2.5%	2.5%	2.0%	5.5%

Source: 7IM. *Includes Short Term Sterling Bonds **Includes Convertible Bonds ***Includes Infrastructure

The past performance of investments is not a guide to future performance. The value of investments can go down as well as up and you may get back less than you originally invested.