



Ethical RL3

Quarterly Report to 30 September 2024

Objective

To provide capital growth by investing in a diversified portfolio of funds classified as investing with an ethical outlook.

Strategy

The portfolio utilises funds investing both in equities and/or fixed interest assets. The funds used all meet strict ethical and socially responsible criteria and mainly do this by excluding investment in certain sectors and industries. In order to meet the desired Risk Level, the portfolio is constructed to meet the IA's guidelines for a Mixed Investment 40% - 85% Shares fund.

Market Commentary

From an economic perspective concern clearly shifted from inflation to economic growth. For now, inflation appears to be behaving itself. In the euro area the rate has fallen below 2%. In the UK, consumer price inflation has now held steady at 2.2% for two consecutive months. In the US, meanwhile, we have also seen a move down towards target, falling most recently to 2.5%. Whilst there are still some components of the inflation basket which remain sticky, such as housing rents, concerns are dissipating.

Narrative is now more closely focussed on economic growth and how central banks protect it. Whilst the most recent forecast from the Organisation for Economic Co-operation and Development (OECD) remains relatively positive, investors are keen to understand how western central banks will navigate from the current higher interest rate environment to one more commensurate with lower inflation. There was concern that the US Federal Reserve (Fed) had left it too long after a weak August jobs report. This triggered them into action, with their first move being a 0.5% reduction.

The market also priced in a number of subsequent cuts in quick fashion. It has not been uncommon for the market to get ahead of itself, a point in case being the fourth quarter of last year. It may have done so again this time too, following a stronger than expected employment report for September which appears to have reinforced the soft landing thesis.

The Fed, European Central Bank (ECB) and Bank of England are all expected to continue their path of cutting moving forward. The exception to the rule is the Bank of Japan who appear to be in hiking mode. They caught the market off guard with their most recent hike at the end of July, which sent equity markets into a downward spiral. Whilst the hike was only a small 0.15%, it was enough to unsettle investors.

With US interest rates moving one way and Japanese in the other, we saw what appears to be a partial unwinding of the carry trade in early August, the carry trade being where investors borrow in a lower yielding currency, i.e. the Japanese yen, to invest in higher yielding currencies/assets. No one is quite sure exactly how large the positioning in the carry trade is, with some wide ranging estimates. The general consensus is that positions in the carry trade still exist and therefore a keen eye will likely be kept on the Bank of Japan.

The weakness in markets was met this time with investors keen to get back into the market at lower valuations. Liquidity is certainly abundant, with the Investment Company Institute reporting \$6.46 trillion in money market funds in the US. The question is, is this money likely to make its way into investment markets or stay parked where it is. Plenty to monitor as we enter the final quarter of 2024.





Performance

The portfolio posted a return of 3.06% for the quarter. This was ahead of the return posted by the IA Mixed Investment 40-85% sector average of 1.64%. We would point out that we draw comparison to the IA Mixed Investment 40-85% Shares sector due to asset allocation. There are of course many, if not most, funds within this sector which do not invest to an ethical mandate.

Those equity funds focussed on investing in UK equities were the best performing during the period. The Liontrust UK Ethical fund was the strongest performer, driven by stock selection and its exposure to mid-cap companies, with these outperforming their large cap counterparts. This was also a factor which contributed to the positive performance posted by the Aegon Ethical Equity and the CT Responsible UK Income funds. The Troy Trojan Ethical Income fund benefited from its focus on quality companies in what was a more volatile quarter for equities in general, particularly at the start of August.

The returns posted by the fixed income funds allocated to were positive. This asset class was supported by the interest rate cuts delivered by numerous central banks during the period, along with the heightened possibility that more could be seen between now and the year end. Whilst the market has shown a habit of getting ahead of itself, it would appear that more cuts will certainly be seen in the US, euro area and UK before the end of December. The scale of those cuts expected could continue to vary between now and then, driven by economic data released. The yield to maturity from the fixed income funds within the portfolio remain attractive, ranging from 5.68% to 6.47%.

Source: FE Analytics, Bid-Bid, Total Return

Portfolio Activity and Positioning

We continue to review the underlying funds that are used within this portfolio. Not only must they be suitable in terms of their performance, but also the ethical criteria which they follow, typically achieved through negative screening. Before we allocate to any funds within the Ethical portfolio, we review these screening rules which are applied to ensure that the fund is investing in line with restrictions which we would expect to see.

There were no changes made to the underlying fund composition in the quarter and therefore the portfolio was rebalanced in July to return them to their original allocation.

Over the last couple of years we have seen a plethora of funds launched or even renamed, which include themes such as sustainable, responsible and positive impact. These funds typically employ a positive screening methodology in the first instance, whereby the fund managers are looking to invest in companies which are seen as making a positive change in their attitude and processes towards topics such as decarbonisation or employee welfare, for example. Whilst these are clearly pleasing to see, this does not necessarily make them suitable for an ethical portfolio.

When reviewing these funds therefore we are careful to ensure that negative screening is also applied, which rules out investment in companies involved in what would be deemed non-ethical activity. The applying of these screens can lead to underperformance relative to the broader market, particularly when sectors/stocks typically excluded perform well, such as oil, tobacco or commodity miners.

Disclaimer

The portfolio is managed on a discretionary basis therefore the investment manager may make changes to the investments held without notice. Investors are agreeing to the investment model as recommended by an Adviser and may not be investing into the specific assets included in this report.

Past performance is not a guide to future performance. The value of investments and any income from them can fall as well as rise and are not guaranteed, so you may get back less than you invested. If you invest in currencies other than your own, fluctuations in currency value will mean that the value of your investment will move independently of the underlying asset.

Consideration should be given to whether it is felt that the outcome of any risk assessment is accurate and advice should be sought for factors such as investment objectives, the investment term, attitude to risk, capacity for investment loss and the level of inflation.

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