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Multi-Asset

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Market review: March 2024

- Fund and portfolio ranges all deliver positive returns in March
- US, European central banks signal rate cuts; Bank of Japan raises rates for first time since 2007
- Fixed income target allocations are diversified geographically in annual strategic allocation review

All the Liontrust Multi-Asset funds and portfolios delivered positive returns in March with global equities, bonds and real estate markets buoyant. UK and value stocks led the equities rally. All our Explorer funds beat their benchmarks.

Bond and real estate markets were mostly negative year to date, struggling amid nervousness around persistent inflation and interest rates staying higher for longer than expected. But in March they were encouraged by signals from central banks on both sides of the Atlantic regarding base rate cuts.

Rate cuts signalled

Federal Reserve chairman Jay Powell boosted markets by stating his preference was to cut rates by three quarter-points this year.[1] The comments came after data showed US inflation was still looking sticky, hitting 2.5% in February and up slightly from January's figure. But markets are now pricing in two to three quarter-point cuts in 2024, albeit down from the five to six that were factored into markets at the beginning of the year.[2]

Bank of England governor Andrew Bailey hinted at more than one reduction in UK interest rates this year[3], expressing confidence that inflation was heading towards its target, while the European Central Bank lowered its forecast for inflation from 2.7% to 2.3% in 2024, raising the possibility of rate cuts in the coming months.[4] All three central banks kept interest rates on hold at their March meetings, however.

Interest rate cuts this year should be supportive for smaller companies. In our Q1 2024 Tactical Asset Allocation (TAA) review, we raised our rating for US smaller companies from a neutral three to a positive four, bringing it into line with our rankings for UK and Japanese small caps. US small caps underperformed amid the monetary tightening and lacklustre economic environment seen in the last two years and currently offer good value. Smaller companies also tend to have a high responsiveness to the strength of the domestic economy.

In our Q1 TAA review, we also cut our rating for cash from a neutral three to our most bearish rating of one. This was an aggressive cut, but we felt it was the right move because inflation appears to have peaked and is falling. The next logical step is for interest rates to fall and a reduced running yield on cash will make the asset class less attractive.

Our annual Strategic Asset Allocation (SAA) review was conducted in Q1. A key feature of our updated SAAs is that we have diversified the fixed income allocations from a geographical perspective. There has been a modest reduction in the target allocations to UK gilts and UK corporate debt and a broadly commensurate increase in global ex UK fixed income hedged into sterling. There has also been a slight reduction in our global high yield target. As a result, there has been a small reduction in our fixed income target allocations, with re-allocations to cash and equities.

The net effects of both our TAA and SAA reviews on the eight risk levels that characterise our funds and portfolios include lower cash and higher fixed income targets in the lowest three risk levels; lower fixed income targets in risk levels four to seven; and higher equity targets for risk levels one to seven.

Bank of Japan steals the spotlight

Although they were still in positive territory, Asia ex-Japan and emerging markets were the weakest equity performers in March with low single-digit returns. China has a significant weighting and impact on both regions and its stock market has fallen around 45% over the last three years, versus an approximate 45% gain in global equities over the same period (in sterling terms). A key challenge to China's economy is weak demand from consumers, who are still stockpiling cash in the wake of Covid. China needs external sources of capital to help fuel its economic expansion and to this end, President Xi hosted a private audience in March for 20 senior US business luminaries, stressing that his country was still open for business despite the diplomatic difficulties of recent years. We rate the outlooks for both emerging markets and Asia ex-Japan as four out of five. We believe they will benefit from a more pro-growth, stimulus-oriented stance in China and the re-opening of international supply lines as the Covid pandemic recedes. Longer term, both regions have strong demographic tailwinds.

Elsewhere in Asia, the Bank of Japan raised interest rates for the first time since 2007 and ended the negative interest rate policy it started in 2016.[5] The target rate for overnight loans was raised to between zero and 0.1% from -0.1% to zero. We raised our TAA ranking on Japanese equities, including large and small caps, from a neutral three to four in Q4 last year and over Q1 2024, the country's equities led globally. Japan continues to offer a combination of fair valuations with a positive outlook for economic growth, and normalising inflation and interest rates for the first time in decades.

The bigger picture

Central banks and their monetary policies were very much centre stage again for markets in March. The expectations are growing for interest rate cuts this year. But as investors with a long-term process, we prefer to avoid being distracted by short-term noise around their timing. It matters less to us whether rate cuts are next month, this quarter or later in the year. The market had similar hopes for rapid cuts last year that were soon dashed.

What is key for us is the bigger picture – that we seem to be through the worst of the inflationary spikes and the next moves in interest rates should indeed be down. Data from this bigger picture also show the benefits of staying invested for the longer term. For example, over the five years to end-March, global equities returned 83% in USD terms.[6] This period encompasses Covid, geopolitical conflict and the biggest increases in inflation and interest rates in several decades, so the return demonstrates the resilience of markets in the face of major challenges and the benefits of a long-term, disciplined investment process.

[1]Source: FT.com, 22 March 2024

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[2]Source: FT.com, 1 April 2024

[3]Source: FT.com, 22 March 2024

[4]Source: FT.com, 7 March 2024

[5]Source: The Economist, 23 March 2024

[6]Source: Liontrust/Bloomberg, 3 April, 2024

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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

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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