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MODEL PORTFOLIOS
QUARTERLY INVESTMENT UPDATE - Q2 2022

Market review

The second quarter of the year proved to be another difficult period for investors after a tough start to the year. Markets have faced a host of concerns, which include the Russia-Ukraine conflict, rising food and energy prices, and lockdowns and an economic slowdown in China. Central banks around the world continue to face a growth-inflation trade off; raising interest rates too much risks triggering a recession, while not tightening enough risks higher inflation expectations.

Over the quarter, the S&P 500 Index fell more than 9%, its biggest one-quarter fall since March 2020. For the first half, the index dropped 20.6% for its largest first-half decline since 1970. The S&P 500 slid into bear market territory (a peak to trough of more than 20% is known as a bear market) after the Fed lifted rates by the most in three decades. In the UK, the FTSE All Share Index fell 5% over the quarter. European equities, represented by the Euro Stoxx 50 Index continued to struggle, down 8% for the quarter. Energy supplies remain a significant risk to the European economy with a reduction in gas supplies coming from Russia. This has continued to drive prices up and is raising fears of outright shortages and rationing if it continues. Emerging market (EM) equities recorded a negative return of 4%, represented by the MSCI Emerging Market Index. All index returns are quoted with GBP as the base currency. Sterling was weak in Q2, falling 8% against the USD dollar. This cushioned some of the falls in equity markets highlighted above.

In fixed income, investors continued to sell bonds due to higher inflation. The yield on the 10-year US treasury bond rose past 3% for the first time since 2018 (yields increase as prices fall). This did reverse over the last weeks of Q2, as investors anticipated lower inflation over the medium term. The Global Aggregate Bond Index fell 8.3% over the quarter while the Global High Yield Index was also down 5.5%. Emerging market bonds registered negative returns and were down 10% for the quarter.

Europe saw a continued rise in inflation and speculation around monetary tightening. The European Central Bank (ECB) has turned hawkish, inflation pressures are increasing, and the Russia/Ukraine conflict remains a key tail risk for the region. European Central Bank President Christine Lagarde indicated that the first interest rate rise could come after its July meeting accompanied by a winding down of its quantitative easing programs. Market consensus is pointing towards a 25-basis point rate rise. Headline CPI inflation in the Eurozone reached 8.4% (year-on-year) in June 2022, in line with the U.S. and the UK. However, core inflation (which excludes food and energy prices) is more subdued at 3.8% compared to around 6% in the U.S. and UK. This should allow the ECB to tighten policy by less than the Fed or Bank of England (BoE). A further escalation of the Russia-Ukraine war will worsen the outlook for the Euro area. A negotiated solution to the conflict however looks increasingly unlikely.

The cost-of-living crisis remains front-page news in the UK: CPI inflation hit a four-decade high of 9.1% In May, bolstering pressure on the BOE to respond aggressively with further tightening. The BOE raised the UK base rate further to 1.25% in June with more rate hikes expected over the coming months. They will be mindful though that with the consumer outlook weakening the risks to the economic outlook have risen. On a more positive note, the Chancellor's package of measures to help with rising energy bills will provide much-needed support to lower-income households who are feeling the impact of the rising cost of living.

Having kept Covid-19 under tight control for most of the past two years, the recent lockdowns in China have seen economic activity slow significantly through the second quarter, but we are now seeing early signs of cautious reopening. The low level of vaccination uptake among the elderly in China means the risk of further lockdowns will continue until either vaccination rates increase, or COVID-19 treatment production reaches critical mass. Valuations on Chinese stocks relative to developed markets now stand at levels not seen since 2015. There is a growing expectation that the People's Bank of China and the government will respond with more fiscal stimulus, infrastructure spending and cutting interest rates. Further easing measures should help the under-stress property market stabilise in the second half of the year. Additionally, the government has announced plans to reduce the uncertainty around regulation, which would be a tailwind for industries that have been negatively impacted.

Central bank policy and geopolitics are key risks that investors will be monitoring closely. The bottom line is that investors are worried about rising inflation, slowing growth and the potential for an aggressive Fed to cause a severe recession. Historically, markets would normally look at policy support to ease the pain. This cycle is different, as sky- high inflation (US consumer price inflation accelerated to 8.6% year-on-year in May) is leaving central banks little choice but to maintain their plans to continue tightening. The US Federal Reserve has made clear it is ready to dampen growth in a step up in the central bank's inflationary countermeasures. The Fed increased rates by 0.75% in June, the largest increase since 1994, with inflation running at a 40-year high. July's meeting will involve a debate among FOMC policymakers over whether to opt for a 0.5% or 0.75% increase. There is a chance that U.S. core inflation has peaked. This, combined with lower job vacancies in the labour market, could allow the Fed to slow or stop interest rate increases in the second half of the year. Market expectations are now calling for the Fed benchmark rate to hit a peak of around 3.5% by the end of the next year. This expected level is more than double the figure at the start of the year.
Monetary policy tightening impacts global financial markets because when interest rates are higher, this increases the rate at which companies future cash flows are discounted. The result is a decline in equity valuations.

Global equity vs Global fixed income comparison

Over the last five years, global equities and global bonds have both risen.

Source: FE Fund Info, 30 June 2022. Index performance is based at 0% as of 30 June 2017
The figures refer to the past and past performance is not a reliable indicator of future results.

YTD 2022 Global equity vs Global fixed income

To see both equities and sovereign bonds fall in this way is an unusual situation, caused by fears around high inflation and in turn, rising interest rates. Bonds have also proven to be not much of a 'safe haven' while the risk off investor sentiment has sent equities lower. There is a risk equities continue to perform poorly especially if the Fed cannot engineer a soft landing of lower inflation without causing a recession.

Source: FE Fund Info, 30 June 2022. Index performance is based at 0% as of 31 December 2021
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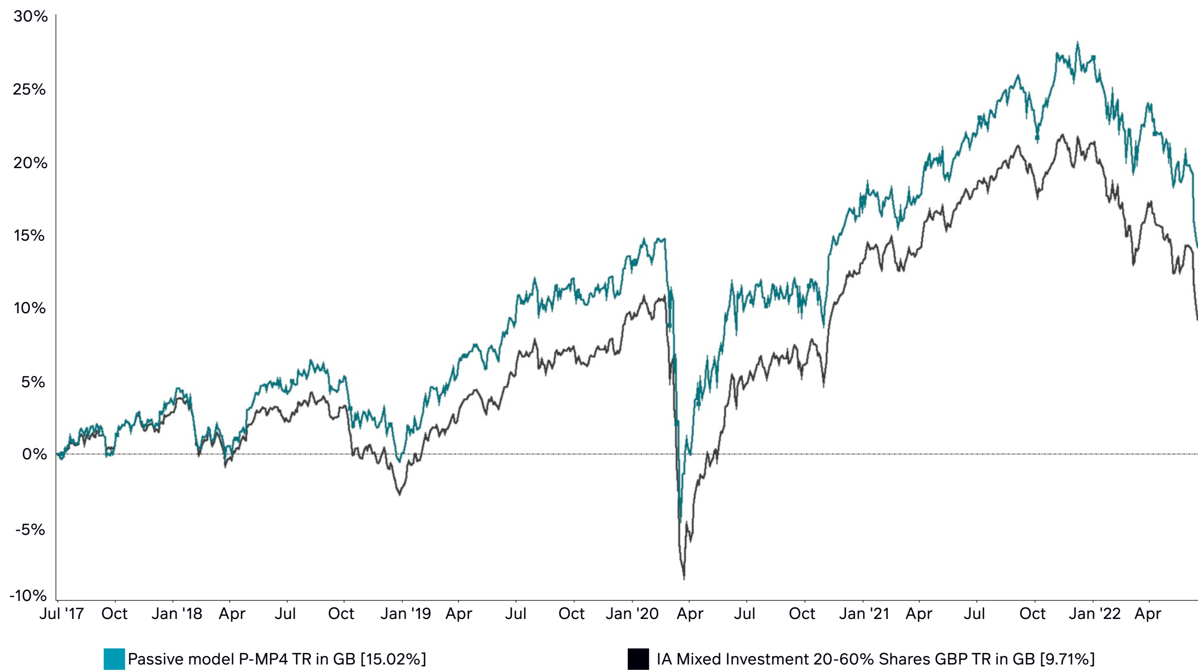
Q3 Outlook

Looking ahead, we believe financial markets are likely to remain volatile as financial conditions continue to tighten and economic growth weakens. The inflation outlook remains uncertain and as such central banks are inclined to raise interest rates more quickly than in prior cycles. Market pricing of rates and inflation suggest an expectation that the Federal Reserve will follow through with its intentions to raise interest rates over the coming months but at a cost of a contraction of output. The risk for equities and bonds heading into H2 is that the expected slowdown in inflation fails to materialise while the economy continues to slow. The economic side effects of the continuing war in Ukraine on energy and commodity markets as well as the scars on supply chains left by COVID-19 provide additional complexity.

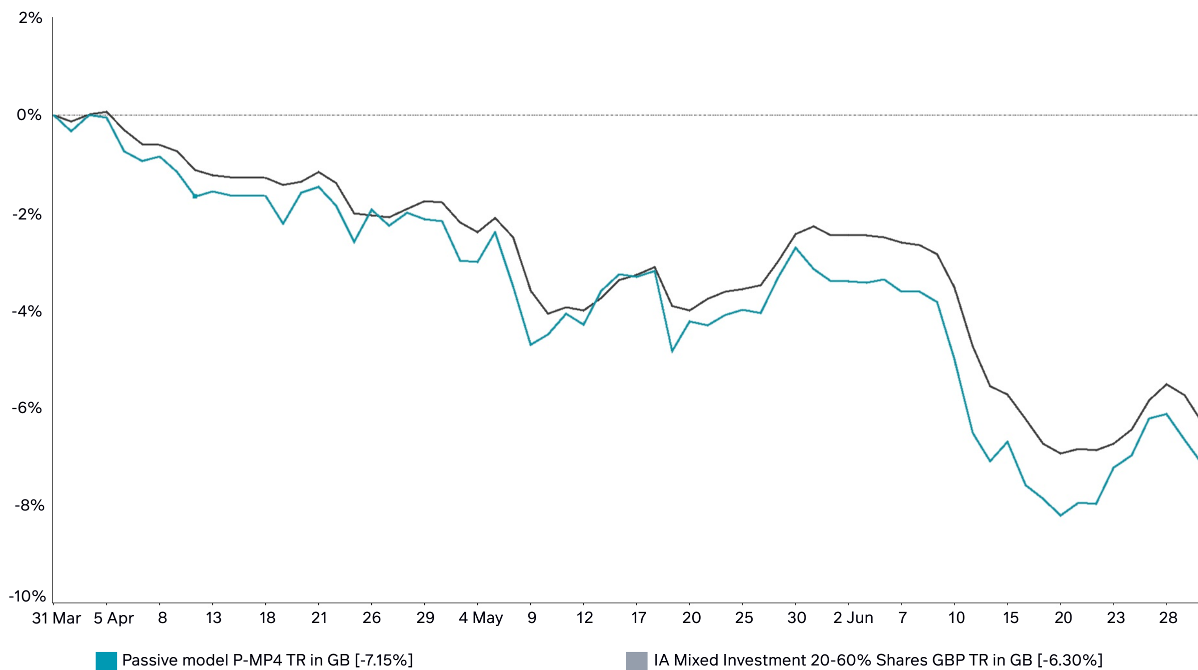
Portfolio snapshot

Passive model 4 vs IA Mixed Investment 20-60% Sector, over five years



Source: FE Fund Info, 30 June 2022. Portfolio performance is based at 0% as at 30 June 2017. The estimates are net of the fees charged by the underlying investments used in the models. The investment management fee of 0.18% pa is not included. Fees for the platform, wrapper and advice fees are not included, and will vary based on customer circumstances. The figures refer to the past and past performance is not a reliable indicator of future results.

Passive model 4 vs IA Mixed Investment 20-60% Sector, QTD



Source: FE Fund Info, 30 June 2022. Portfolio performance is based at 0% as at 31 March 2022. The estimates are net of the fees charged by the underlying investments used in the models. The investment management fee of 0.18% pa is not included. Fees for the platform, wrapper and advice fees are not included, and will vary based on customer circumstances. The figures refer to the past and past performance is not a reliable indicator of future results.

Model portfolio returns

Portfolios' performance (to 30/06/2022)

Model	1 year	5 years
Passive 3	-6.24	8.93
Passive 4	-5.48	15.02
Passive 5	-4.39	21.50
Passive 6	-4.09	24.31
Passive 7	-3.64	25.32
Hybrid 3	-6.57	8.42
Hybrid 4	-6.47	14.00
Hybrid 5	-6.06	20.05
Hybrid 6	-6.91	23.11
Hybrid 7	-7.75	23.64

Source: Data to 30/06/2022. These figures do not take into account fees for the investment management, platforms, wrappers or advice. The figures refer to the past and past performance is not a reliable indicator of future results.

Current fact sheets are here:
https://www.mandg.com/wealth/hub/investment-solutions/mps/support

Tactical Asset Allocation

Relative to the strategic asset allocation for each portfolio, we hold more in listed infrastructure equities and less in investment grade bonds. Within equities, we have more in US equities and less in European equities. We believe the US economy is better insulated from the global economic slowdown than other regions. Additionally, US companies are so far able to maintain margins suggesting the hit to earnings per share from higher inflation will be less pronounced than other regions. We are underweight European equities. Europe has a high weighting to GDP sensitive sectors such as industrials and financials. We think there is a risk of a sizeable economic deceleration as a result of a prolonged period of high energy prices. We retain our neutral stance to UK and Emerging Market Equities. We see the UK market as fairly valued and favour other developed market equities such as U.S. Regarding EM equities, headwinds in the form of higher inflation pressures and tighter policies will hamper growth, hence the neutral stance.

In July 2022, we added an overweight to Listed Infrastructure Equities, which we think can act as a good diversifier and provide inflation protection characteristics. Listed Infrastructure consists of companies that are listed on a stock exchange and earn a significant portion of their revenues from developing and operating critical physical infrastructure. This includes toll roads, airports, water systems, and energy infrastructure. The advantage is that demand tends to be stable for these services and the prices are often linked to inflation. In the current environment, we believe this area will outperform other equity sectors. Where our portfolios do have infrastructure in the strategic asset allocation, we maintain an overweight allocation to cash, as a diversifier to Equities and Bonds.

We hold less in European and UK corporate bonds. We think Europe and UK are set to face significant policy challenges as authorities try to manage rising inflation and a stagnant economy. We think rates could go up higher particularly in the Euro area. Higher rates cause the capital values of bonds to rise, as the value of future interest payments falls. We think the ramifications of the policy dilemma to create heightened uncertainty is high in the UK and European fixed income markets and prefer to have less in this area.

Fund Changes

In our Hybrid portfolios, we introduced 9 new holdings across our portfolio range this quarter. Please note that not all funds are used in each of the hybrid models we offer. There are differences, driven by the risk profile of each portfolio and the platform used.

Fidelity China Focus Fund: This is an actively managed China equity fund with a value investment style. This strategy is focused on companies, across any sector and of any size, that is based or does most of their business in China. The fund managers search for quality companies and management teams that are out of favour due to short-term macro factors. This combined with a long-term investment horizon gives them the ability to pick stocks that are undervalued but should be beneficiaries of China's structural growth dynamics.

Matthews Asia Funds - China Fund: This fund offers a balanced exposure to the Chinese market, with a focus on firms with robust long-term earnings prospects and moderate valuations. The fund manager makes full use of the market-cap spectrum, readily invests outside the most popular areas, and pays attention to firms that will profit from the rise in income levels of consumers in the region.

Pimco Global Investment Grade Credit ESG Fund: The Global Investment Grade Credit ESG Fund is an actively managed fund that invests primarily in investment grade global corporate instruments while delivering positive environmental and social benefits. The fund is diversified broadly across industries, issuers, and regions based on PIMCO's macroeconomic and company-specific views. The fund uses an ESG screening process which includes ESG exclusions, evaluation, and engagement decisions. The fund may invest up to 15% in "non -investment" grade securities which are considered to be riskier but typically produce a higher level of income.

Pimco Global High Yield Bond Fund: This is a Global High Yield Bond Fund, focused on high-quality assets with an emphasis on high yield bonds with stronger credit ratings. The fund can have a maximum of 20% of its assets in securities rated lower than B. The fund manager seeks to add value through active management by underweighting or overweighting the portfolio of the fund in different sectors (industrials, utilities, and finance) as compared to the weightings of such sectors in the benchmark. The fund benefits from PIMCO's fundamental research process, which include top-down economic views, bottom-up security selection and extensive global resources.

Pimco GIS Total Return Bond Fund: The PIMCO Global Total Return Bond Fund is a diverse portfolio of investment grade securities, actively managed to maximise total return while minimising risk relative to the benchmark. The benchmark is Bloomberg Barclays U.S. Aggregate (GBP Hedged) Index. The index covers the U.S. investment grade fixed-rate bond market.

M&G Emerging Markets Bond: The M&G Emerging markets bond fund invest in fixed income securities from issuers in or economically tied to emerging or developing countries. It is run by a well-resourced emerging market debt team at M&G. The investment process combines top-down macroeconomic views with bottom-up credit analysis across the breadth of Emerging Markets governments and companies.

M&G Episode Allocation Fund: The M&G Episode Allocation Fund is an actively managed strategy that has the flexibility to invest in a different mix of assets including company shares, bonds, convertibles, and currencies. The fund targets combined income and capital growth of at least 5% a year above the Sterling Overnight Index Average (SONIA), before any charges are taken, over any five-year period.

Royal London Ethical Bond Fund: This fund invests in sterling-denominated corporate bonds, which meet the fund's predetermined ethical criteria. The bonds selected in the portfolio have passed an ethical screening process that filters out companies with significant involvement in gambling, tobacco, alcohol, fossil fuels and pornography. The performance target is to outperform the benchmark over a rolling 5-year period. The fund manager's preference for secured debt over unsecured has been a significant factor in the level of performance achieved by the fund over the years.

Federated Hermes SDG Engagement High Yield Credit Fund: A global High yield bond fund, investing at least 80% in a diversified portfolio of below Investment grade debt securities, such as these include bonds, credit default swaps and secured loans. The team believes that creditworthy companies, which show a willingness and ability to address specific needs of society and are aligned with the United Nations Sustainable Development Goals, have the potential to deliver superior risk-adjusted returns. The global focus of the fund is viewed favourably as it helps to identify opportunistic companies across different markets and get exposure to different sources of return

Portfolio views

In our view, it is still too soon to position for a rebound in risk assets, as there are some risks that have not been fully priced in. We continue to monitor market moves carefully and will adjust our allocations as the economic outlook improves.

Summary asset allocation

The table below shows the asset class split of the passive models (SAA) at 15 July 2022.

Asset Class %	3	4	5	6	7
Cash	5.00	3.00	2.50	2.00	2.00
UK Equity	5.50	10.25	13.75	20.50	24.25
US Equity	4.00	7.25	10.00	15.00	17.50
Europe Ex UK Equity	2.75	5.25	7.25	10.75	12.75
Japanese Equity	1.50	2.75	3.50	5.50	6.50
Asia Ex Japan Equities	4.00	7.50	10.00	15.00	17.50
Emerging Markets Equities	2.25	4.00	5.50	8.25	9.50
UK Investment Grade	22.25	16.00	11.75	4.75	1.75
European Investment Grade	7.50	5.25	4.00	1.50	1.00
US Investment Grade	24.25	17.25	12.75	5.25	1.75
US Government Bond	6.00	3.50	2.50	1.25	1.00
Global High Yield Bond	5.00	6.00	5.50	3.50	1.50
Emerging Market Debt	10.00	12.00	11.00	6.75	3.00

Source: M&G Wealth (Figures are % of the overall portfolio model allocation)

Platforms

These passive and hybrid portfolios are now available on a growing range of platforms.

Platform	Passive	Hybrid
Advance by Embark	LIVE	LIVE
AEGON (Ex CoFunds)	N/A	LIVE
AEGON (ARC)	LIVE	LIVE
Aviva	LIVE	LIVE
Embark	LIVE	LIVE
M&G Wealth	LIVE	LIVE
Novia	LIVE	LIVE
Nucleus	LIVE	LIVE
Quilter Wealth (Old Mutual)	LIVE	LIVE
Transact	LIVE	LIVE

Source: M&G Wealth

Where can I find more information:	
Defaqto	https://www.defaqto.com/advisers/
Selectapension	https://www.selectapension.com/
O&M Profiler	https://html.omprofiler.co.uk/
Synaptic Software	https://www.synaptic.co.uk
DDhub	https://www.ddhub.co.uk

Total costs (OCFs at 30/06/2022) (varies by platform)

Note the impact of transaction costs and share class availability may mean illustrations from platforms show different (higher or lower) total costs.

Passive - M&G Wealth, Embark, Novia, Transact (includes ETFs) costs %pa

Risk Level	Fee	Est. underlying OCF	Total
Passive 3	0.18	0.09	0.27
Passive 4	0.18	0.10	0.28
Passive 5	0.18	0.09	0.27
Passive 6	0.18	0.11	0.29
Passive 7	0.18	0.12	0.30

Passive - Advance by Embark, Aviva, Nucleus (Excludes ETFs) cost %pa

Risk Level	Fee	Est. underlying OCF	Total
Passive 3	0.18	0.13	0.31
Passive 4	0.18	0.12	0.30
Passive 5	0.18	0.12	0.30
Passive 6	0.18	0.13	0.31
Passive 7	0.18	0.14	0.32

Hybrid - Advance by Embark, Aviva, Nucleus, OMW (Excludes ETFs) cost %pa

Risk Level	Fee	Est. underlying OCF	Total
Hybrid 3	0.18	0.25	0.43
Hybrid 4	0.18	0.28	0.46
Hybrid 5	0.18	0.32	0.50
Hybrid 6	0.18	0.41	0.59
Hybrid 7	0.18	0.45	0.63

Source: FE Fund Info as at 30/06/2022

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The value of investments will fluctuate, which will cause values to fall as well as rise and investors may not get back the original amount invested. The numbers may not reflect the performance of individual customer portfolios. To the extent that the assumptions (see below for main assumptions) used to calculate performance are not experienced by individual customer portfolios then actual portfolio returns will differ, positively or negatively, from those in this document. Returns are expressed as a percentage and represent an estimate of the time-weighted total return over the relevant period. The main assumptions are: 1. instrument total returns are as per data from Financial Express; 2. a proxy benchmark return is assumed for the cash return; 3. transactions resulting from rebalances or changes in the model occur at the date of the Investment Committee meeting which considered changes to the portfolios (unless the Investment Committee resolved a later implementation date, in which case transactions are assumed to occur at that date); 4. the ongoing charging figure of the underlying investments used in the models is deducted from the return estimates; 5. M&G Wealth's investment management fee, platform, wrapper and advice fees are not deducted. Deduction of these charges will have the result of reducing the estimated performance shown above; 6. no transaction costs are assumed (usually zero for mutual funds but exchange traded-fund transaction costs are sometimes applied depending on platform).

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