Baillie Gifford™

Multi Asset
Q2 investment update

July 2024

Investment manager James Squires and investment specialist Steven Milne give an update on the Multi Asset Strategy covering Q2 2024.

Your capital is at risk. Past performance is not a guide to future returns.

Steven Milne (SM): Hi, and welcome to this Multi Asset update. I'm Steven Milne, and I'm an investment specialist in the multi-asset Clients Department.

As a brief reminder, the Multi Asset strategy aims to achieve 3.5 per cent over the relevant Base Rate, providing that all-important portfolio diversification across different asset classes.

Today, we're going to be discussing market backdrop, the performance, and also the outlook and those areas of opportunity that we're finding. Today, I'm joined by James Squires, who is the Head of Multi Asset and a Partner of the firm. So, perhaps nobody better to answer my questions today. James, welcome.

James Squires (JS): Thanks, Steven.

SM: I think starting with market backdrop first, if we're to look at the start and the end of the period, it seems fairly benign, but there's obviously been quite a lot going on in amongst that. So, what's been the main highlights for you?

JS: I suppose there's always a lot going on, a lot of noise. So, we've had elections. We've got some active conflicts in the Ukraine and Gaza. We've got angst about whether inflation is coming down or not. We've got discussions on tariffs. There's plenty going on.

I think cutting through all of that though and what's caught our eye over the last few months, and I'd say it's the divergence of monetary policy. Why do I say that? If you think about the last few years, actually, all of the major economies have broadly done the same thing. Growth has kind of moved in lockstep; inflation has been an issue in lockstep; and, central banks have all moved together. But, actually, in the last few months, we've started to see some real divergence.

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The US - the Federal Reserve - has been keeping its interest rates high, tight policy, waiting for clear signals that inflation is going to come down before making any changes to that. But that's not the case all over the world.

In Europe, even though growth is picking up and there's actually some positive signs from the consumer, the ECB has gone ahead and cut rates. In Sweden and Canada, they've cut rates. Then we go to China, and China is fiscally stimulating, trying to get growth out of the economy. So, it was a different approach in China.

And then we've got Japan, completely different. Here, [at the] very end of the last quarter, they abandoned the negative interest rate policy and raised rates. Now, they're winding up or winding down, I suppose, quantitative easing, the QE that they have done. They're tightening policy and so you've seen yields move up quite substantially.

So, you've got major economic blocks doing quite different things and that creates volatility. It creates opportunity in asset classes.

SM: I think, like you say, the biggest difficulty for you is cutting through that market noise, really. And you also mentioned as well, certain things have been catching your eye. Maybe you could elaborate a little bit on what it is that's been catching your eye that's relevant for the portfolio.

JS: Well, and as you say, there's a lot of noise. Equities had a wobble in April and they've bounced back. Credit spreads, government bond yields a little bit wider but, generally, at fair or tight levels. Well, what's caught my eye? Commodities, I think is an interesting asset class to talk about.

Generally, it's been a really good quarter for commodities. Part of that is the positive stimulus from China but another part of it is a scarcity of critical materials and I think that's particularly true for some of the industrial metals that are important in the energy transition - the coppers, the aluminiums - that, as you know, we own in the strategies. Now, it's not just been them. We've also seen precious metals and energy commodities moving higher for other reasons. But commodities as a whole have had a really good quarter.

SM: Just sticking with the theme of performance then, you've obviously mentioned that commodities have done particularly well over this time period. The strategy has done well since the end of last year, really. We've continued that positive performance momentum. But what have been the main contributors and detractors over the three months?

JS: Performance has been pleasing. We need to be producing good performance, if only to get the long-term numbers back to where they should be; that's important. But we've got a portfolio that we're confident in and has been delivering and, as you expect from us and from our approach, the drivers, the contributors, have been many and varied.

Over the last three months, yes, commodities, that has absolutely been one of the key asset classes but alongside that, I'd set active rates and currencies where the Japan position, the Japan position being a bet, if you like, that interest rates are going to rise. We think that's a very high probability. They have risen, as I talked about earlier, because of the policy change, up about 30 basis points in the quarter, that's worth about half a percent to strategy performance. So, it's things like that.

Also, infrastructure, where we've seen renewable developers deliver. Renewable developers have struggled for the last 12-18 months. It's a period where despite all of the policy promoting a rollout of renewables, actually getting projects financed, permitted, built has been much more difficult than you would think about, particularly in the US. But, actually, we've seen some positive progress on that and that's seen renewable developers do well in the last three months.

So, the commodities, the rates and currencies, the infrastructure, structured finance had another good quarter. So different drivers of performance contributing to a decent quarter all round.

SM: The performance aspect is obviously the backward-looking part. In a slight pivot to the more forward-looking thoughts, obviously, we've conducted recently our long-term return expectations work, key for the investment process as well. So, what are the asset classes that you're finding that are going to be the main drivers to future returns?

JS: The long-term return expectations is a great place to start that conversation. This is, as you know, it's a key part of our investment process. We're forecasting asset class returns for the next 10 years, and then we're using that as the base for our portfolio, and there's a number of asset classes that are coming out of that well.

Again, similar to the last message, there are many drivers and it's right across the asset class spectrum, particularly in the less traditional asset classes, I'd say, actually. So structured finance, loans, especially sort of private loans, emerging market debt, emerging market equities, they all come out well. As do insurance linked securities and infrastructure and they're the two I'd probably highlight right now for different reasons.

Insurance linked securities because the returns there – or the return outlook - is improving, and more so than any other asset class. That's a function of insurance premiums rising as capital has been pulled away from this market. We've been a bit down on insurance linked securities for most of the last 10 years. We've said that the returns aren't really there, apart from in one or two particular spots or peril areas, as we would call them.

But, actually, the whole universe looks much more attractive now. And okay, there needs to be a bit of adjustment to take account of climate change and the impact that's bringing. But the opportunities that we're seeing are taking yields to a place where there's now multiples of the risk that we're being asked to bear. So that's of great interest to us.

And then I said infrastructure. People have heard me talk about infrastructure a lot in the last year or two but I think it's just a really powerful asset class. It's our top pick, if you like, from our long-term return expectations, it comes out with the highest return. And in terms of something that drives return, we've got stable cash flows delivered at a relatively low beta. We've got great demand for the asset class coming from, particularly, the energy transition and the various things associated with that. That's bringing growth.

So, we've got stable income; we've got growth; and, then, we've also got a situation where a number of particular investments are sitting at discounts to their net asset value or their fair value. So, you've got valuation as well. That's a really powerful combination to drive returns for the next 10 years, so that's where I would be focusing.

SM: That is quite a broad base of asset classes that you're actually covering from the long term. I think from a shorter-term perspective, what would you say [are] the scenarios that are most relevant to the portfolio and how do you have the portfolio positioned to take advantage of those opportunities?

JS: You mean economic scenarios with that?

SM: Yes.

JS: Okay, yes. I guess, so thinking out the next year or two on that, where are we? Well, we expect inflation to continue to moderate; we expect growth to continue to moderate. That's kind of what we're investing to and that's a relatively benign outcome for most of the asset classes.

But we want to make sure we're robust to if inflation does turn back around and start rising again, or if any of the geopolitical scenarios I'm talking about flare up, and that robustness is important. It's been pleasing to me that over the first few months of the year that, actually, where we have had those moments where the market has obsessed about one thing or another, portfolio performance has not been thrown around. I think that's important.

In terms of how we're positioning for those scenarios, really, it's just leaning into those opportunities I highlighted a moment ago. Our biggest positions are in infrastructure. We're owning lots of those cheap UK renewable trusts. We've also got double-digit-type allocations to the likes of insurance linked securities, where we've just bought an interesting Mexican earthquake bond, for example. Emerging market debt, where we've got a big position in Egypt where, despite the backstopping that's now being given by the IMF and the UAE, actually you're getting a really high yield and currency appreciation.

Structured finance, which just continues to deliver quarter in, quarter out, high yields, low default risk. And we're reasonably heavily invested in emerging market equities as well. We've bought into Vietnam and India, high-growth markets, in the last quarter. So, there's an awful lot going on in the portfolio. We think there are a number of opportunities, often in those less traditional areas and we're trying to take advantage of them. We've got a portfolio that's pretty settled, based around those long-term return expectations. We've got confidence in it, and we're just sitting back and watching it deliver from here.

SM: That's great. Well, sadly, we have run out of time today. I do thank you for all your comments that you've made today.

As James touched on, the positive performance has continued since the end of last year. That's really been driven by a wide variety of asset classes, including structured finance and commodities. And really, we're looking forward to the future in terms of our long-term return expectations that we have and all the opportunities that we're finding. But with that, I thank you for joining us today.

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Diversified Growth (representative of Multi Asset, Multi Asset Growth, Diversified Return, Sustainable Multi Asset)

Annual past performance to 30 June each year (net%)

	2020	2021	2022	2023	2024
Diversified Growth Composite	-3.1	13.9	-9.8	-2.1	6.2
Base rate +3.5%	4.1	3.6	3.9	6.7	8.8

Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years
Diversified Growth Composite	6.2	0.7	2.3
Base rate +3.5%	8.8	5.4	4.7

Source: Revolution. Sterling.
Base Rate: UK Bank of England.

Past performance is not a guide to future returns.

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