Oxfordshire County Council Pension Fund

Quarterly Investment Report

Q1 2025

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Key Indicators at a Glance

	Index (Local Currency)	Q1	2025 YTD
Equities		Total Return	
UK Large-Cap Equities	FTSE 100	6.11%	6.11%
UK All-Cap Equities	FTSE All-Share	4.51%	4.51%
US Equities	S&P 500	-4.27%	-4.27%
European Equities	EURO STOXX 50 Price EUR	7.53%	7.53%
Japanese Equities	Nikkei 225	-9.91%	-9.91%
EM Equities	MSCI Emerging Markets	2.93%	2.93%
Global Equities	MSCI World	-1.79%	-1.79%
Government Bonds			
UK Gilts	FTSE Actuaries UK Gilts TR All Stocks	0.55%	0.55%
UK Gilts Over 15 Years	FTSE Actuaries Uk Gilts Over 15 Yr	-0.89%	-0.89%
UK Index-Linked Gilts	FTSE Actuaries UK Index-Linked Gilts TR All Stocks	-1.42%	-1.42%
UK Index-Linked Gilts Over 15 Years	FTSE Actuaries UK Index-Linked Gilts TR Over 15 Yr	-3.36%	-3.36%
Euro Gov Bonds	Bloomberg EU Govt All Bonds TR	-1.33%	-1.33%
US Gov Bonds	Bloomberg US Treasuries TR Unhedged	2.92%	2.92%
EM Gov Bonds (Local)	J.P. Morgan Government Bond Index Emerging Markets Core Index	4.10%	4.10%
EM Gov Bonds (Hard/USD)	J.P. Morgan Emerging Markets Global Diversified Index	2.24%	2.24%
Bond Indices			
IBOXX Sterling Corporates	IBOXX Sterling Corporates Overall Total Return Index	0.46%	0.46%
European Corporate Investment Grade	Bloomberg Pan-European Aggregate Corporate TR Unhedged	-0.16%	-0.16%
European Corporate High Yield	Bloomberg Pan-European HY TR Unhedged	0.54%	0.54%
US Corporate Investment Grade	Bloomberg US Corporate Investment Grade TR Unhedged	2.31%	2.31%
US Corporate High Yield	Bloomberg US Corporate HY TR Unhedged	1.00%	1.00%
Commodities			
Brent Crude Oil	Generic 1st Crude Oil, Brent, USD/bbl	0.13%	0.13%
Natural Gas (US)	Generic 1st Natural Gas, USD/MMBtu	13.38%	13.38%
Gold	Generic 1st Gold, USD/toz	18.24%	18.24%
Copper	Generic 1st Copper, USD/lb	25.02%	25.02%
Currencies			
GBP/EUR	GBPEUR Exchange Rate	-1.17%	-1.17%
GBP/USD	GBPUSD Exchange Rate	3.21%	3.21%
EUR/USD	EURUSD Exchange Rate	4.46%	4.46%
USD/JPY	USDJPY Exchange Rate	-4.61%	-4.61%
Dollar Index	Dollar Index Spot	-3.94%	-3.94%
USD/CNY	USDCNY Exchange Rate	-0.58%	-0.58%
Alternatives			
Infrastructure	S&P Global Infrastructure Index	4.62%	4.62%
Private Equity	S&P Listed Private Equity Index	-5.35%	-5.35%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	0.00%	0.00%
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP	-1.36%	-1.36%
Volatility		Change in Volatility	
VIX	Chicago Board Options Exchange SPX Volatility Index	28.41%	28.41%

Source: Bloomberg. All return figures quoted are total return, calculated with gross dividends/income reinvested and in local currency.

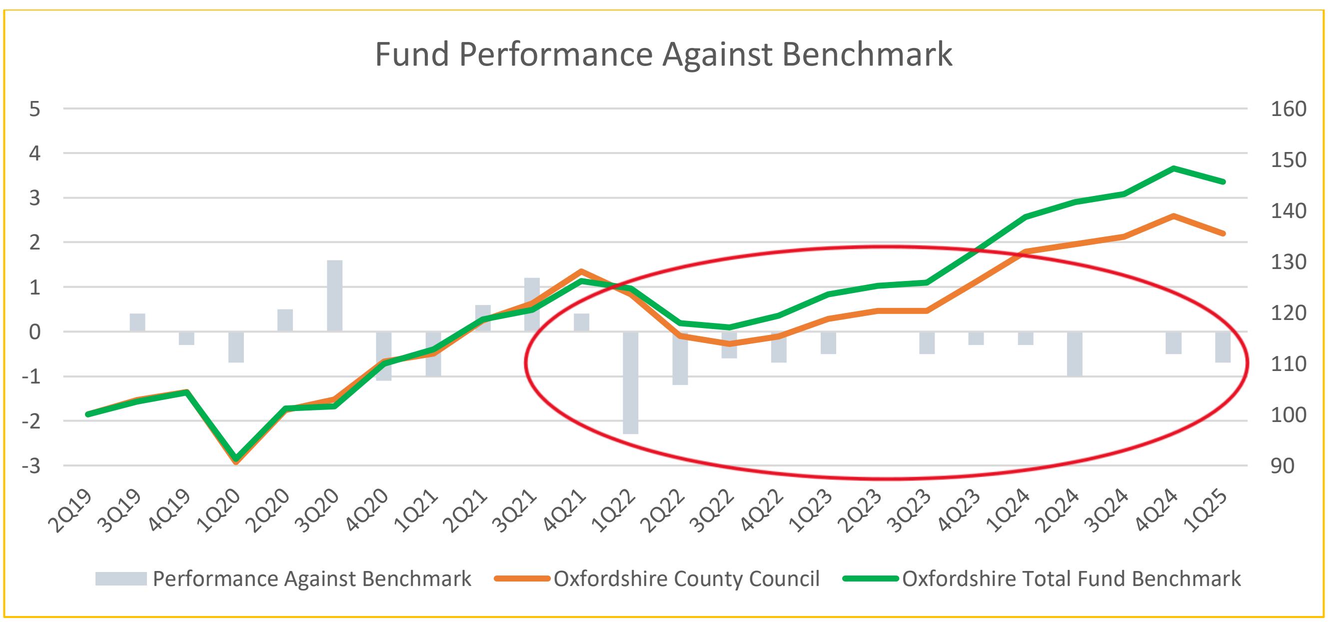
Performance

The Fund fell by -2.5% in the first quarter of 2025 to a value of £3.630bn. The Fund underperformed its benchmark which fell by -1.8% driven by poor performance from the Global and UK equity portfolios managed by Brunel. The first quarter of 2025 saw a much more volatile investment environment as newly elected President Trump took to presidential decree to enact several policies around immigration and trade which destabilised financial markets in the US and globally. US equities fell with the S&P index down -4.3% in US Dollar terms over the quarter. The US Dollar also weakened against all major currencies which lowered the return of US assets to a Sterling based investor. Gold continued to perform strongly in this uncertain environment and real assets, property and infrastructure, also held up well.

All investment markets have continued to be highly volatile post the quarter end with the US S&P 500 share index falling over 20% in the 6 trading days post President Trump's introduction of a minimum 10% import tariff on all trading partners on the 2nd of April and then recovering 10% intraday as these tariffs were rolled back or delayed. Markets fell again when President Trump was directly critical of the independence of the Federal Reserve (US Fed) chairman, Jerome Powell, before recovering as he again rowed back on his comments. It is difficult, in this environment, to see through the noise but what has changed is the response of US assets to a market sell-off when investors look to reduce risk quickly. For over half a century, if equities fell rapidly as an event spooked the markets, investors would rush to safe-haven assets, particularly US Treasury bonds as the most liquid and secure asset available, pushing these higher (yields down) and forcing the US Dollar higher. Things are different this time. Global Equity markets were led lower by the US, particularly the mega cap US tech stocks, but this has been accompanied by falling US Government bond prices (rising yields) and a weak US Dollar, i.e. investors are selling US assets because they are re-evaluating these as a safe-haven and are repricing the credit quality of the US Government as a borrower. This is a direct consequence of the inconsistency of President Trump's policy announcements and their lack of detailed intellectual support, although, as noted in the last quarterly report, US Equities were starting from a stretched valuation.

With markets recovering as I write, it is noticeable that Equities and Bonds are rising but not the US Dollar which remains near its recent lows.

Chart 1: Oxfordshire Pension Fund Performance



The chart on the previous page shows the cumulative performance of the Total Fund against its Strategic Benchmark rebalanced to 100 (the lines) on the right-hand scale and the Fund's quarterly relative performance against its strategic benchmark (in blocks) on the left-hand scale. All the Fund's underperformance has occurred since the transfer of assets to Brunel and, in particular, since the Russian invasion of Ukraine in 2022 and the subsequent rise in inflation and then interest rates and it is this that has driven the poor performance of their selected managers, particularly within the main active equity portfolios. Because of this the Fund continues to lag its benchmark over the longer term, underperforming over 1 year (by-2.2%); over 3 years (by -2.0%); over 5 years (by -1.3%) and over 10 years (by -0.3%).

Over the last 3 years the performance of the underlying managers selected by Brunel has been disappointing with over half the total underperformance of -2.6% relative to the Strategic Benchmark coming from the poor performance of the two main Global Equity portfolios, Sustainable and Global High Alpha. However, I believe this to be heavily influenced by the strong environmental slant which is a core part of Brunel's ethos. I continue to support this environmentally focused slant for the longer-term, however, the poor performance is showing no signs of recovery at present, and this was another disappointing quarter. Other LGPS Pools have also performed poorly across their equity mandates for much the same reason and 7 years after pools started, we have no real proof that any of the Pools can add value through manager selection!

Returns of 7.2% per annum over the last 30 years, being above the Fund's actuarial discount rate assumption for future investment returns, will have helped improve the funding ratio between the triennial actuarial revaluations.

Asset Allocation

Table 1: The Fund's current asset allocation against the Strategic Benchmark

Asset class	Asset Allocation as at 31/12/24	Strategic Asset Allocation	Position against the SAA	Deviation in cash terms
UK Equities	10.9%	**10%**	+0.9%	-£33m
Global Equities ex UK	43.3%	**41%**	+2.3%	-£83m
Fixed Interest	8.4%	**9%**	-0.6%	+£22m
Index-Linked Gilts	5.7%	**7%**	-1.3%	+£47m
Property	6.5%	**8%**	-1.5%	+£54m
Private Equity	12.4%	**10%**	2.4%	-£87m
Secure Income	4.1%	**5%**	-0.9%	+£33m
Private Debt	2.4%	**5%**	-2.6%	+£94m
Infrastructure	4.1%	**5%**	-0.9%	+£33m
Cash	2.0%	**0%**	+2.0%	-£73m

These figures are taken from the State Street report. Figures may not add up due to rounding.

The current deviation from the Fund's SAA is within acceptable bounds although I would recommend taking the equity weighting back to the benchmark and reinvesting into short-dated UK Corporate Investment Grade Bonds or cash, particularly as this money has already been committed to invest into Alternative Asset Classes and is awaiting drawdown. This holding would be temporary as the money would be drawn down into the Alternative portfolios over time.

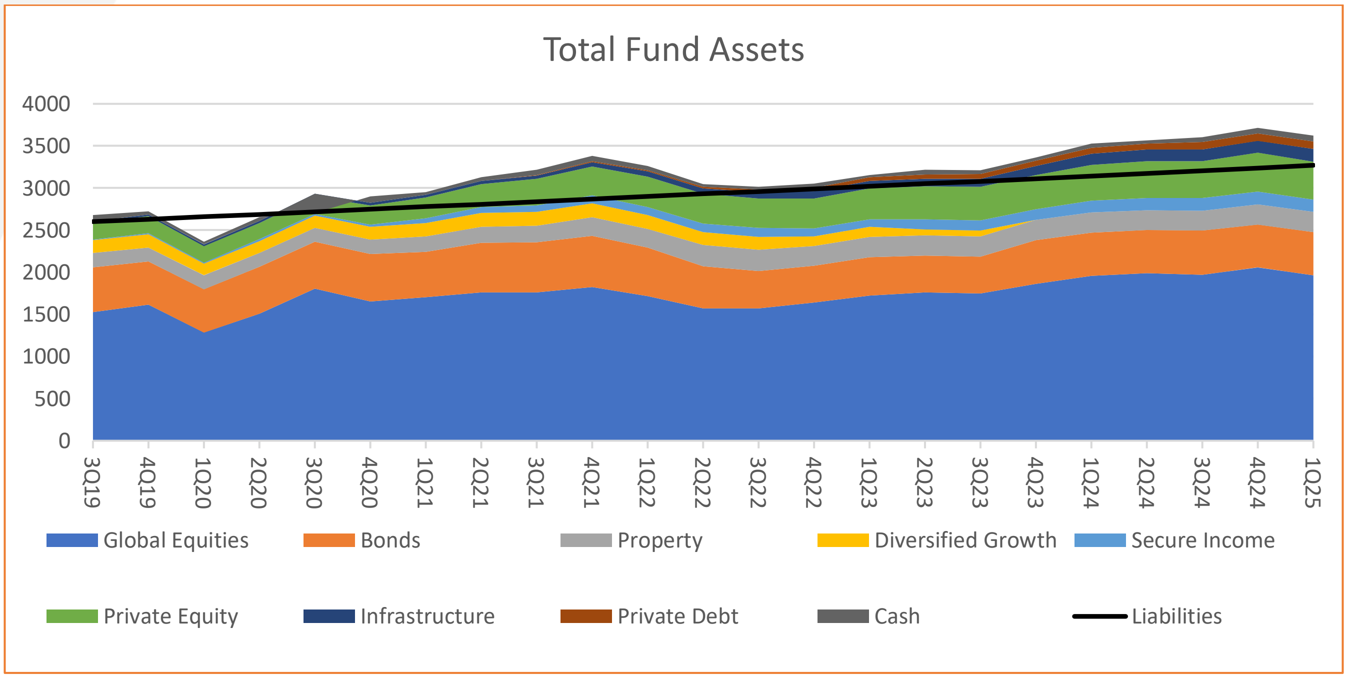
The recent work on Affordable/Social Housing has gone well with the four selected managers presenting to your Officers and myself in May and a decision made to bring to committee. This investment, if approved, can be financed from available cash balances and will bring the property weighting into line with the Strategic Benchmark.

I note the Government's decision to red flag Brunel and require the Fund to appoint an alternative Pool. I see this as less than desirable at the current time and the timeline the Government has given for this to be enacted (by 31/9/25) as

woefully short. This will lead to increased costs to the Fund with little obvious prospect of better investment returns in my view.

Chart 2, below, shows the assets of the Fund by asset class. I have also shown a black line which is the assumed valuation of the liabilities. Please treat this with some caution, the liabilities are valued by the actuary every three years. At this time, they calculate the value of all earnt pension benefits plus the expected value of all future pension entitlements by the existing membership. This future liability is discounted back to today's value using a discount rate which reflects market conditions on the day of the valuation so, in essence, a snapshot once every three years. At the time of the actuarial revaluation, the actuary also calculates the future investment return which gives them the required probability of maintaining full funding into the future. To create the line in the chart, I have compounded up the valuation of the liabilities in March 2022 by the required investment return for each quarter.

Chart 2: Oxfordshire Pension Fund Assets



As bond yields have risen since the last actuarial revaluation it is likely that the actuary will use a higher discount rate to value future pension liabilities when they revalue the liabilities using 31/3/25 data. This will reduce the current valuation of future pensions in today's money and, thereby, reduce the value of the liabilities and increase the funding level of the Fund all else being equal, but, in addition, the actuary is likely to require a higher investment return going forward. There are also a number of other assumptions that the actuary makes when calculating the value of the pension liabilities including longevity and I have not made any estimation for these.

Comment

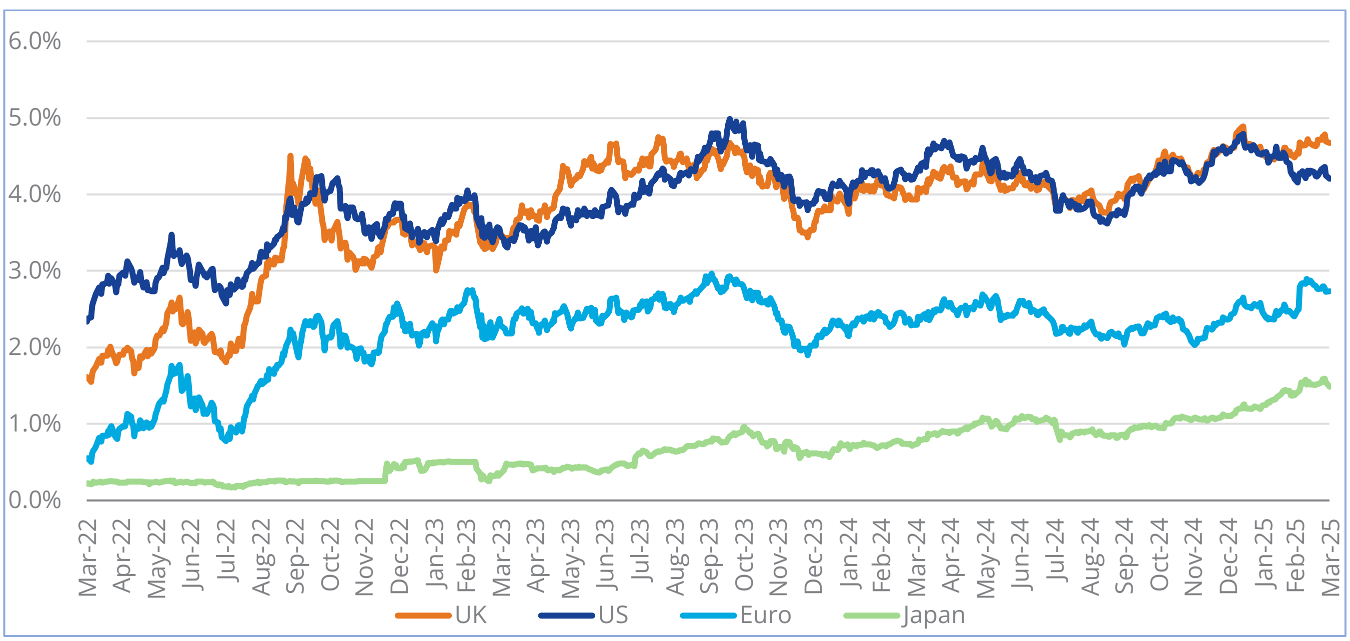
At present, the US economy continues to perform well with GDP growth ending 2024 at +2.4% per annum and Consumer Price Inflation (CPI) falling to 2.4% per annum in March 2025. Initial jobless claims remain low and falling and the consumer continues to spend. However, these are all backward looking indicators. First quarter 2025 US GDP growth of -0.3% is distorted by a high level of imports as companies rushed to build inventories ahead of the tariff announcements, yet consumption remained robust throughout Q1. Job creation remained positive in March although the detail suggests a strong element of this was within the warehousing sector which fits with a narrative of companies building inventory in the US prior to the imposition of trade tariffs. What of the future? Has the US economy hit a Wille-e Coyote moment, running off the edge of a cliff with legs still pumping waiting for gravity to take effect?

I do believe that the instability created by President Trump's approach to policy setting will cause lasting damage to the US and global economy. Economic growth figures in the US will be distorted for the next couple of months by inventory stocking ahead of the tariff announcements and a stronger second quarter may be driven by falling imports much as Q1 has been restrained by raising imports. (Gross Domestic Product is calculated as economic activity plus the balance of exports less imports so a high level of imports restrains GDP and vice versa.) Thereafter, the ability of the corporate sector to make investment decisions will be severely hampered by having no certainty on the tariff, or wider policy environment they will be operating in. Supply chains will become disrupted and product shortages will appear, this will be inflationary. In addition, the consumer is not immune to the uncertainty and is likely to restrain spending, particularly as inflation will start to rise as supply chains are disrupted and tariff increases are passed on to the end consumer. Unsurprisingly, we are already seeing a falloff in shipping routes into US ports, particularly from China and most survey data around consumer sentiment and corporate investment intentions in the US looks very bad.

President Trump then has a problem, the US is running a heavy budget deficit, spending more than it raises in taxes. This has been made worse by the President making permanent the temporary tax cuts passed in his first term. The US Budget deficit ended 2024 at 6.4% of GDP with total outstanding debt at over 120% of GDP (higher than at the end of the second world war). The US needs overseas investors to service its growing debt pile, and it needs a growing economy so that the outstanding debt pile does not continue to rise as a percentage of GDP and become unsustainable. Whilst these issues may be an inconvenient truth to President Trump, they are facts and, because of this, President Trump does not have a free hand in setting economic policy in the US, even if he likes to think so. This may explain the frequent 'U' turns in policy when markets fall.

The next step of this reality show may well be the promise of tax cuts to offset the economic pain of the introduction of tariffs, but if investors do not believe the figures put forward for economic growth and the sustainability of the US debt pile is bought into question then we will have a Liz Truss moment where lenders are no longer prepared to buy US Government debt at any price. Because of this, there is still the possibility that US 10-to-30-year bond yields could still go higher in these circumstances, thereby forcing a policy retreat.

Chart 3: Government Bond Yields



Source: Bloomberg

With such a major reset in global trade policy, the chance of a misjudgement is high and although President Trump seems to be heavily influenced by the market reaction to his policy announcements, he does seem to want higher tariffs to last longer-term. Trade tariffs will have an immediate effect on supply chains yet the US aim of encouraging greater manufacturing to be based in the US will take years to achieve as investment decisions are not made on the same short-term timescale that US economic policy now appears to be made on.

We also have US borrowing nearing the debt ceiling which will need to be raised by Congress. We have seen games of brinkmanship over raising the debt ceiling in the past but, with the Republican party historically the party of low tax and restrained Government spending, it could be taken to new found limits this time. The threat of the US reneging on its debts will again cause consternation in investment markets and lead to a weaker US Dollar.

There remains a fundamental inconsistency in President Trump's tariff policy. On the one hand he champions the revenues raised from importers suggesting that they be invested into a sovereign wealth fund and used to lower taxes, yet, on the other hand, claims to be negotiating reductions in tariffs at every opportunity. If tariffs are negotiated down, they will not provide a revenue boost to the Government coffers, helping to balance the books, if they do not fall, they will have a harmful impact on the US economy thereby reducing Government revenues. Last year revenue from tariffs accounted for 1.5% of total US Government revenues and the last time tariffs were raised as a percentage of GDP was in 1930, in the aftermath of the Great Crash of 1929. This act is now accredited with exacerbating the great depression of the 1930's. The General Agreement on Tariffs and Trade (GATT) was originally agreed by 23 major economies in 1948 with a view to lowering tariffs and raising longer-term economic growth through greater international trade. Current raises in tariffs are likely to take the global impact of trade tariffs to above the level which led to the creation of GATT. The recent agreements on tariffs with the UK and then China still leave trade tariffs above the level they were before President Trump got elected.

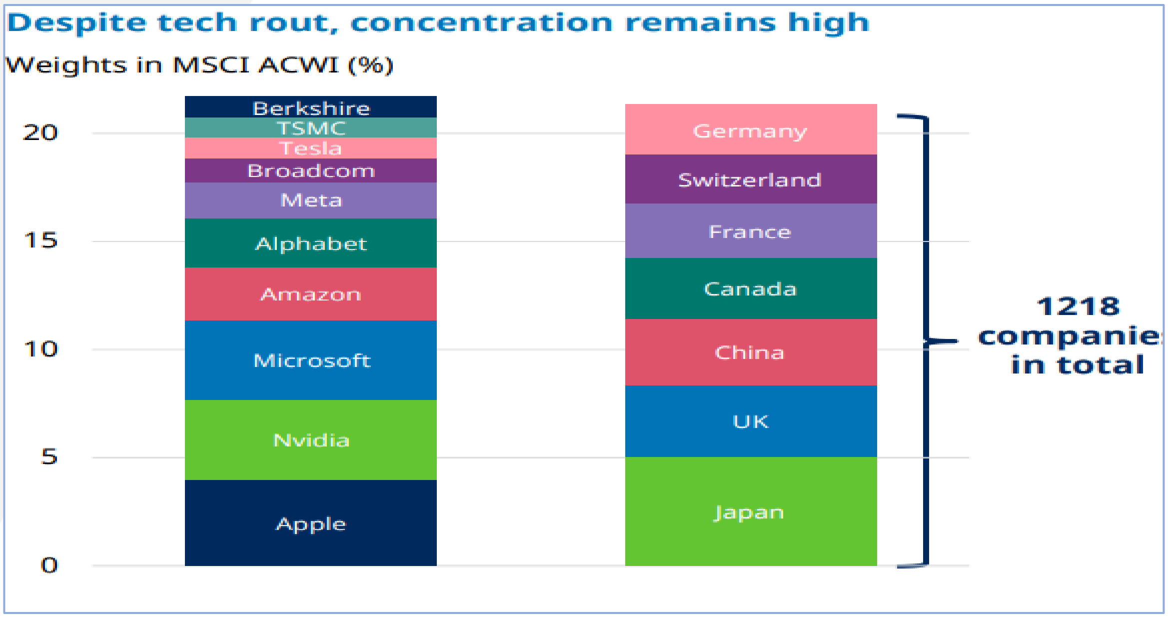
There is, as always, a grain of truth in all misguided policies. The US has, until now, charged fewer and lower tariffs on imports than most of its trading partners. The EU raised 14% of its revenue from tariffs in 2024, China is higher as are almost all emerging economies. The US does run a trade deficit, although it runs a surplus in the services sector.

If President Trump's tariff policy is just a negotiating stance to improve America's terms of trade, then deals can be done and we could end up with lower tariffs across the board which would be positive for global trade, would be deflationary and probably boost consumption and economic growth globally. This would be good for both equity and bond markets, but, now comes the subjective part…

Trade tariffs are only part of the policy dynamics coming out of the US. The hardened stance on immigration and removal of undocumented migrants will be inflationary as it will reduce the supply of cheap labour. As the UK saw post BREXIT, unqualified nationals may not want to take on low paid work at the price foreign labour was prepared to accept, particularly in the agricultural and hospitality sectors.

Of greater concern is the attack on many of the guardrails of the American structure of governance. The removal of government contracts from legal firms that have fallen on the wrong side of the President. The attacks on educational establishments), including Yale and Harvard on charges of antisemitism, the removal of many of the military top brass and the gutting of many regulators including the Federal Trade Commission. I am, personally, concerned that the modus operandi that President Trump is moving towards is one of a system of patronage where economic success or failure is at the hand of the all-powerful President himself. Patronage is secured through providing either political support or money to those favoured by the President. The benefits of such patronage are large as policy can be written in a single business's favour with limited constraints. We see this system of 'governance' across many emerging economies with each change of government accusing the last of the massive misappropriation of funds and fraud. It seems autocracy and kleptocracy are fundamentally linked suggesting that the whole purpose of an autocracy is the accumulation of assets and wealth by the ruling family. The effect of such an approach in economic terms is to increase the misdirection of capital investment leading to sub optimal-returns over the long-term. All this suggests to me that the era of US exceptionalism we have seen with a stronger economy and greater investment returns since the Global Financial Crisis in 2008/9 is coming to an end. This is a major concern for global equity markets because the US accounts for 70% of the main global equity index and this weighting is concentrated in a few mega cap names mainly in the technology sector.

Chart 4: Equity index concentration



Much of the strong performance of the US economy over the last decade has been driven by high fiscal (Government) spending through a high budget deficit. With cuts to Government spending and cost cutting measures now being enacted, this boost to growth will now reverse suggesting lower GDP growth into the future.

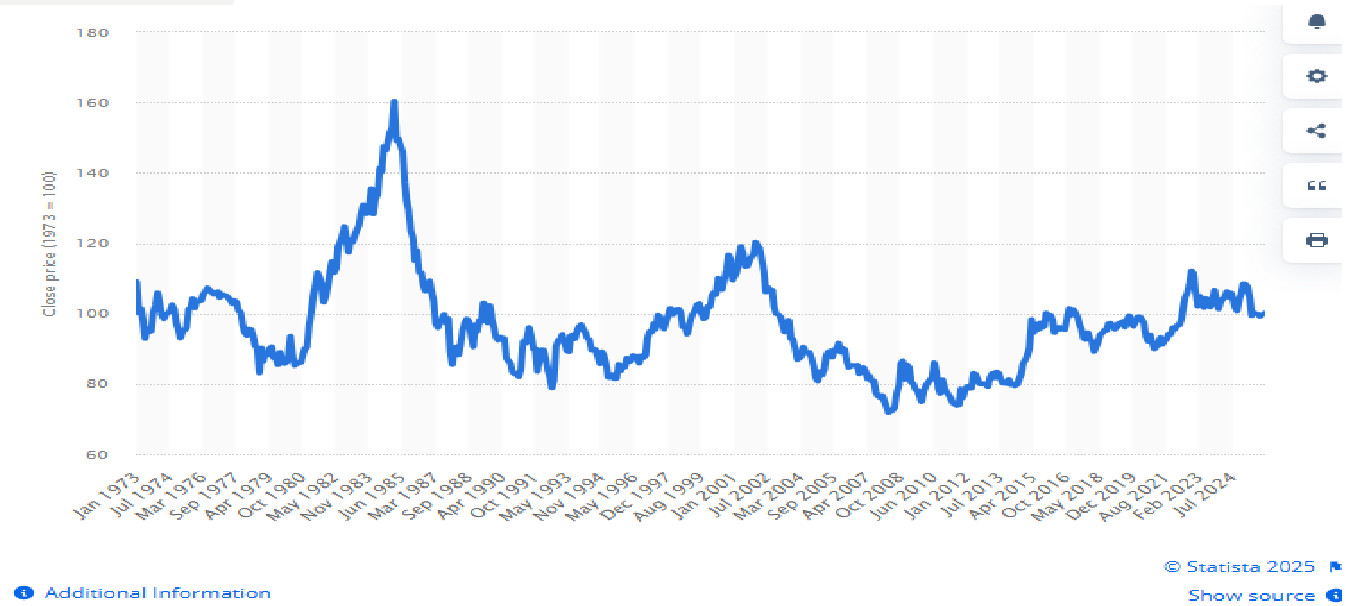
In terms of investment implications, I do expect the US economy to slow in 2025 and it may end the year approaching a recession, although the quarterly data will be difficult to interpret. US equities, particularly the mega technology stocks, do not look cheap even after the recent pullback so unless we see major policy announcements on tax cuts and deregulation which are coherent and believable and retain the confidence of bond investors, then it will be hard for US equities to make much progress in this environment. The ability for Europe, led by Germany, to increase Government spending is greater and I would expect EU equities to now outperform the US. We have yet to see any earnings downgraded, but the effect of tariffs will feed through at some stage this year.

I continue to retain a preference for short-term, high-quality debt, as any economic slowdown will eventually be met with falling interest rates irrespective of the heightened inflationary environment. Any blow-out in bond yields driven by further policy missteps could well signal a buying opportunity but would require a major change in the US policy dynamic to then drive long-term yields sustainably lower (prices higher).

I continue to see real assets (property and infrastructure) as attractive given their linkage to inflation rates and continue to monitor Index Linked yields on the same basis.

The difficult decision is the US Dollar. With the US accounting for over 70% of the major global equity indices, any portfolio which follows these indices will have significant US Dollar exposure and returns will fall for a UK investor when the US Dollar falls. President Trump is undoubtedly, in my mind, destroying the US's reputation as a reliable ally and trading partner and, thereby, the US Dollar's role as a global reserve currency. In addition, reducing the trade deficit will mean less export earnings for the likes of China and Japan. Currently these US Dollar earnings are often reinvested into US Treasuries rather than remitted back home. Japan and China do not need to actively sell their US Treasury holdings to weaken the US Dollar, they just need to stop buying the US Dollar in such quantities. This will happen if the trade deficit with either of these two countries falls. This should lead to longer-term weakness in the US currency, but the US Dollar will be buffeted by short-term policy announcements and could stage a recovery from the current sell-off if believable measures to boost short-term economic growth are now introduced in the US.

Chart 5: US Dollar Index



I am afraid I think the Committee needs to consider hedging a proportion of the Fund's Global Equity currency exposure and my **recommendation would now be to take action on this and hedge 50% of the Strategic Asset Allocation weighting to Global Equities back into Sterling.**

This will have operational complications as the hedging is managed by selling currency options forward, usually monthly, with cash being paid or received at month end depending on the profit or loss of the strategy. This means that a portion of the bond portfolio would be needed to provide collateral for the currency options held.

As an aside, the scale of volatility in asset prices since President Trump's re-election has been a boon for Wall Street traders with many investment banks reporting blow-out trading revenues and profits. The gutting of the budgets of many regulators including those in the financial industry will make it very difficult to stop nefarious practices in this industry and having one individual capable of making announcements which can move global equity, bond and currency markets in such scale creates much scope for those connected to power to game the system to their own advantage. It is very noticeable that the President has blurred the lines between his own family dealings and those of the state.

Points for Consideration

1) **UK Active Equity mandate**. Brunel is in the process of changing the UK active equity benchmark from the FTSE All-Share to a mandate which will focus more on mid-sized companies domiciled in the UK and has selected new investment managers for the portfolio to fulfil this brief. I support this move as previously discussed. Given that the Committee will now have to find a new Pooling partner, there is a question over whether this move should be completed. My understanding is that none of your three prospective pooling partners currently have a mid-cap focused, active UK equity mandate and that one of the criteria on which future pooling partners are to be accessed

is their ability to take on the Funds existing portfolios without major changes to the investment managers and thereby keeping transition costs low. As such, I would assume that any decision made now in changing this portfolio will not lead to a further transition once a new pooling partner has been appointed. Therefore, rather than delay this change and put the investment decision on hold, my recommendation would be to progress with this move as planned.

2) **Appointing a new pooling partner.** Whilst it falls upon your officers and this Committee to decide on a new pooling partner, it is important that the hiatus this causes does not mean all investment decisions are put on hold. The time scale the Government has suggested for completing the appointment of a new pool is far to short and I note the letter sent to the Government by the LGPS Scheme Advisory Board reflecting this. I also reiterate my comment earlier in this report that none of the Pools have so far proved themselves in the area of manager selection which is a core rationale of forming the pools alongside cost savings. It is vital that the chosen pool has the scale of investment knowledge, experience and adequate resources in this area to assist the Fund in implementing its investment decisions going forward. Whilst finding a Pool which reflects the Fund's ethos from a responsible investment perspective and ensuring that the Fund has a voice in the Governance of the new Pool are important considerations along with restricting the costs of moving to a new pool, the Fund needs to consider investment performance as a core requirement of any new pooling arrangement as this will be the main determinant of future investment returns and thereby the cost of the provision of pensions over the long-term.

Underlying Mandates

Rather than comment on each portfolio separately, duplicating the reporting from Brunel, the table below sets out each portfolio within the Fund with a note on my opinion of the management and performance using a traffic light system. Because of the transfer of assets to Brunel all the portfolios will have changed manager over the last four years. For this reason, I have rated some of the portfolio's amber purely because the performance history is too short to support an opinion.

We now have 3-year performance figures for both Private equity and Infrastructure and, whilst the initial drawdowns to these portfolios were slow and Brunel's speed of commitment was initially poor, this has now speeded up and performance figures do suggest that Brunel are achieving a reasonable level of return from these asset classes.

Portfolio	Benchmark	Inception	Performance	3-year relative p.a.	Comment
UK Equity	FT All-Share EX IT	09/18		-0.3%	Performance has been below benchmark across all longer-term periods. Mandate/managers to be changed.
Global High Alpha	MSCI World Equity	11/19		-2.0%	Underperformance over five years of -1.0% p.a. but outperformance since inception.
Global Sustainable	MSCI All World Equity	10/20		-5.3%	Performance a major concern with the portfolio underperforming by over 5% p.a. since inception.
Global Paris Aligned	MSCI Paris Aligned	07/18		n/a	A poor quarter for the index and I have some concerns over portfolio construction.
UK £ Corporate Bond	£ Non-Gilt Credit	11/21		1.2%	Acceptable performance in a strong credit environment.
Passive Index-Linked	FTSE >5 Year Index-Linked			n/a	

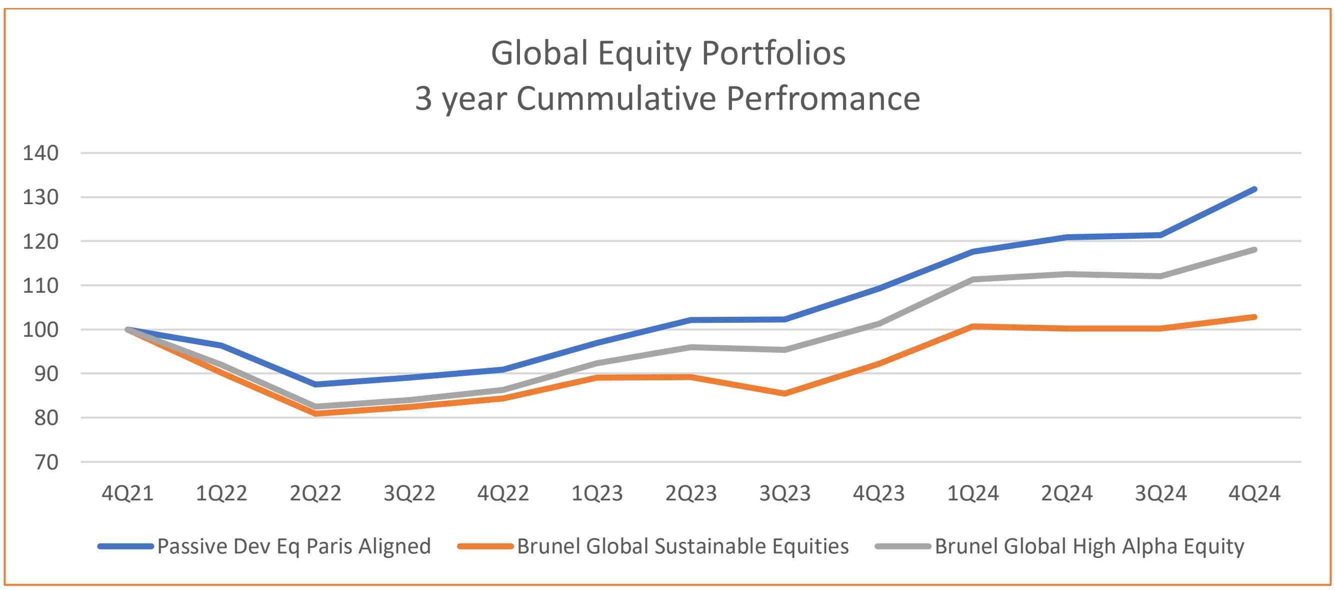
Multi Asset Credit	Cash + 2%	11/21		-2.8%	Performance behind the benchmark since inception. Portfolio construction heavily weighted to one, defensive manager which has impacted returns.
Property	Property benchmark	04/20		n/a	UK Performance has been good outperforming since inception, but international property has been very poor.
Secure Income	Cash + 4%	07/20		n/a	Noticeable performance issues.
Infrastructure	CPI	01/19		n/a	Drawdown has been slow; performance looks OK.
Private Equity	MSCI All World Equity	01/19		n/a	Drawdown has been slow; performance looks good for cycle 1 but poor for cycle 2. Direct Private Equity has been strong.
Private Debt	Cash + 5%	08/17		n/a	Drawdown has been slow; performance looks good.

Portfolio Performance

From the table above it is noticeable how few of the Brunel managed portfolios are achieving their investment goals in performance terms. The charts below are an update of the performance of the main Global Equity portfolios from last quarter.

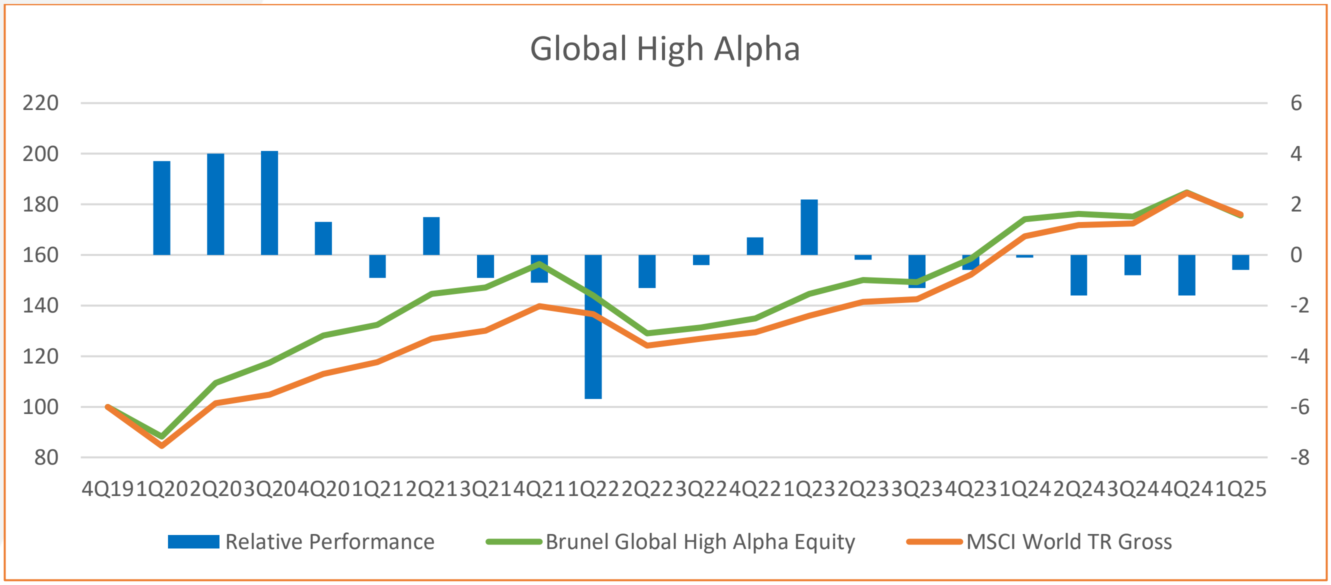
Global Equities

Chart 6: Global Equities



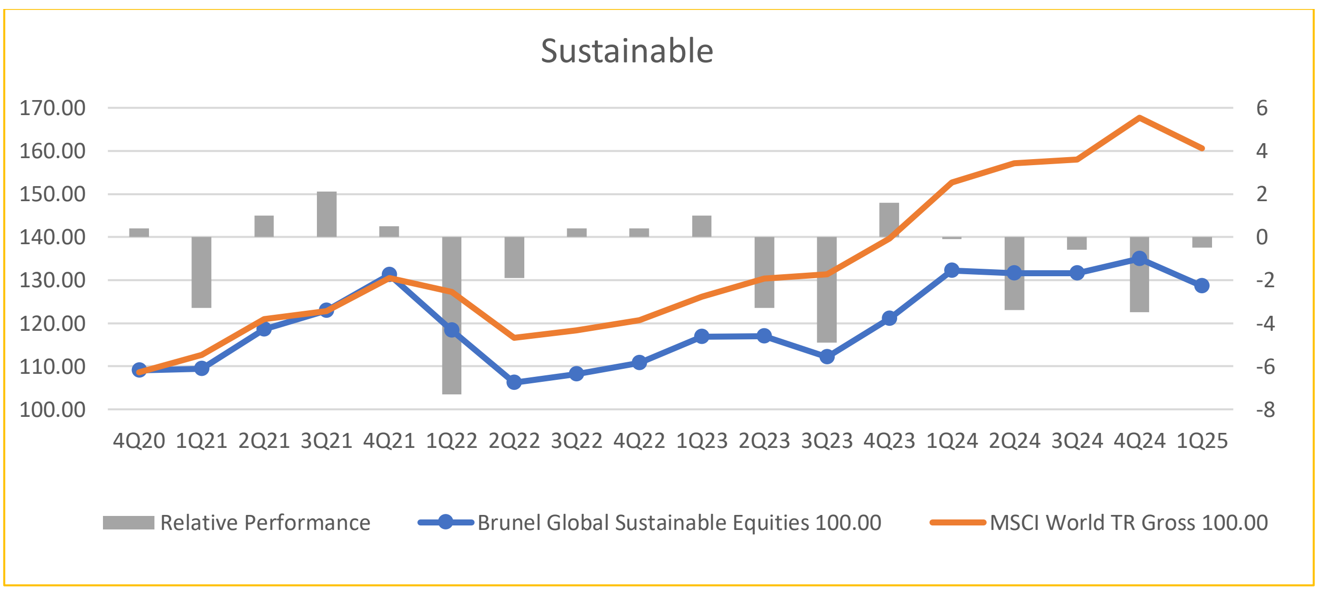
The chart above shows the cumulative performance of the Fund's three global equity portfolios over the last four years. Over that period, the effect of the underperformance of the two actively managed portfolios, Sustainable and Global High Alpha, against the performance of the Paris Aligned passive portfolio was over £150m. I.e. if the Fund had chosen to invest all its global equities into the Paris Aligned portfolio rather than across all three portfolios the Total Fund would now be approximately 5% larger. This underlines the scale of the underperformance by the managers appointed by Brunel to run the active Global Equity portfolios.

Chart 7: Global high Alpha portfolio



As can be seen from the above chart the initial performance of the Global High Alpha portfolio in 2020 was very strong but the Russian invasion of Ukraine, rising inflation and rising interest rates undermined the portfolio's performance against its benchmark and the portfolio is yet to show solid signs of recovery.

Chart 8: Sustainable Equity Portfolio



The Sustainable Equity portfolio was invested into a year after the Global High Alpha portfolio so missed out on the market conditions where a focus on innovative, smaller, fast-growing companies, was rewarded by investors. Instead, this portfolio has been held purely through a period when interest rates have been rising and companies with a strong environmental slant have been out of favour. Nonetheless, if you match the time periods between the two charts above and look at the bars (the quarterly relative performance) you will see a strong similarity. This is because Brunel's Responsible Investment and ESG mantra runs through all their manager selection briefs thereby giving all the portfolios they produce an overriding style bias which will have a dominant effect on each portfolio's performance against its benchmark.

Market Summary

- Q1 was marked by a reversal of "Trump trades" and rising volatility amid concerns over tariffs and valuations alongside increased fiscal stimulus in Germany. The move reflected rapid shifts in sentiment after a period of stretched expectations of US outperformance following the 2024 US presidential election. Consumer discretionary, growth stocks and IT were the hardest hit sectors in equities, while European equities finished the quarter in positive territory. At the time of writing, escalation of tariff threats and unpredictable decision-making by the White House has led to heightened volatility, with fears mounting over a global trade war leaving few safe havens beyond gold (+18%), which continues its upward trend. Eurozone rates were cut twice during the quarter with one cut from the UK and the US taking no action, marking a continuing divergence between EU and US / UK rates. US government bonds returned +2.9% on rising recession fears, while EU stimulus and a concerning fiscal position in the UK resulted in higher yields in Europe. In tandem with the reversal of Trump trades, the US Dollar index fell by c. 4%, with Sterling down modestly versus the Euro. Leading economic indicators were mixed, with manufacturing weakness persisting despite some growth in the US. UK Manufacturing PMI fell to 44.9 from 47.0 in December, whereas in the Eurozone rose to 48.6 from 45.1. Inflation remained above 2% in all developed economies, notably in Japan (+3.7%). GDP growth slowed to 2.5% in the US in Q4, again driven by large fiscal spending, with the UK (+1.5%) and Eurozone (+1.2%) continuing to lag.
- Global equities were mixed, with the S&P dropping sharply towards the end of the quarter (-4.3%), driven by growth stocks and big tech, accompanied by a material rotation into European indices (FTSE 100 +6.1%, Euro STOXX 50 +7.5%). European outperformance was not unforeseen given the long-term relative performance of the US, with concerns over valuations and an overheating economy, however, the extent of European fiscal stimulus had, for a time at least, created bullish sentiment for the continent. In Japan, a stronger Yen from narrowing interest rate differentials created headwinds for the equity market. We note as at time of writing, mounting uncertainty surrounding trade tariffs has led to volatility across all regions, with bond markets often positively correlated to equities. The outlook, particularly with respect to President Trump's willingness to stick with tariffs over the long-term, remains highly uncertain. In bond markets, rising recession risks led to a return of 2.9% from US Treasuries. Conversely, in Europe, expectations of much larger issuance to finance new government spending programmes weighed on sovereign bond returns, with EU bonds ending the quarter down 1.3%. UK Gilts rose slightly despite stagnation fears. Commodities performed well, notably gold (+18%), natural gas (+13.4%, due to cold winter weather) and copper (+24%, partly driven by underlying demand and partly due to strong US demand ahead of tariffs). Agriculture was the worst-performing component, driven lower by a sharp fall in the price of cocoa. Declines in the price of wheat, cotton and corn were more modest, while coffee and sugar prices gained in the quarter. Bitcoin fell c. 16.5% (-30% from its peak, but remains 15% up on pre-election levels and has been relatively resilient overall). Altcoin markets saw significantly larger drawdowns (Ethereum: -50%, Solana: -34%) as the post-election euphoria dissipated and brought to an end the 3-year bull run.

We highlight the following themes impacting investment markets:

- **Trade war uncertainty driving fear and a flight to safety:** Markets were volatile in Q1 amid persistent tariff-related headlines. After February's tariffs on imports from Mexico, Canada, and China, March saw further measures on steel, aluminium, and autos. Shifting expectations ahead of incoming announcements drove sentiment swings, with investors watching for signs of economic drag, such as declining small business capex intentions. Bond gains are being offset by the inflationary nature of tariffs, selling pressure and positioning leaving few places for investors to hide within financial markets.
- **Geopolitical uncertainty driving power shifts:** President Trump's approach to the Russia-Ukraine war, tariffs, negative rhetoric towards Europe and question marks over commitments to NATO all contributed to market uncertainty. In response, multiple European countries, notably Germany, marked significantly increased defence spending plans, which boosted markets. The extent to which Germany engages in fiscal expansion remains to be seen, and whether this extends beyond defence into infrastructure, but the momentum is clear that longer-term the US will be less involved in Europe and driving it towards self-sufficiency on defence.
- **US exceptionalism and Big Tech challenged:** The US deficit relative to GDP reached c. 7% in 2024 vs GDP growth of <3%, with a surplus appearing unlikely in the short-term. With debt a driver of past US growth and now over 120% of GDP, American exceptionalism is being challenged and demographic issues in China and Japan (the largest holders of US debt) are contributing to concerns over erosion of the US Dollar as global reserve currency and leading to higher interest rates. Big Tech also sold off during the quarter. We note DeepSeek demonstrated significant efficiency gains in AI and, critically, does not intend to monetise its product, making the wider Chinese economy the likely beneficiary. This makes the path to profitability for western AI players less clear and may exacerbate concerns over the West lagging Asia on manufacturing automation.

Regional Commentary

- In the US, at quarter-end the total return of the S&P 500 was -4.3%. We note this comes off the back of a +25% return in 2024. The more recent sell-off has been broad-based, but notably driven by big tech, which in addition to valuation concerns has faced rising competition from China (notably DeepSeek) at a fraction of the cost, leading to concerns over capex plans and profitability. Trade tariffs were a major focus, with President Trump imposing tariffs on countries such as Mexico and Canada and on goods such as cars, steel, and aluminum. Investors awaited "Liberation Day" on 2 April, when a broader set of tariffs was expected. Meanwhile, the US Fed cut its 2025 growth forecast to 1.7% from 2.1% and raised its inflation outlook to 2.7% from 2.5%, while keeping interest rates at 4.25–4.50%. The US Dollar weakened 3.9%, with annual CPI inflation moving from 2.9% in December to 2.8% in February. Government and investment grade bonds increased by 1-3%, with high yield underperforming. US Services PMI fell to 54.4 from 56.8 in December, with manufacturing at 50.2 vs 49.4 at the end of last quarter.
- At quarter-end, the EuroStoxx 50 total return was +7.5% reflecting rotation from the US into European equities and supported by higher fiscal spending forecasts. The top performing sector for the quarter was financials amid robust earnings updates alongside relative insulation from trade tariff concerns. Other top gaining sectors included industrials, energy, communication services and utilities. Underperforming sectors in the quarter included consumer discretionary, information technology and real estate. The ECB cut rates by 50bps, with CPI falling to 2.2% in March. Eurozone bonds fell by 1.3% on increased spending, while investment grade was flat and high yield up 0.5%. Manufacturing PMIs recovered to 48.6 vs a December print of 45.1, while services remained steady at 51.

- The FTSE all-share index rose by 4.5%, again reflecting a rotation out of US equities. UK small and mid-caps struggled amid weak economic sentiment, minimal relief from avoiding recession, and Spring Statement spending cuts. The OBR flagged stable finances but warned of potential autumn tax hikes. The BoE cut rates by 25bps in February, with inflation prints of 3.0% and 2.8% in Jan / Feb respectively. Gilts fell on persistent inflation concerns and the tight fiscal position. Economic growth and the near-term outlook remain subdued and, as such, alongside the CPI prints, stagnation concerns remain.
- The Nikkei 225 total return was -9.9% due to tariff concerns, weak performance of larger tech stocks and exporters exacerbated by a weaker USD/JPY. Certain Japan-specific sectors found support from rising bond yields, wage and inflation gains, Berkshire Hathaway's investment in trading houses, higher defence spending, and a Bank of Japan (BoJ) rate hike boosting financials. Corporate governance reforms and activist activity also provided a lift. The BoJ increased rates by 25bps to 0.5% in January, with inflation diverging from Western economies and reaching 4% in January. Manufacturing PMI fell to 48.4 from 49.6, with services at 50.0 from 50.9. GDP growth of 1.1% remains subdued but is improving versus prior quarters.
- Emerging markets equities gained 2.9% in the quarter, reflecting a blend of concerns over tariffs, rotation out of US equities and a weaker US Dollar. Given the high trade imbalances of many EM countries, certain regions were impacted by tariff concerns in Q1. As of March 31st, emerging Europe (Poland, Greece, Czech Republic, Hungary) rallied on the improved Eurozone outlook. China gained on AI optimism and new stimulus. Brazil outperformed with a stronger Real and three rate hikes; South Africa also rose despite a rate cut. Mexico benefited from delayed US tariffs. UAE and Saudi rose; India fell on growth concerns and a rate cut; whereas Indonesia, Thailand, and Taiwan saw sharp losses amid growth and trade worries.
- In commodities, Brent crude rose 0.1%, natural gas increased 14% due to colder weather, gold increased 18.2%, copper rose 25%. The Goldman Sachs Commodity Index increased 2.2%, within which precious metals led gains as gold and silver rose on safe-haven demand. Agriculture lagged, mainly due to a sharp cocoa drop. Energy rose across the board, led by natural gas. In industrial metals zinc fell.
- Global listed property fell, with the FTSE EPRA Nareit Global Index declining by 1.4%.
- The Nationwide House Price Index in the UK posted solid gains throughout the quarter, culminating in 3.9% growth in March YoY, continuing from a strong Q4.
- The VIX rose to 22 from 17, reflecting tariff concerns and stretched valuations leading to some fear in the market.