Lumin
VZ Group

# Investment Review

Q2/26

**A US Navy radio communique**

**Voice 1:** Please divert your course 15 degrees to the North to avoid a collision.

**Voice 2:** Recommend you divert your course 15 degrees to the South to avoid a collision.

**Voice 1:** This is the captain of a US Navy ship. I say again divert YOUR course.

**Voice 2:** No. I say again you divert your course.

**Voice 1:** This is the aircraft carrier Gerald R Ford, the largest warship of the US Navy. DIVERT YOUR COURSE NOW!

**Voice 2:** This is a lighthouse. Your call.

An old and apocryphal story, but the principle is undisputed: in a contest between military might and geography, the latter will always 'Trump' the former. Think Vietnamese jungle and tunnels, Afghanistan mountains and caves, brutal Russian winters, the Strait of Hormuz…

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# Introduction

*"The worst mistake that the United States ever made, in my opinion, was going into the Middle East. It's a quagmire." – Donald Trump, 2019*

It was all going so well. Global equities in the first two months of the year building on the trends seen in 2025, notably the FTSE 100 and MSCI Emerging Market indices adding impressive further gains of 10% and 14% respectively.

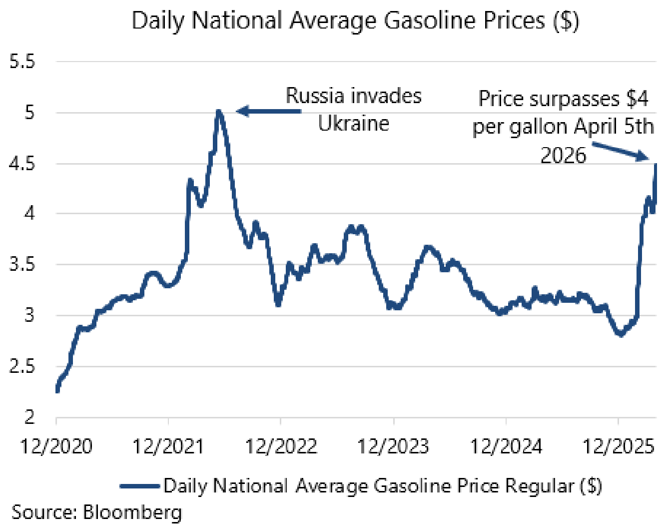
Then on February 28th came the US/Israeli attack on Tehran – a 'surprise' presaged by the biggest build-up of US military assets in the Gulf since the 2003 Iraq War. Fortunately, Vice-President JD Vance can guarantee that President Trump "is not interested in getting us…into the kind of long-term quagmires that we've seen in years past." Well, that is a relief!

We regularly warn in the quarterly that what we write may be overtaken by events by the time you read it. We are now at risk of being overtaken by events before we finish writing the sentence.

It is a desperately sad and a bad state of affairs that trillions worth of financial assets can move within seconds on a single unchecked outburst on the ironically named 'Truth Social.' This continual moving of the goal posts has inevitably added to already elevated uncertainty. As long-term investors, it is wrong to react to knee-jerk market moves, but necessary to reflect on the longer-term economic and political implications.

The war started with no clear objective and no exit plan. It will end Trump says, "when I feel it, feel it in my bones." Unhelpful in the extreme for markets craving certainty, the single most important question is when will the Strait of Hormuz reopen?

"It doesn't really affect us" he claims (based on US oil self-sufficiency). But this ignores the fact that oil is a




*Tehran has its foot on the throat of the global economy*

fungible commodity, priced globally – witness the surge in the gasoline price, $2.80 in January, to over $4 now (see chart bottom left). Traditionally seen as a tax on the consumer and hugely unpopular for Trump's typical voter-base in the run up to the mid-term elections.

The Strait of Hormuz is not just a conduit for oil and gas, but the channel through which petrochemicals go to the Far East, fertiliser to US farmers and helium to global chip makers. Nor is it as simple as turning the taps back on when it reopens, oil production is a complex high-pressure process that can take years to repair, between three to five for the world's largest Ras Laffan gas field, we are told. Risks and transit costs now appear permanently elevated, with maritime insurance premiums providing one example.

The implications are therefore profound and long-term. Wars are inherently inflationary and the disruption to supply long-lasting. The former comes at a time when inflation remains stubbornly high, above target in three out of four developed markets.

Events in the Middle East dominate the front pages, but the story running parallel in the financial pages is the 'slow-motion car crash' in private credit. We warned about this in the last quarterly and will update you on developments later in this report.

Clearly, a lot going on! Hopefully, the situation will have improved by the time you read this. We noted back in January 'an air of complacency' going into 2026 after three years of double-digit global equity returns. And whilst we did not predict a war with Iran (no one did), we used our last two quarterly rebalances to prepare and protect portfolios for trickier times ahead. Actions taken this quarter detailed, as always, at the back of this report.

# Market data

| Group/Investment | Cumulative Performance % 3m | 6m | 1yr | 3y | 5y | Annual Performance % 2025 | 2024 | 2023 | 2022 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| **UK** | | | | | | | | | | |
| UK Large Cap Equity | 3.4 | 10.5 | 22.6 | 48.7 | 82.0 | 25.8 | 9.7 | 7.9 | 4.7 | 18.4 |
| UK Mid Cap Equity | -5.1 | -2.3 | 12.9 | 24.1 | 14.9 | 13.0 | 8.1 | 8.0 | -17.4 | 16.9 |
| UK Small Cap Equity | 2.4 | 8.9 | 21.5 | 45.6 | 69.3 | 24.0 | 9.5 | 7.9 | 0.3 | 18.3 |
| UK All Cap Equity | -3.6 | 0.8 | 15.1 | 31.9 | 26.4 | 14.4 | 10.7 | 6.7 | -13.6 | 23.0 |
| **Global** | | | | | | | | | | |
| Global Equity | -1.2 | 2.3 | 18.0 | 50.5 | 68.2 | 14.6 | 19.8 | 15.7 | -7.3 | 20.0 |
| **North America** | | | | | | | | | | |
| US Equity | -2.4 | 0.3 | 15.3 | 55.3 | 84.9 | 9.8 | 27.3 | 19.2 | -7.8 | 29.9 |
| US Tech Equity | -3.9 | -1.5 | 21.4 | 72.8 | 97.3 | 12.7 | 28.1 | 46.4 | -23.9 | 28.7 |
| **Europe** | | | | | | | | | | |
| Developed Europe ex UK Equity | -2.1 | 4.3 | 16.3 | 37.1 | 58.3 | 27.9 | 2.8 | 15.8 | -7.5 | 17.6 |
| **Asia Pacific & EM** | | | | | | | | | | |
| Emerging Equity | -0.8 | 1.1 | 17.8 | 37.8 | 28.0 | 17.8 | 14.8 | 2.9 | -6.4 | 1.0 |
| China Equity | -6.1 | -12.5 | 4.1 | 15.3 | -16.7 | 23.0 | 21.8 | -16.6 | -12.2 | -20.2 |
| Japan Equity | 3.8 | 7.0 | 24.1 | 46.7 | 46.1 | 17.1 | 10.1 | 13.3 | -4.8 | 2.5 |
| **Fixed Interest & Cash** | | | | | | | | | | |
| Global Government Bonds | -0.2 | 0.5 | 2.6 | 8.2 | -3.2 | 3.7 | 2.0 | 5.5 | -13.8 | -2.4 |
| UK Gilts | -1.9 | 1.2 | 2.5 | 1.3 | -19.5 | 5.0 | -3.3 | 3.7 | -23.8 | -5.2 |
| UK Index Linked Gilts | 1.3 | 4.6 | 4.1 | -9.0 | -29.9 | 1.3 | -8.3 | 0.9 | -33.6 | 4.2 |
| Bank of England Lending Rate | 0.9 | 2.0 | 4.1 | 15.1 | 17.9 | 4.4 | 5.3 | 4.8 | 1.4 | 0.1 |
| **Other Assets** | | | | | | | | | | |
| Global Real Estate Equity | 2.9 | 2.4 | 7.8 | 16.2 | 15.9 | 3.4 | 3.4 | 3.6 | -14.0 | 24.2 |
| Global Energy Equity | 34.0 | 39.0 | 38.8 | 58.7 | 159.5 | 9.2 | 4.2 | -1.4 | 47.7 | 34.7 |
| Gold | 9.9 | 23.3 | 45.4 | 120.9 | 185.3 | 53.1 | 29.8 | 7.1 | 12.4 | -2.6 |

Note: Data as at 31 March 2026. Index returns are shown in GBP.

The indices used are the following: UK Large Cap Equity: FTSE 100, UK Mid Cap Equity: FTSE 250, UK Small Cap Equity: FTSE Small Cap, UK All Cap Equity: FTSE All Share, Global Equity: FTSE All World, US Equity: S&P 500, US Tech Equity: NASDAQ 100, Developed Europe ex UK: FTSE AW Dv Europe ex UK, Emerging Equity: FTSE Emerging, China Equity: FTSE China, Japan Equity: FTSE Japan, Global Government Bonds: FTSE WGBI (Hdg GBP), UK Gilts: FTSE Act UK Cnvt Gilts All Stocks, UK Index Linked Gilts: FTSE Act UK Index-Lnk Gilts AS, Bank of England Lending Rate: SONIA, Global Real Estate Equity: FTSE EPRA Nareit Global, Global Energy Equity: FTSE AW Ind/Energy. Gold: S&P GSCI Gold Spot.

FTSE WGBI: The FTSE World Government Bond Index provides exposure to the global sovereign fixed income market, the index measures the performance of fixed-rate, local currency, investment-grade sovereign bonds.

FTSE Act UK Cnvt Gilts All Stocks: The FTSE Actuaries UK Conventional Gilts All Stocks Index provides exposure to all British Government Bonds quoted on the London Stock Exchange.

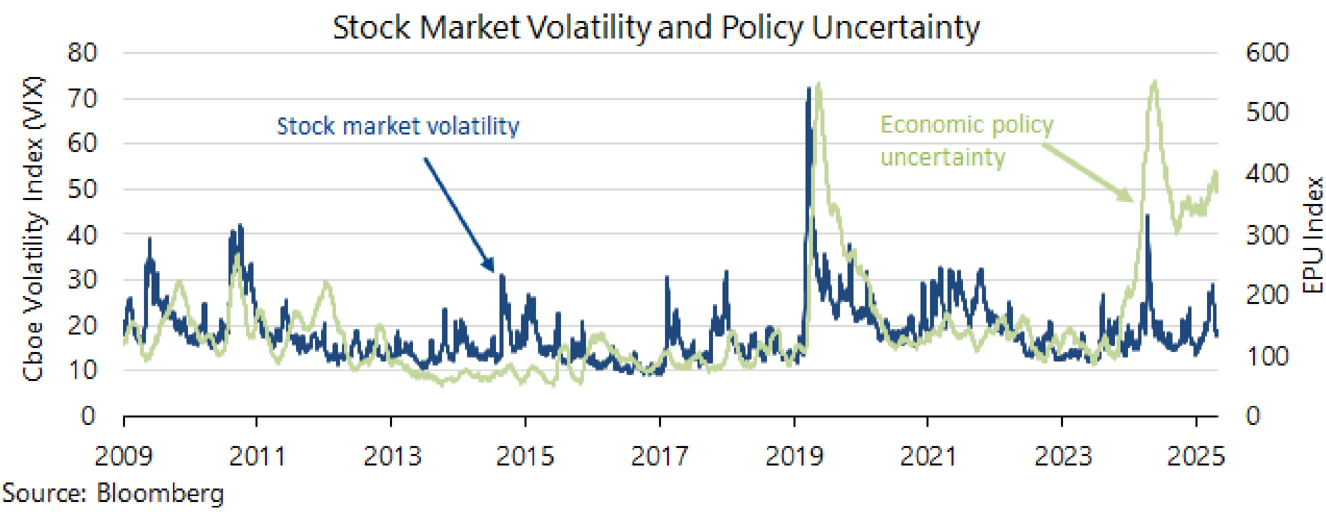
FTSE Act UK Index-Lnk Gilts AS: The FTSE Actuaries UK Index-Linked Gilts All Stocks Index provides exposure to all index-linked British Government Bonds quoted on the London Stock Exchange.

FTSE EPRA Nareit Global. The index is designed to represent general trends in eligible real estate equities worldwide. The index covers Global, Developed and Emerging Markets.

FTSE AW Ind/Energy includes all companies in the FTSE World Index that are categorised as Energy in the ICB sector breakdown.

# Conflict, complacency and the cost of oil

*We are almost a third of the way through 2026 and despite the Middle East conflict, the technology theme has continued to dominate stock market return.*




## Resilience or exuberance

If you had slept through the last few months and woken to check your investments, there would be little to suggest that a major global conflict had occurred. US stocks have reached fresh all-time highs and most major indexes are back to levels seen on the eve of the Iran War. Historically, increased policy uncertainty has tended to coincide with elevated market volatility (as shown above). In Q1, policy uncertainty fueled by the Iran conflict spiked – the large gap between the two now reveals what we believe is investor complacency.

## Pavlov’s market

In recent months we have witnessed the NASDAQ drawdown by 10%, followed by a 13-day winning streak – the longest string of gains in over a decade. Investors have been programmed to “buy the dip” (the Pavlov reaction). The S&P 500 now trades on a price-earnings multiple of 21 (down from 32 last year), thanks to blockbuster earnings. Collectively, S&P 500 earnings expectations for 2026 are 17% year-on-year growth. But, the 'e' in price-earnings is a lagging indicator, often behind real economic news. Such elevated earnings expectations leaves room for negative surprises, most likely within cyclical areas that see the biggest impact from inflation and interest rates.

## Crude awakening

Oil peaked at $110 a barrel four weeks into the Iran conflict, up from $70 in mid-February. With the fragile 'ceasefire' doing little to restore confidence, elevated prices appear likely to persist. Even if oil falls meaningfully, the damage may already be done. The more insidious threat lies in inflation's delayed grip on growth – echoing the 1970s, when Arab embargoes caused only minor stock market losses at the time. It was only after the embargo lifted that the true scale of economic damage became apparent. Between March and October 1974, the US market fell 40%.

## Damned if you do

Stagflation – simultaneous stagnant growth and rising inflation – presents policymakers a near-impossible dilemma: raise interest rates and risk choking growth, or cut them and risk reigniting inflation. The consensus is that the Iran War could shave half a percentage point off global growth while adding a full point to inflation. With oil demand largely inelastic (the commute and school run don’t stop with higher petrol prices), the longer-term impact on Europe – given its limited productivity and energy dependency – could be considerable. The OECD warns the UK could be hit hardest, halving its 2026 growth forecast to just 0.5%.

# A wide dispersion of asset returns

*The 'HALO' trade reflects a rotation towards companies with hard, tangible assets and low disruption risk, as investors seek resilience amid AI uncertainty and geopolitical instability.*

S&P 500 Sector Performance

| 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 YTD |
|---|---|---|---|---|---|---|---|---|---|---|
| Energy 27.36% | IT 38.83% | Health Care 6.47% | IT 50.29% | IT 43.89% | Energy 54.64% | Energy 65.72% | IT 57.84% | Comm. svs 40.23% | Comm. svs 33.55% | Energy 25.35% |
| Comm. svs 23.49% | Materials 23.84% | Utilities 4.11% | Comm. svs 32.69% | Cons Discr 33.3% | Real Estate 46.19% | Utilities 1.57% | Comm. svs 55.8% | IT 36.61% | IT 24.04% | Materials 13.34% |
| Financials 22.8% | Cons Discr 22.98% | Cons Discr 0.83% | Financials 32.13% | Comm. svs 23.61% | Financials 35.04% | Cons Staples -0.62% | Cons Discr 42.41% | Financials 30.56% | Industrials 19.42% | Industrials 10.73% |
| Industrials 18.86% | Financials 22.18% | IT -0.29% | S&P 500 31.49% | Materials 20.73% | IT 34.53% | Health Care -1.95% | S&P 500 26.29% | Cons Discr 30.14% | S&P 500 17.88% | Real Estate 9.29% |
| Materials 16.69% | Health Care 22.08% | Real Estate -2.22% | Industrials 29.37% | S&P 500 18.4% | S&P 500 28.71% | Industrials -5.48% | Industrials 18.13% | S&P 500 25.02% | Utilities 16.04% | Utilities 8.63% |
| Utilities 16.29% | S&P 500 21.83% | S&P 500 -4.38% | Real Estate 29.01% | Health Care 13.45% | Materials 27.28% | Financials -10.53% | Materials 12.55% | Utilities 23.43% | Financials 15.02% | Cons Staples 6.49% |
| IT 13.85% | Industrials 21.03% | Cons Staples -8.38% | Cons Discr 27.94% | Industrials 11.06% | Health Care 26.13% | Materials -12.27% | Real Estate 12.36% | Industrials 17.47% | Health Care 14.6% | Comm. svs 5.13% |
| S&P 500 11.96% | Cons Staples 13.49% | Comm. svs -12.53% | Cons Staples 27.61% | Cons Staples 10.75% | Cons Discr 24.43% | S&P 500 -18.11% | Financials 12.15% | Cons Staples 14.87% | Materials 10.54% | S&P 500 2.96% |
| Cons Discr 6.03% | Utilities 12.11% | Financials -13.03% | Utilities 26.35% | Utilities 0.48% | Comm. svs 21.57% | Real Estate -26.13% | Health Care 2.06% | Energy 5.72% | Energy 8.68% | IT 2.45% |
| Cons Staples 5.38% | Real Estate 10.85% | Industrials -13.29% | Materials 24.58% | Financials -1.69% | Industrials 21.12% | IT -28.19% | Cons Staples 0.52% | Real Estate 5.23% | Cons Discr 6.04% | Cons Discr 0.14% |
| Real Estate 3.39% | Energy -1.01% | Materials -14.7% | Health Care 20.82% | Real Estate -2.17% | Cons Staples 18.63% | Cons Discr -37.03% | Energy -1.33% | Health Care 2.58% | Cons Staples 3.9% | Health Care -4.1% |
| Health Care -2.69% | Comm. svs -1.25% | Energy -18.1% | Energy 11.81% | Energy -33.68% | Utilities 17.67% | Comm. svs -39.89% | Utilities -7.08% | Materials -0.04% | Real Estate 3.15% | Financials -4.25% |

## The HALO effect

Against a backdrop of AI uncertainty and geopolitical turmoil, one emerging school of thought has been the 'HALO' trade – identifying stocks of companies with 'hard assets, low (risk of) obsolescence'. It is an antidote to increasing fears about the long-term profitability of software and other white collar service companies vulnerable to AI disruption. In a world where investors worry which businesses AI might disrupt, companies with large physical footprints (think BP/Rio Tinto) are near impossible to replace.

## Bricks, barrels and bullets

This year, energy, materials and industrials have outperformed the broader market (as shown in the above chart), a sharp contrast from recent years of tech dominance. For those board game enthusiasts, we are essentially transitioning from a Monopoly era to Age of Empires. What was previously a focus on efficiency, cheap goods and global supply chains, is now giving way to one defined by geography, resources and defence – an environment where real assets are likely to outperform paper assets.

## Blighty's moment

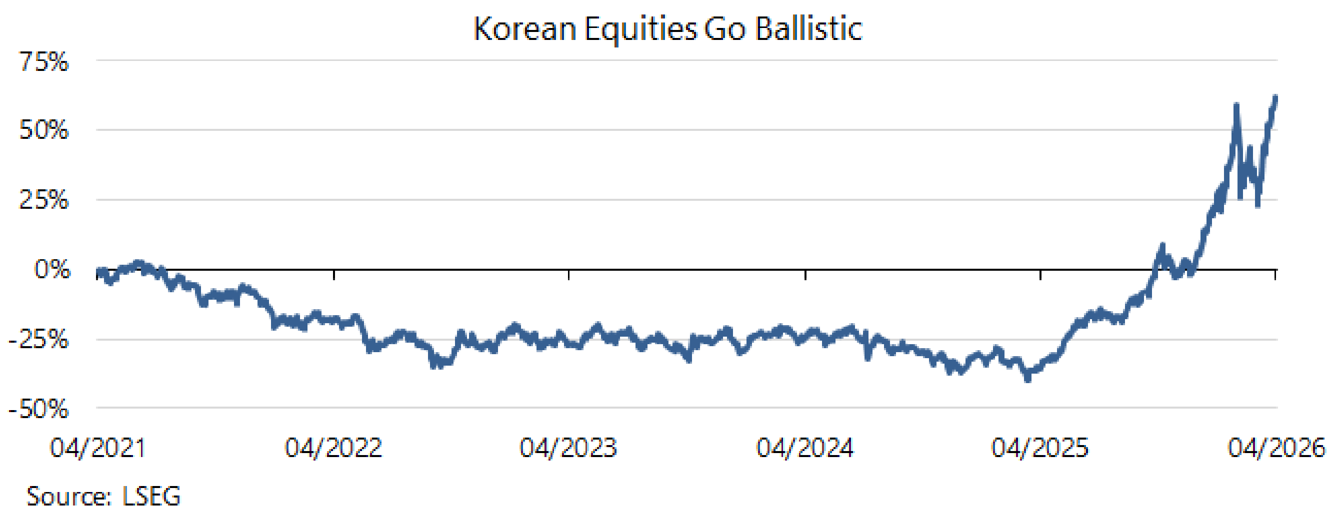
It's not all doom and gloom for the UK. The FTSE 100 has been Europe's best-performing major index over the past year, gaining 27% against an average of 14% for France, Germany and Switzerland. Even the more domestically-focused FTSE 250 returned a respectable 19%. Although higher energy prices are bad news for the economy, the UK market's sector composition has proved quietly advantageous. Energy and materials account for 22% of the UK market versus just 6% in Germany, meaning it doubles up as a handy inflation hedge. Meanwhile, financials and defence names insulated it from some of the AI-related volatility and general risk-off volatility seen elsewhere.

## Au revoir, rally

European shares enjoyed a rare burst of outperformance in 2025, but the continent is very clearly the 'loser' from rising energy prices. Much of last year's rally came from 'valuation multiple expansion', reflecting bets on a renaissance in company profits. Yet momentum cuts both ways. At the height of the sell-off more than half of the fall in value on European markets came from declines in just three companies: Louis Vuitton's owner (LVMH), Danish obesity drug maker Novo Nordisk and German software giant SAP. On a price-to-earnings ratio of 18 (at the time of writing), the Stoxx Europe 600 is still cheaper than the US. Although with hopes of further earnings progress slipping away, there appears little juice left.

# A geopolitical test for emerging markets

*Diverging regional outcomes reflect varying exposure to global energy flows and evolving investor sentiment.*




## Up, down and up again

As previously mentioned, Emerging Markets (EM) had enjoyed a strong start to the year and an even stronger February, rising just shy of 15% on the eve of the conflict with Iran. It was therefore natural that EM found itself among the biggest fallers in the initial market reaction, as investors looked to lock in gains before hunkering down into safer assets. However, at the time of writing, the MSCI EM Index has recovered all of its losses and is pushing to new highs.

## Gulf Cooperation Council panic

Leading the conflict were several EM economies, notably Kuwait, Saudi Arabia and the UAE. The UAE saw its market fall by around 16% in response, with trading temporarily halted, while Saudi and Kuwaiti markets remained broadly flat throughout. Before the conflict, the Gulf had been viewed as an attractive destination for foreign capital. The key question is whether the conflict has damaged that perception.

## Asia's reliance on the Gulf

The South Korean stock market, the KOSPI, had been on a tear, rallying an astonishing 50% from the start of the year to the end of February. Signs of excess were beginning to emerge, particularly through increased retail investment and the use of leverage. With around 70% of its oil imports and 20% of its LNG passing through the Strait of Hormuz, the market reaction to conflict was understandably severe. The KOSPI subsequently experienced its largest ever single-day decline, falling over 12% and surpassing its previous record during 9/11. However, the market has rebounded strongly, driven by its large semiconductor names.

## China stocked up

Asian economies are broadly more reliant on the Gulf than their Western counterparts. China had been steadily increasing oil stockpiles ahead of the conflict, a prudent move given it's the world's largest oil importer. However, with Iran being a close ally, China is in a difficult geopolitical position.

## Divergent performance

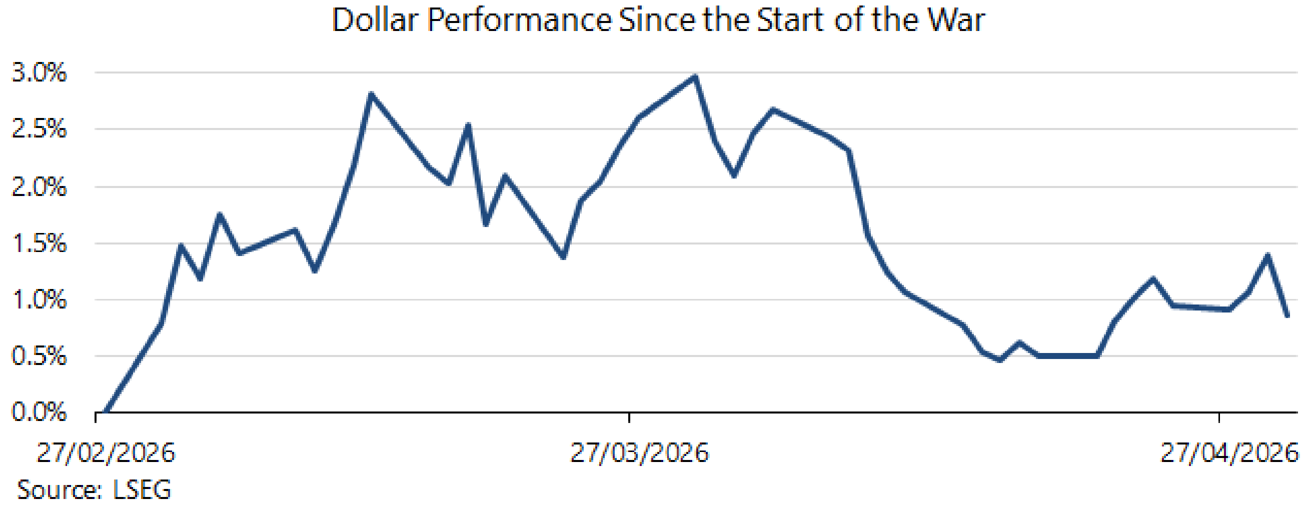
Since the conflict began, China has marginally lagged the MSCI EM Index, while India has significantly underperformed and remains down over 10% year to date. Korea has led performance, with Taiwan, also driven by its semiconductor sector, not far behind and up over 40%.

## Frontier preservation

One area of immediate concern following the outbreak was certain frontier economies. In response, urgent measures to reduce energy consumption were introduced, such as Thailand implementing limits on air conditioning temperatures. Despite these concerns, the MSCI Frontier markets index finds itself positive since the start of the war.

# The Dollar returns and policy diverges

*In times of stress, investors return to the Dollar, while inflation and energy risks complicate the outlook for Emerging Markets (EM) and Japan.*




## The Dollar

The US Dollar had been weakening prior to the conflict, largely in line with expectations that the Fed had entered an easing cycle and political rhetoric focused on improving the competitiveness of US exports through a weaker currency. Concerns around US institutional credibility had also led to question marks over the dollar's long-term role as the world's reserve currency.

## Flight to safety

However, at the onset of the conflict, investors reverted to type, moving into the Dollar as a "safe haven" and driving a short appreciation. While much of this initial strength has since unwound, the episode does indicate that the Dollar's role during times of stress, at least in the initial days, remains somewhat intact.

## Inflation and EM central banks

The inflationary nature of war is likely to make EM central banks more cautious in their approach to rate cuts. While many had been poised to ease policy, the outlook now suggests a more measured path. That said, EM central banks entered this period from a position of relative strength, with already high real rates and credit in the bank having tightened policy earlier than their developed market peers during the previous energy shock in 2022.

## BOJ on the other hand

The Bank of Japan finds itself in a more challenging position. With policy rates still low at 0.75%, despite a recent tightening cycle, it is caught between a weakening growth outlook and the risk of renewed inflation driven by higher energy prices.

## Japan's energy dependence

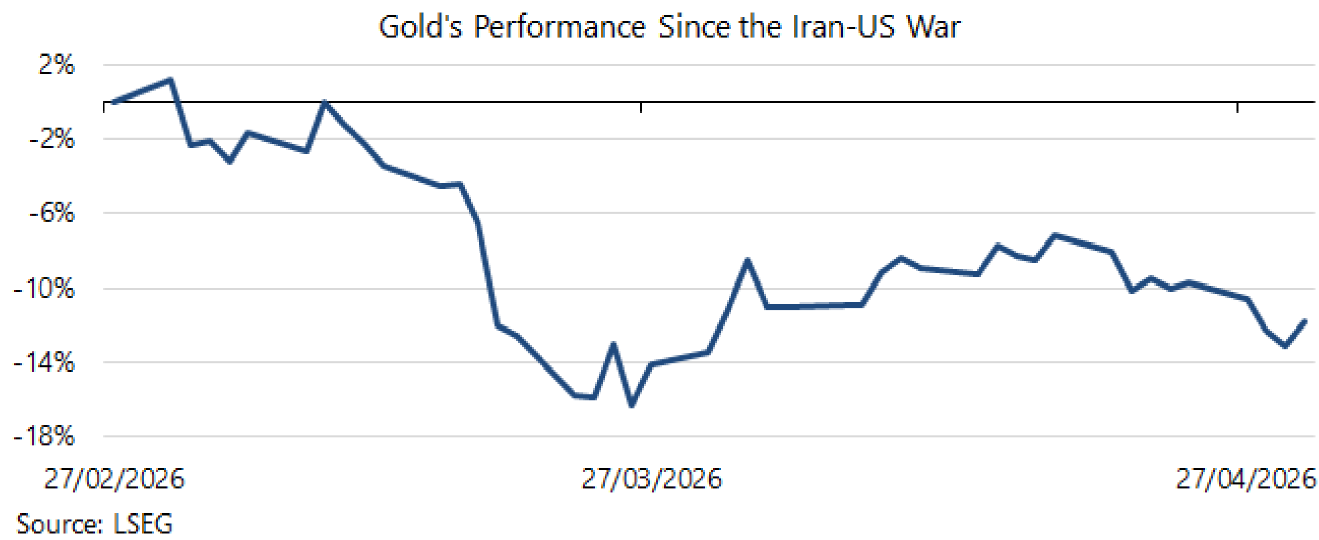
As a volcanic island chain, Japan has limited domestic natural resources and is heavily reliant on imports. This leaves it exposed to energy market disruptions, especially as it imports around 90% of its oil from the Gulf. However, Japan maintains substantial strategic reserves exceeding 200 days of supply. In response to recent tensions, the government has been releasing part of these reserves to ensure stability of supply.

## Early momentum hits energy limits

Like EM, Japan enjoyed a strong start to the year, with the TOPIX index rising around 14% prior to the onset of the conflict, supported by a broader rotation away from the US. Similar to Korea, Japan was among the more impacted markets during the initial sell-off, reflecting its reliance on imported energy. While the market has yet to fully recover to its pre-war peak, it remains positive year to date.

# Commodities command centre stage

*Gold has disconnected from fundamental drivers whilst crypto gains correlation and energy soars.*




## Midas has lost her touch

Since *almost* the beginning of time, Gold has been used as a currency and a store of value. It is widely viewed as being an inflation hedge and a "safe haven" asset in times of market volatility. 2025 was an incredible year for the diversifier, rising over 64% to over $4,300 per troy ounce. One would then be excused for assuming that the US-Iran War and closure of the Strait of Hormuz would have sent prices even higher. Gold is down over 10% since the beginning of the war, with commentators questioning whether the asset has now dislocated from the traditional catalysts for price movement. As we touched on last quarter, significant retail flows occurred during 2025 – often a sign that the ship of excess returns has sailed and an institutional sell-off will ensue. In a market desperate for answers, it can be certain that the duration of the war will play a crucial role in the outlook for the precious metal.

## Bitcoin bites the dust

The first quarter of 2026 began with relative steadiness for crypto following prior strength but ended with the asset class experiencing a sharp downturn and elevated volatility. The quarter was defined by a broad leverage reset and risk-off attitude, with Bitcoin falling 22% and Ethereum 29%, while total crypto market capitalisation contracted by around 20%. Although select tokens experienced strong gains, the overall market was weighed down by macro uncertainty and shifting liquidity conditions. Sentiment plays a key role in crypto markets, often amplifying price moves as shifts in risk appetite and liquidity conditions feed directly into trading behaviour. Despite the market continuing to mature, crypto remains a speculative proxy for US technology assets; starkly different to their once claimed status of being likened to 'digital gold'. One positive outlook for the asset class would be incoming Federal Reserve Chair Kevin Warsh, who is a vocal supporter of cryptocurrencies.

## Energy prices power on

Market consensus entering 2026 was that energy prices globally were on the way down, 'fuelled' by global oversupply and expanding production from both OPEC and non-OPEC producers. However, this could not be any further from the outcome. In Q1, Brent Crude oil soared by 94%, with March alone rising 63%. Despite this, prices have still not reached the peak of the Russia-Ukraine War. The closure of the Strait of Hormuz, responsible for transporting roughly 25% of the worlds oil and 20% of the worlds liquefied natural gas, added a significant premium to the commodities. As with many raw materials, price is a direct function of supply and demand and this closure significantly reduced supply. Even when the Strait is fully open, it is extremely likely that an added premium will be added to the commodities for a long time, reflecting higher risk of navigating the passage.

# The "sensible mate" analogy

*The UK Gilt market is no laughing matter, but the 2022 Truss/Kwarteng "mini budget" fiasco has since inspired many a witty and unflattering analogy. The "sensible mate" comparison was used by MP, Gordon McKee, to explain why the UK pays high interest rates, despite having a lower debt burden than most other major economies. Japan is the mate "always in overdraft." The United States is the "guy who spends a lot but always shows up to work." The UK previously the "sensible one," but who lately "bought a dog, a new car, and a hair transplant all in one month."*

The "sensible" bit relates to how historically the UK was viewed as a "safe pair of hands" in terms of fiscal rectitude, maintaining a commitment to "sound" long-term financial management over short-term political gains.

But then the sudden rush of blood to the head that was the radical decision by Truss/Kwarteng to announce massive unfounded tax cuts, instantly and fatally dispelled that "safe pair of hands" belief. It has left the UK on the naughty step ever since, guilty until proven otherwise, and having to pay a premium over others on our borrowing costs.

As with all other asset classes, a quarter of two contrasting parts, pre and post-Iran War. It started well enough. Inflation in developed markets stubbornly above target but forecast to trend gently lower, and the expectation therefore of two rate cuts in the US and UK – less than predicted six months previously, but still supportive.

The strike on Iran hit government bond markets hard – the spike in the oil price inciting an immediate hawkish repricing of rate expectations, particularly in the UK (from the two cuts), to forecasts of up to three hikes. The benchmark 10-year gilt yield briefly reaching its highest level since 2008, topping 5% in March, but has since settled back a little. Remember, when bond yields rise, the price falls.

The timing of the strike is unfortunate for Chancellor Reeves who presented her Spring Statement just three days later, using forecasts that were rendered instantly obsolete.

In their rate setting meeting back in mid-March, the Bank of England duly left rates on hold. They pointed to the "significant increase in global energy and other commodity prices," but their biggest concern is the second-round effects in terms of wages and price-setting – the longer high energy prices persist, the greater the risk. Paradoxically, UK household energy bills will fall this month due to the April 1st price, set by the regulator before the war. Then, sadly, rise again in June. Unlike previous geopolitical crises where government bonds have acted as a "safe haven," yields rose and prices fell because the conflict was seen as a direct driver of inflation.

It is interesting to note how gold has similarly failed to perform its "safe haven" function. From a record high of c. $5,500 end of January, it fell through February and has fallen a further 12% since the Iran conflict began. There are a number of possible reasons for this: some of the prior speculative froth blown off the price, higher rates on government bonds increasing their relative appeal compared to no return on gold, and Middle Eastern holders selling gold as oil and gas revenue dries up.

Bond market weakness challenges the traditional 60/40 balanced portfolio rule, as it did post-Covid in 2022, when the strategy suffered its worst performance in decades. It worked again in 2024 and last year, contributing to returns and dampening volatility. But a second let-down so soon after has prompted renewed efforts to find alternative mixes. Real assets like infrastructure, real estate, and commodities have materially underperformed financial assets in the period since the 2008 financial crisis and an area we favour.

# "The more things are forbidden, the more popular they become" – Mark Twain

*A psychological quirk we have seen played out in private credit markets as the quarter progressed. All the largest players in the space have one-by-one had to implement withdrawal limits (gating) or restrictive redemption caps on their biggest retail-facing funds following a surge in exit requests. We warned about private credit in the last quarterly. As a reminder, direct loans from non-traditional banks with bespoke terms but limited liquidity, assets grown from near zero before 2011 to c. $3 trillion now.*

What started as a trickle has become a torrent as first Blue Owl gated one of their flagship funds. Despite protestations – or perhaps because of ("doth protest too much") – from the other major players regarding the strength and quality of their portfolios, all have now followed suit. As the saying goes, "nothing inspires panic like the advice not to."

Efforts to restore confidence have not been supported by a steady stream of respected commentators expressing their concerns. Jamie Dimon (longtime CEO of JP Morgan) followed up his 'cockroach' theory by warning private credit could be a "recipe for a financial crisis." Andrew Bailey (Bank of England Governor) noting "worrying echoes" of the 2008 financial crisis. The IMF, UBS, Moody's, and a host of others have all now weighed in.

Subprime mortgages (at the core of the 2008 crisis) and private credit do share certain characteristics. Both arose from efforts to circumvent existing regulation and market practices. Each lacks transparency and liquidity (the ease with which assets can be bought or sold), is valued internally rather than by market forces, and reflects investors' willingness to trade higher risk for higher yield in an otherwise low-interest-rate environment.

But there are also critical differences – most notably in leverage. Private credit typically employs less than twice the underlying capital, compared with roughly eight to ten times for the debt instruments (CDOs) behind the 2008 crisis. Secondly, private credit debtors are typically mid-market companies versus subprime individuals with poor credit records and few assets.

A definite cause for concern, therefore, and potential counter-party risks for banks, insurance groups, and asset managers. But not of the same scale as the subprime issue, and having attracted a lot of critical attention, we would hope the authorities are managing the situation. Interesting to note that the US Fed (it is primarily a US issue) seem relatively relaxed and currently assess that it does not pose a "systemic risk" to the broader financial system. We do not directly own any private credit funds.

In the hierarchy of debt instruments, private credit comes closest to high yield, both operate in the sub-investment grade space – private credit typically sitting higher in the capital structure, but a lot less liquid. To date, there has been no obvious cross-over infection from investor stress in private credit to high-yield. On the contrary, US high yield has proved relatively resilient during the 'risk-off' period post the US/Israeli attack on Iran.

Global credit markets started the year well, but in common with other asset classes, have suffered from the war in Iran stoking fears surrounding inflation and growth. Spreads (yield premium over equivalent government bond as compensation for extra company risk) have widened and most major credit markets registered small negative total returns by the end of the quarter.

This, however, should be put in the context that spreads started the year at record low levels. In some respects, we would have expected spreads to have widened further given the heightened risks, but as reported on the previous page, the yields on government bonds have themselves risen materially since the war started.

We remain of the view that in general terms, the compensation in terms of additional yield does not warrant the extra risk. It is a huge asset class, an estimated $60 trillion, so there will always be some attractive opportunities. Therefore, whilst underweight the credit asset class, we do still own specialist debt funds which invest selectively in high-quality situations.

# Asset class views

Preference by asset class

| Asset Class | Sub Asset Class | -- | - | = | + | ++ | Change | Description |
|---|---|---|---|---|---|---|---|---|
| Equities | **Equities** | | ● | | | | ↓ | Slight trim as we take profits following a third year of double digit equity returns and a recovery following the sell-off, given that the full impact of disruption has yet to feed into company earnings. |
| Equities | UK | | | ● | | | ↑ | Neutral due to 'HALO' exposures in the FTSE 100 but offset by a weak domestic outlook. |
| Equities | U.S. | | ● | | | | – | Underweight remains due to high valuations and index concentration concerns; namely in Tech and Software. Not immune from higher energy prices. |
| Equities | Europe ex UK | | | ● | | | – | Remain neutral but continue monitoring the region due to higher exposure to rising energy prices. |
| Equities | Japan | | | ● | | | – | Had been enjoying a general ex-US rotation but concerns around reliance on Middle Eastern energy imports. |
| Equities | Emerging Markets | | | | ● | | ↓ | Strong performance over the last year has led us to take some profits and redeploy elsewhere. Long-term story remains. |
| Fixed Income | **Fixed Income** | | | ● | | | ↑ | Moving to neutral as we lower overall portfolio risk, adding to short duration fixed income. |
| Fixed Income | Global Aggregate[1] | | | ● | | | ↑ | Preference for shorter-duration and high-quality debt. Longer-term concerns around DM debt dynamics remain. EM not insulated from war but offers higher yield cushion and resilient balance sheets. |
| Fixed Income | UK Gilts | | | | ● | | – | Offering the highest yields of any developed market economy, with relatively lower debt levels relative to other key peer economies and a poor growth outlook. |
| Fixed Income | Global Index Linked | | | ● | | | – | Short-term inflation expectations are elevated but yet to feed into medium or long term. Less attractive given budget deficit concerns in US. |
| Fixed Income | Global High Yield[2] | | ● | | | | – | Spreads moved wider initially following the war but are now back to being tight. Balance of risks skewed to the downside. |
| Other | **Diversifiers** | | | | ● | | – | A higher inflation environment should be supportive for infrastructure and supply disruption continues to support asset prices within commodities. |
| Other | **Cash** | ● | | | | | – | Risk of heightened inflation eroding the purchasing power of cash. |

**1 Global Aggregate refers to investment grade bonds which could be government or corporate.**

**2 High Yield refers to corporate bonds with a higher default risk as decided by the ratings agencies.**

**Up/down arrows indicate a positive (↑) or negative (↓) change in view since the prior Investment Quarterly Review.**

# Equities

## What we think

It is always worth remembering that the economy and financial markets are not the same. But they are interconnected: information from the former tends – at varying speeds and to differing degrees – to feed through into the latter. This feels like one of those particular moments when there is a timing disconnect between the two.

Our view at the start of the year was that the key risk facing markets was a reemergence of inflation. This would endanger forecast rate cuts and remove a supportive leg to further asset price returns.

Wars are inflationary. The conflict in Iran has seen the oil price spike higher, driving a sharp increase in the gasoline price at US pumps. Reserves and inventories in oil, and a myriad of other essential raw materials trapped by the blockade, will be steadily depleting – progressively exposing global economies to an adverse supply/demand dynamic.

Why then have equity markets been so resilient, with the US racing higher since the end of March? Is it that the full effect of the supply disruption has not yet fully fed through to businesses and consumers, or is it simply that investors (particularly in the US) have become conditioned to "buy the dip."

We do not know the answer and suspect nobody does. The economic environment is undeniably worse than it was just two months ago, but equity markets have now typically fully reversed initial losses, with some setting new highs.

In the context of three years already of double-digit global equity market returns, we believe this shows a degree of complacency, overenthusiastic market participants who are behind the curve, and yet to respond to markedly changed circumstances.

We have decided, therefore, to tactically de-risk portfolios a little, to shift marginally from higher-risk equities to lower risk bond and real asset (commodities, real estate, infrastructure) funds.

Our peer-group leading performance has been built on participating in the upside in good times and, crucially, protecting the downside when times are more difficult. This is what we are doing now – shifting the emphasis from participation to protection.

## What we have done

We have not changed any of the funds in our portfolios. Rather, we have trimmed a couple of positions that are at the higher risk/higher reward end of the spectrum.

The Artemis SmartGARP Global Emerging Markets fund is up c. 60% over the last year, demonstrating fully the strong returns that can be achieved in this dynamic and very diverse area of the market. With that reward, obviously comes some risk and after that level of extraordinary performance, we have decided to take our foot off the gas a little and bank some profit, all whilst still retaining a sizeable position in the fund.

Smaller company funds are also generally regarded as higher risk – strong performers over the long-term, but volatile shorter-term and typically highly sensitive to the domestic economy in which they operate. Hopes that the UK economy would emerge from the doldrums this year, dashed again by events in the Gulf, hitting expectations for growth. We have therefore trimmed our Artemis UK Smaller Company fund.

# Fixed interest and diversifiers

## What we think

Core inflation in developed markets at the start of the year was proving stubborn. Its decline from post-Covid highs has followed an 80/20 pattern: the initial, larger portion of the adjustment was relatively quick and easy, while the final, smaller stretch – down to the common central bank target of 2% – has taken longer and proved more difficult. The Bank of England though, still confidently predicting that they would meet their 2% target by the second quarter.

Then came the Iran War and the closure of the Strait of Hormuz. This changed everything. Bond markets, typically faster than equities to respond to shifting macro conditions, adjusted rapidly – yields rose across fixed-income markets (prices falling), and UK rate expectations swung from one or two cuts to the same number of hikes.

UK Gilts have fared worse than most. The wider market views the UK as having a persistent inflation problem, and this together with the Truss/Kwarteng 'mini budget' fiasco – when the Bank of England had to step in to stem a Gilt free fall – still fresh in the memory, leaves UK government debt under heightened scrutiny.

The upshot is that yield the UK pays on its debt, the cost of servicing that debt, is substantially higher now than in France, Italy and Greece – all three of whom have (or have had) significant government debt issues. It is closer but still materially above equivalent US government debt (Treasuries), despite their increasingly serious debt addiction problem.

This all feels a little harsh on Gilts with their premium yield and yield cushion (the income that acts as a buffer against potential capital losses). Admittedly, it does not feel a comfortable investment currently given the prevailing negative news flow, but then the best investments seldom do – "be greedy when others are fearful" (Warren Buffett).

Elsewhere in the bond world, we gain exposure to high-yielding, short-term fixed-income with a focus on capital security. These strategies tend to be lowly correlated to equity returns, and add a useful diversification to portfolios during highly uncertain times like the present.

## What we have done

We have left our existing bond holdings untouched, happy with the modest overweight to government bonds and underweight to corporate credit over concerns around spread tightness. We do not believe we are being adequately compensated for the extra risk of holding non-government backed securities.

We have, however, added a new fund into the fixed interest line-up within portfolios. Although in truth, this fund could just as easily sit within the diversifiers asset class given its focus on capital preservation and low performance correlation to equities.

Using the proceeds from trimming our overall equity position, we have added the Royal London Short-Term Fixed Income fund. Royal London are the recognised experts in this space with a long and successful track record. The fund focuses on capital security – managing risks via a broad diversification into investment grade fixed interest securities, driven by in-depth credit analysis and, by virtue of its size and long history, close issuer engagement. It comes with a good yield and at a low fee.

Within diversifiers, we have modestly added to the Cohen and Steers Diversified Real Assets fund. It does exactly what it says on the tin, investing in a broad range of real assets, including commodities, real estate and infrastructure. We have held the fund for a while and pleased with its consistently strong track record and offered at a very competitive fee.

**St Albans**

2nd Floor,
2 Beaconsfield Road
St Albans
Hertfordshire
AL1 3RD

01727 893 333

**London**

3rd Floor,
65 Carter Lane
London,
EC4V 5DY

0203 988 7788

**Reading**

Merlin House
Brunel Road
Theale
RG7 4AB

01189 797 596

**Bournemouth**

9 Nimrod Way
Ferndown
Dorset
BH21 7UH

03300 564 446

**Bishop's Stortford**

Office 13 Riverside
House Riverside
Bishop's Stortford
CM23 3AJ

01279 701 317

**Beaconsfield (Penn)**

4 Pauls Hill
Penn
High Wycombe
HP10 8NZ

01494 816 858

**info@luminwealth.co.uk**
**www.luminwealth.co.uk**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