Aberdeen Target Return MPS

Quarterly commentary

Q1 2025

Investors should remember that the value of investments and the income from them can go down as well as up and that past performance is not a guarantee of future returns.

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Objective

The Aberdeen Target Return Managed Portfolio Service (MPS) is designed to target a return of SONIA +1%, +2%, 3%, 3.5% and 4% (after assumed fees and charges of 2%) through an actively managed discretionary portfolio.

Discrete annual returns - year to 31/03

	2021	2022	2023	2024	2025
Aberdeen Target Return MPS 1	6.52%	-1.90%	-3.91%	4.57%	4.08%
SONIA +1%	1.06%	1.14%	3.24%	5.95%	6.00%
Aberdeen Target Return MPS 2	9.69%	-1.93%	-4.74%	5.42%	4.38%
SONIA +2%	2.06%	2.14%	4.27%	7.00%	7.06%
Aberdeen Target Return MPS 3	13.28%	-2.38%	-5.17%	6.20%	4.54%
SONIA +3%	3.06%	3.14%	5.29%	8.04%	8.12%
Aberdeen Target Return MPS 4	15.95%	-2.37%	-4.22%	7.31%	4.72%
SONIA +3.5%	3.56%	3.64%	5.80%	8.56%	8.65%
Aberdeen Target Return MPS 5	18.58%	-2.56%	-3.97%	8.21%	4.58%
SONIA +4%	4.06%	4.14%	6.31%	9.08%	9.18%

Portfolio performance is based on Aberdeen Target Return MPS hosted on the Aberdeen Wrap platform. Performance figures are net of the abrdn Portfolio Solutions Ltd management fee and underlying funds OCF. Source: Aberdeen, Financial Express. As at 31.12.2024. ARC Private Client Indices are based on actual client portfolio returns provided by various investment management companies. These portfolio returns are allocated to one of four categories based on the volatility of their returns relative to world equities, and an average return is calculated for each category. Grouping portfolios by their volatility differs from the traditional approach, which compares portfolios which have similar asset allocations. Instead, investment managers may use whatever asset allocation they consider appropriate to achieve the desired levels of return and volatility.

Key points

- In what was a volatile quarter for global markets, the broadest index for world equities ended the period down more than 4%. In the face of increased geopolitical tensions, predominantly characterised by a burgeoning tariff war between the US and its trade partners, central banks struck a 'wait and see' tone in the early months of 2025, when considering interest rate cuts. The first quarter of 2025 did, however, see both the Bank of England (BoE) and European Central Bank (ECB) cut rates by 25 basis points (bps).
- January saw the inauguration of Donald Trump, serving for a second term, this time as the 47th President of the United States. Following through with many of his proposals on trade, the new man in the White House set about proposing a long list of tariffs, including a 25% levy against goods from Mexico and Canada, a 10% tariff on Canadian energy imports, 20% on all Chinese goods and a 25% tax on all cars and car parts entering the US. While some measures were withdrawn or delayed, the tit-for-tat tariff war playing out with many of America's traditional trade partners only served to spook investors.
- Reflationary worries were also unleashed on domestic shores as the Labour Party's first Budget, announced last year, continually stoked fears into the new year that higher corporate National Insurance contributions and an increased minimum wage would force companies to hike prices at the tills. In October, the UK government's official economic forecaster, the Office for Budget Responsibility, said that the government would be able to meet that

rule with £9.9 billion to spare. However, an increase in government borrowing costs since then has meant that this headroom has all but disappeared.
- Moving in a different direction to most western economies, the Bank of Japan (BoJ) continued to tighten monetary policy, raising Japan's borrowing costs to 50 bps in response to rising wage pressures and services inflation. BoJ Governor Kazuo Ueda commented that "if such moves lead to broad-based inflation across the economy, we must respond by raising interest rates". Japan's core consumer inflation hit 3% in February.

Market commentary

During a quarter in which an abnormal number of deadlines were set and then either delayed or cancelled, usually concerning trade tariffs, for many Brits, there was only one countdown that really mattered.

There is nothing like leaving it to the last minute – a mantra exemplified by those 750,000 filling out their online tax returns on the last possible day (31st January). Data from HMRC also showed that 31,442 completed the forms with just mere seconds to go, while an estimated 1.1 million people missed the deadline altogether.

However, with US President Donald Trump moving into the White House in January, investors also had plenty of interest to declare this quarter. Rarely the self-depreciating type, Trump's 100 executive orders in his first 70 days in office characterised the turbulent start to the year for markets. The sheer unpredictability of tariff proposals, aimed not only at those who were targeted during Trump's last administration, such as China and Mexico, but also now at Canada and the Eurozone, repeatedly spooked investors.

Following through with many of his proposals on trade, an ever-increasing list of tariffs was drawn up, including a 25% levy on goods from Mexico and Canada, a 10% tariff on Canadian energy imports, 20% on all Chinese products and a 25% tax on all steel and aluminium, as well as cars and car parts entering the US. While some measures were withdrawn or delayed, the tit-for-tat tariff war had a profound impact on US markets especially.

Both consumer and investor sentiment started to sour with increased rhetoric over levies on goods entering the US and the potential price rises those policies could usher in. Surveys throughout the period increasingly mention anxiety over tariffs, with cost increases becoming a daily topic for some businesses. Indeed, even Trump was in the mood to make declarations (just not on his tax), commenting that he "couldn't care less" if carmakers raise prices after his 25% tariffs on foreign-made vehicles comes into effect. "People are gonna buy American-made cars, we have plenty," was very much his bottom line.

With worries that the spectre of inflation could rear its ugly head again, it was up to the US Federal Reserve (Fed) to allay fears that it would act if necessary. Refraining from lowering borrowing costs during the quarter, Fed Chair Jay Powell noted the risks to cutting rates too aggressively, saying "we know that reducing policy restraint too fast or too much could hinder progress on inflation".

Failing to mind the GAAP, the broadest measure of American stocks suffered its worst first quarter performance in three years, falling 5.75% in March alone, with big tech firms bearing the brunt of the sell-off. Despite several American stocks entering the year with valuations near multi-decade highs, late January's news that DeepSeek, a Chinese AI offering, that claimed to require significantly less computational resources to achieve results comparable to the more expensive ChatGPT, led to some pretty gross deductions in American equivalents.

On the news, the value of the world's largest company, chip maker Nvidia, fell by as much as 17%, wiping out $593 billion from its market capitalisation in a day – the largest one-day loss in history. The semiconductor sub-index also fell by 9.2%, suffering its biggest loss since March 2020. The fall set the tone for the sector, with the tech-heavy Nasdaq index falling into correction territory (defined as a fall of 10% from a recent high) during the quarter.

Balancing the books while US markets got off to a difficult start to 2025 were European markets, which picked up the slack. The much-overlooked region finally received some appreciation from investors. Attractive valuations coupled with an accommodative central bank that was able to cut rates in both January and March by a combined total of 0.5%, with space to move further if required throughout the rest of the year.

On the geopolitical front, the US applied pressure for Russia and Ukraine to come to the negotiation table. Further positive news on the continent came in March as Germany's new government agreed to loosen fiscal rules for defence spending. This decision will allow the creation of a special €500 billion fund to boost the country's defence capability as well as implement a number of infrastructure projects. With events in Washington overshadowing much of what was happening around the rest of the world, it is no exaggeration to view this this policy as monumental in nature.

Turning towards domestic shores, investor euphoria was more tempered, as the impact of Chancellor Rachel Reeves's October Budget continued to be felt by markets and the broader economy. Such proposed policies are likely to see prices rise as companies aim to offset rises in National Insurance contributions and minimum wage.

The result has been a rise in gilt yields, as inflation made its way above the Bank of England's (BoE) 2% target again, having briefly touched 1.7% in September last year. However, it must be noted that the final reading of the quarter saw inflation come in at 2.8%, below the 3% expected. Although inflation has proven stickier than first anticipated, the BoE has adopted a more 'wait and see' approach, embracing a monthly hold-cut tempo, allowing the bank to lower borrowing costs by 25 basis points during February, but hold in January and March.

Interestingly, the government's Spring Statement, delivered in March, struck a very different tone to the Autumn Budget, painting a more downbeat picture for UK finances. Back in the halcyon days of October, the government's official economic forecaster, the Office for Budget Responsibility said that the government would be able to meet its self-imposed finance rules with £9.9 billion to spare. However, an increase in government borrowing costs since then, has meant that this headroom has all but disappeared. It's an accrual world, as those in the Treasury are learning.

Investment strategies

The first quarter of 2025 proved to be anything but dull. US President Donald Trump's slightly eccentric style when it comes to foreign policy, and the 'will-he-won't-he' approach to tariffs kept markets, politicians and central bankers on their toes. In reaction to the change in approach from the US administration, European politicians have rewritten debt rules, while the pressure for Russia and Ukraine to come to the negotiation table to end their current conflict has intensified. However, the cessation of hostilities has extended beyond the day-one conclusion that the US President had vaunted in his election campaign. Add to this, the suggestion that Canada will become America's 51st State, that Palestinians will be exiled from Gaza so that the US can rebuild the region as a high-end resort and that Greenland will shortly be taken over by the US, much to the confusion of Greenland and Denmark, and you get a good idea of the level of disruption that the 47th President's first 70 days in office has caused.

From an equity market perspective, the initial hubris following Trump's re-election seemed to have given way to a more sanguine period, especially within the US. As more uncertainty spread concerning the levels of tariffs that could be expected, the inflationary impact this could cause led to concerns that higher rates for longer could lead to lower growth, which in turn saw US equity markets shed the gains witnessed since the election and a little more. European ex-UK equities, having lagged the US market in the later stages of last year, were buoyed as the prospect of higher government spending on defence (among other areas) was seen to sufficiently offset any challenges that tariffs may have across the broader economy. In the UK, the emergence of a burgeoning relationship between Prime Minister Keir Starmer and President Trump in conjunction with the limited impact of tariffs on the more value-orientated UK market saw headline indices end the quarter closer to European than US markets. There was mixed performance across Asia and emerging market (EM) equity bourses. Japanese equities suffered as the Bank of Japan continued to tighten interest rate policy to combat once-in-a-generation levels of inflation. Asia ex-Japan and EM equities were volatile but boosted by Chinese fiscal stimulus and both regions ended the quarter marginally higher.

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From a fixed interest perspective, the first three months of the year were rather volatile. Markets tried to digest the changing growth and inflation backdrop, largely driven by the erratic policy announcements by the US administration, but also by changes in fiscal approaches in Europe and the UK. Although returns varied during the quarter, in most cases, overall market returns were positive. Global government bonds delivered positive returns, largely driven by US Treasuries, where the slowing growth environment meant that bond market expectations of rate cuts this year increased. UK gilts also delivered marginally positive returns over the quarter, driven by shorter-dated maturities with longer maturity issuance having a far more difficult time. Investment grade corporate bonds also performed well, despite material widening in spreads. This was also the case in the global high yield market, with the shorter maturity profile of these bonds being especially beneficial.

The market's evolving view of the divergence in growth and inflation expectations heavily impacted currency markets. Lower growth and more rate cuts in the US saw the dollar weaken notably against a broad basket of currencies, including sterling. This translation effect weighed on returns of dollar assets for sterling investors, while the relative strength of the euro versus the British pound enhanced returns for UK investors who hold European assets.

Alternative assets, such as global infrastructure and real estate investment trusts (REITs), delivered mixed returns. The inflation-linked cash flows that are a feature of many infrastructure contracts proved beneficial for this asset class, while the more variable path and the higher interest rate sensitivity of REITs proved more of a headwind.
Our selection of absolute return funds performed well over the quarter. Positive returns slightly in excess of cash provided some support and beneficial diversification to lower-risk portfolios.

Portfolio Activity
We switched our European government bonds into short-dated gilts and short-dated global investment grade bonds during March. We bought European government bonds opportunistically in April 2024 after yields had risen quite sharply, improving bond valuations. We wanted increase portfolios' exposure to government bonds, and European government bonds in particular, as we expected the European Central Bank to ease monetary policy ahead of other major central banks. This position was profitable as European bond yields fell through most of 2024. However, developments over the first quarter, such as the prospect of higher European defence spending which necessitates increased bond issuance, led us to believe that European bonds are no longer attractive. We prefer short-dated gilts and short-dated investment grade bonds, which currently offer very attractive yields with low levels of interest rate sensitivity.

We also made some adjustments to our fund selection during the quarter. We switched from the Royal London Short Duration Gilts Fund to the iShares Up To 10 Years Gilt Index Fund. We preferred the duration profile of the iShares Fund and it has a lower management fee. We also switched from Legal & General Global Real Estate Dividend Index Fund to the iShares Developed Real Estate Index Fund. The iShares Fund is a better match to our reference index for global REITs and has a lower management fee than the L&G Fund.

Outlook
With tariffs and trade tensions taking up many of the column inches during the first quarter of 2025, if we learned anything during Donald Trump's last administration, it is that the self-proclaimed "Tariff man" will not lose interest in pursuing what he believes are economic injustices.

While geopolitical tensions could go on to characterise much of the year ahead, bringing bouts of heightened volatility, there are some bright spots emerging. An unintended consequence of Trump's tariffs is that it has led to more opportunities outside of the US for investors, with areas such as Europe and China showing signs of a renaissance. In the end, investing for the long term isn't too different from filling out your tax returns. Ultimately, it's all about finding that balance.

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Risks
All investments involve risk. The risks of some of the funds may be comparatively high. The risk descriptions at the end of this document correspond to the main risk factors for each fund within the model. "General Risks" mostly apply to all funds within the model. A fund could potentially be affected by risks beyond those listed described in this document, nor are these risk descriptions themselves intended as exhaustive. For full information and key risks, please refer to the end of this document.

Credit risk: The fund invests in securities which are subject to the risk that the issuer may default on interest or capital payments.

Interest rate risk: The fund price can go up or down daily for a variety of reasons including changes in interest rates, inflation expectations or the perceived credit quality of individual countries or securities.

Equity risk: The fund invests in equity and equity related securities. These are sensitive to variations in the stock markets which can be volatile and change substantially in short periods of time.

Emerging Markets risk: The fund invests in emerging market equities and / or bonds. Investing in emerging markets involves a greater risk of loss than investing in more developed markets due to, among other factors, greater political, tax, economic, foreign exchange, liquidity and regulatory risks.

Derivatives risk: The use of derivatives carries the risk of reduced liquidity, substantial loss and increased volatility in adverse market conditions, such as a failure amongst market participants. The use of derivatives may result in the fund being leveraged (where market exposure and thus the potential for loss by the fund exceeds the amount it has invested) and in these market conditions the effect of leverage will be to magnify losses.

High Yield Credit risk: The fund invests in high yielding bonds which carry a greater risk of default than those with lower yields.

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