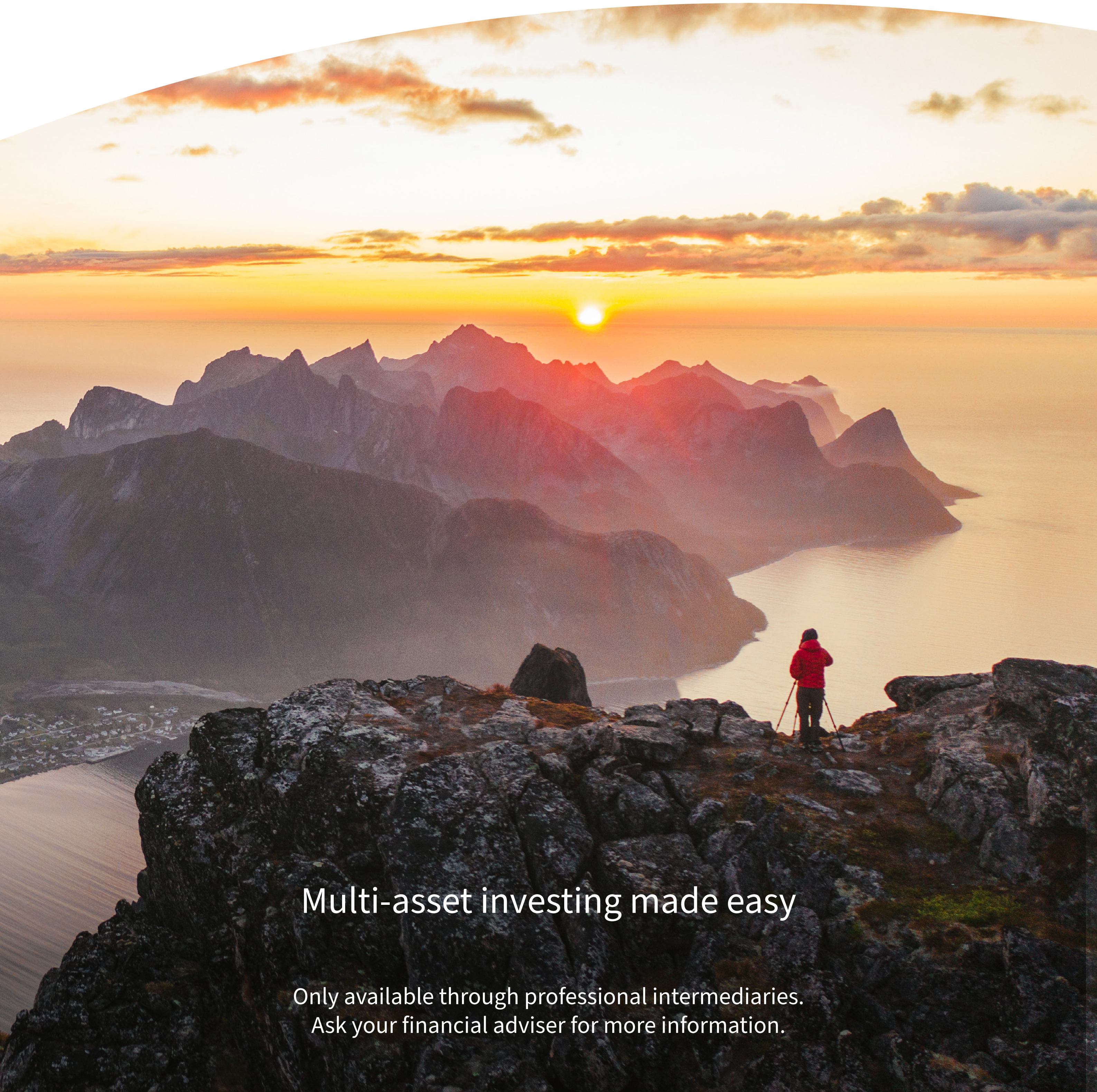
AJ BELL INVESTMENTS

Strategic Asset Allocation 2025



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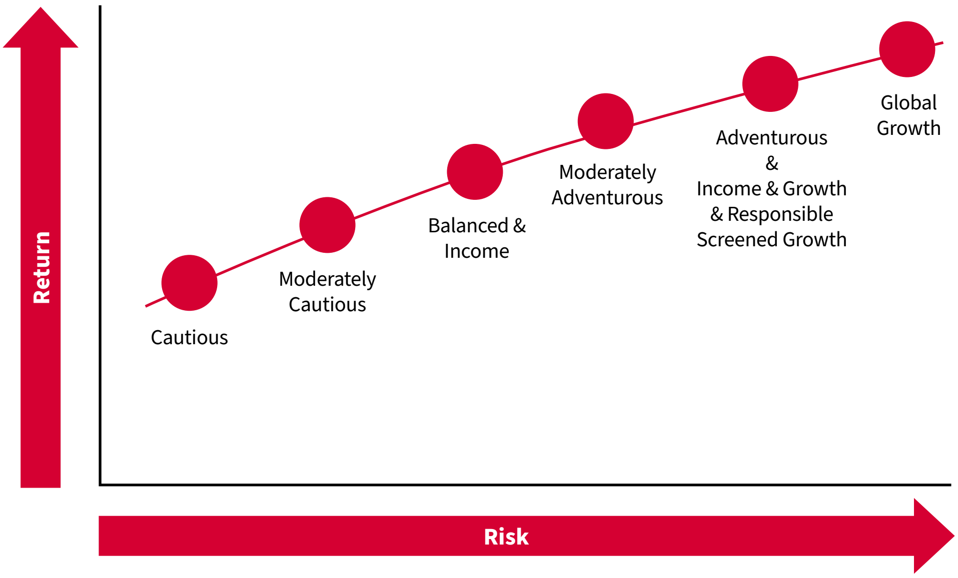
Introduction

Welcome to the asset allocation update for the AJ Bell Funds. This document explains the changes we're making to the AJ Bell range of investment solutions for 2025, based on our understanding of current market conditions and the long-term outlook for different asset classes around the world.

A reminder of the investment approach

The AJ Bell Funds are designed to behave in a predictable manner, around pre-defined levels of risk as measured by volatility. Our Investments Team uses a set of Capital Market Assumptions (CMAs) for selected asset classes to construct a range of portfolios that sit on or close to the efficient frontier, using a Mean Variance Optimiser (MVO) following the principles of Nobel Prize winner Harry Markowitz.

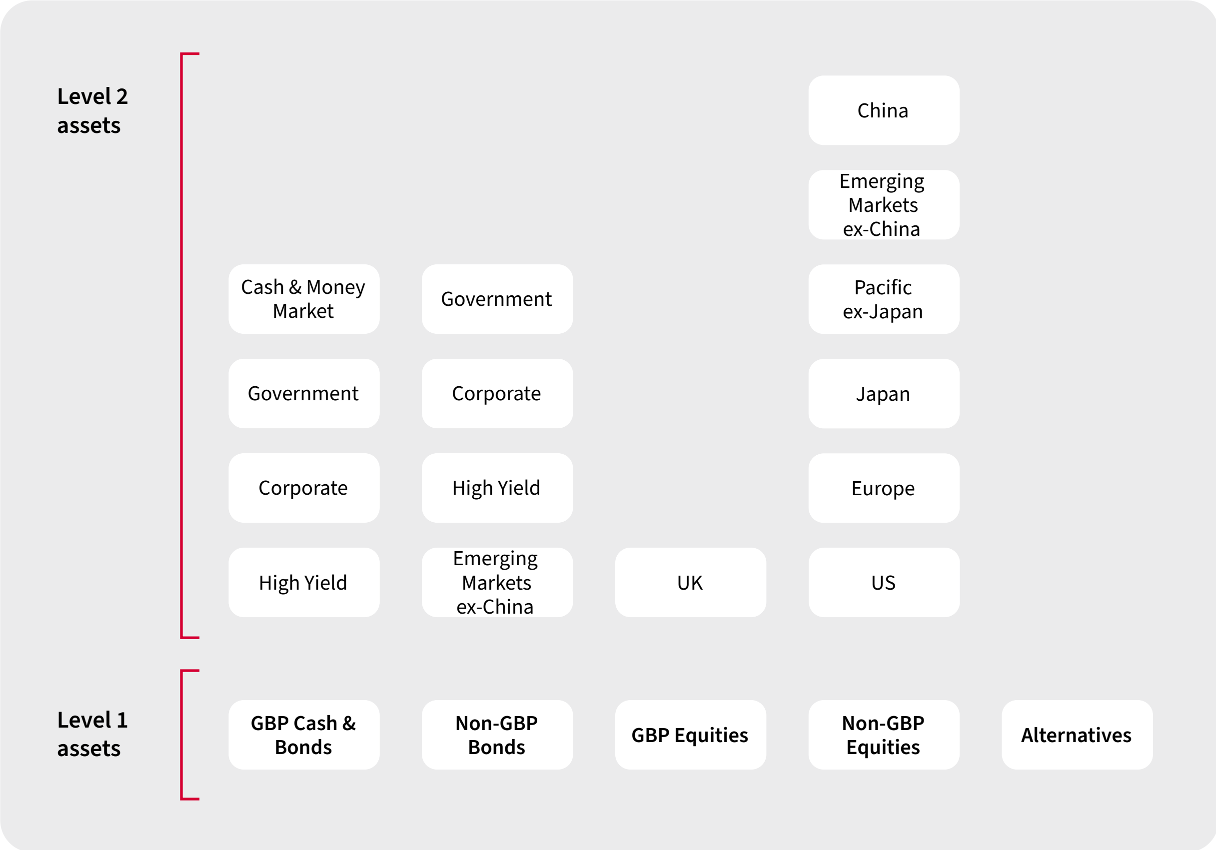


Illustrative only

The Strategic Asset Allocation (SAA) process is focused on five defined high-level 'buckets' (Level 1) that see the level of exposure varied depending on the level of risk being taken:

- Cash and UK fixed interest
- International fixed interest (unhedged)
- UK equities
- International equities
- Alternatives

Sitting underneath these core asset classes, 15 sub-asset classes (Level 2) are optimised using the MVO to build the most efficient portfolio possible for the given level of risk, taking into account the constraints that have been built into the optimisation process.



If you've been following our investment process, you'll notice a couple of changes for 2025.

Firstly, we're no longer using alternatives within the MVO setting. Instead, we now consider property and infrastructure to be Non-GBP equity sectors that are available for use tactically. This change is the result of research we conducted to assess the merits of having long-term exposure to alternative asset classes, and their diversification benefits. Our conclusion is that they haven't provided enough diversification to portfolios, and therefore do not warrant a permanent allocation. For more information, please read this article.

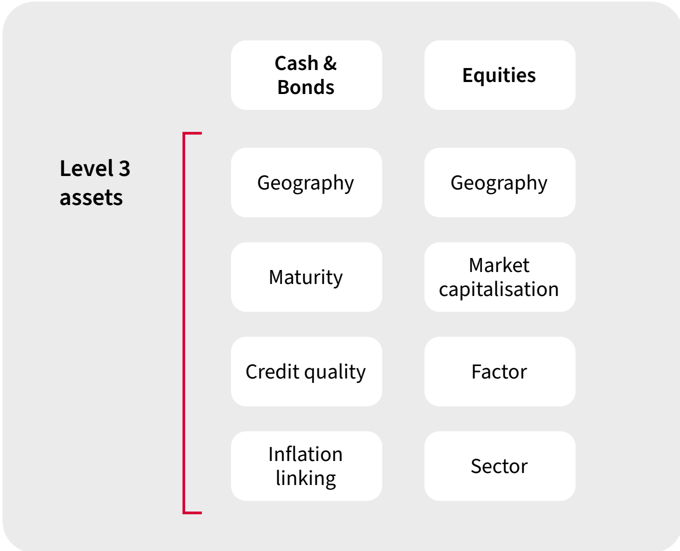
Secondly, we're now more granular in our approach to Asia and Emerging Markets. Previously, China sat within both the Emerging Market and Asia Pacific ex-Japan asset classes (as did India). By splitting out China as a standalone asset class, we can increase transparency and flexibility. It's worth noting that this doesn't mean we have a strong view one way or the other on China, but we do want to ensure we have the tools needed to adjust exposure should we deem it necessary. Again, you can find out more about this decision in this article.

Tactical Asset Allocation (TAA)

It's important to remember that the optimiser is an unemotional beast that lacks context around current market conditions. Instead, it simply takes the inputs of long-term expected returns, correlations and volatility, and gives its most efficient portfolio – i.e. the one with the highest annual return for the level of risk being taken. However, there are occasions when manual intervention is required in the form of tactical adjustments.

Where our Investment Team sees an opportunity to enhance the risk adjusted return, either by increasing the return or reducing the risk, a tactical adjustment may be made to the Strategic Asset Allocation. Importantly, these are not short term 'calls' on the market, but well-evidenced adjustments that consider current market or macro-economic conditions that are outside the scope of the optimiser.

Significant adjustments are relatively infrequent, as clear mispricing of risk or returns is not a regular occurrence within broad asset classes. In all instances, the adjustments are implemented within strict 'tramlines' to ensure each risk-targeted portfolio doesn't stray outside of its designated risk band. Any TAA we undertake must operate within the set confines of the Level 1 asset class, and takes place by either adjusting the relative weight of the Level 2 assets or by considering Level 3 assets. These Level 3 assets can be thought of differently across equities and bonds, as shown in the graphic.



Capital Market Assumptions (CMAs) – where are we today?

Bond yields were a frequent topic of discussion entering 2024. However, interest rate expectations and government bonds proved volatile, while corporate bonds fared much better as credit spreads contracted. As we turn to 2025, government bonds yields sit around the heights seen over the last couple of years, while corporate bonds offer less compensation for the credit risk assumed. With inflation declining towards target over the course of 2024, real returns from bonds have fared much better than they did in 2023. The decline of inflation has allowed major central banks to cut interest rates, but not quite as quickly as many expected two years ago. As a result, the prevailing yields available on cash continue to look interesting.

Equity markets had another positive year in 2024 and expected returns from most markets have declined as a result. Corporate earnings growth remains healthy in most regions, so they broadly remain an attractive proposition – however diversification remains key in our minds.

Strategic Asset Allocation (SAA) – the year ahead

Despite most equity market expected returns declining, you will see the portfolios increasing their equity content at this SAA. This is partly due to the relative attractiveness of bonds – in particular global bonds (currency unhedged), where yields are not an adequate compensation for the interest rate, credit and currency volatility. Additionally, the AJB 1-4 portfolios have increased their allocation to cash, which necessitates an increase in volatility elsewhere to ensure the portfolio is appropriately positioned within its target volatility range. Finally, the removal of listed commercial property means equities must pick up the volatility slack here too.

The portfolios after the optimisation step of the process are shown in the Level 1 allocation in Table 1. The SAA formally sets the 'Level 1' allocation of portfolios within which we can deviate using TAA.

Table 1

Level 1 2025 AJB Positions	AJB 1	AJB 2	AJB 3	AJB 4	AJB 5	AJB 6
GBP Cash & Bonds	65.0%	46.0%	32.0%	17.0%	7.0%	2.0%
Non-GBP Cash & Bonds	9.0%	6.0%	6.0%	4.0%	3.0%	-
GBP Equities	6.0%	12.0%	14.0%	18.0%	21.0%	24.0%
Non-GBP Equities	20.0%	36.0%	48.0%	61.0%	69.0%	74.0%
Alternatives	-	-	-	-	-	-
Changes year-on-year	**AJB 1**	**AJB 2**	**AJB 3**	**AJB 4**	**AJB 5**	**AJB 6**
GBP Cash & Bonds	+5.0%	-	+1.0%	-	-2.0%	-7.0%
Non-GBP Cash & Bonds	-4.0%	-4.0%	-4.0%	-6.0%	-	-
GBP Equities	-	-	-2.0%	-2.0%	-4.0%	+1.0%
Non-GBP Equities	+3.0%	+8.0%	+9.0%	+11.0%	+9.0%	+9.0%
Alternatives	-4.0%	-4.0%	-4.0%	-3.0%	-3.0%	-3.0%

Level 2 allocations

The Level 2 asset class allocations and changes are shown in Table 2, below. Aside from the structural changes to the regions, there has been an increase in allocation to Europe ex-UK and the US. In Europe valuations remain attractive and the MVO is moving to an allocation that is more in keeping with the weighting within major global equity indices. Similarly in Japan, the exposure across the six asset allocations has been adjusted to bring it more in line with its place in the global equity market.

In the US, we have adjusted the guardrails that the portfolio must operate within to ensure that the underweight relative to the global indices is kept under control. This has resulted in increased US equity exposure, and we've used this opportunity to adjust the type of exposure we seek within portfolios, which will be covered later.

The other major change within the Level 2 allocation is Emerging Market debt / bonds (EMD), which is favoured by the MVO, and gives an additional source of higher yield than traditional global high yield corporate bonds. EMD has attractive correlation characteristics versus other parts of the bond market, given the different types of country and economic exposure have very different cycles and monetary policies to traditional, developed, markets. EMD is also a growing part of the bond universe, and offers exposure to both government and corporate bonds.

Table 2

Level 2 2025 AJB Positions	Risk Profile 1	Risk Profile 2	Risk Profile 3	Risk Profile 4	Risk Profile 5	Risk Profile 6
Cash	26.0%	19.0%	11.0%	4.0%	2.0%	2.0%
Government Bonds	18.0%	9.0%	4.0%	-	-	-
Corporate Bonds	16.0%	13.0%	12.0%	8.0%	-	-
High Yield Bonds	5.0%	5.0%	5.0%	5.0%	5.0%	-
GBP & GBP Hedged Cash & Bonds	**65.0%**	**46.0%**	**32.0%**	**17.0%**	**7.0%**	**2.0%**
Government Bonds	3.0%	-	-	-	-	-
Corporate Bonds	-	-	-	-	-	-
High Yield Bonds	-	-	-	-	-	-
Emerging Market Bonds	6.0%	6.0%	6.0%	4.0%	3.0%	-
Non-GBP Bonds	9.0%	6.0%	6.0%	4.0%	3.0%	0.0%
UK Equities	6.0%	12.0%	14.0%	18.0%	21.0%	24.0%
GBP Equities	6.0%	12.0%	14.0%	18.0%	21.0%	24.0%
Europe ex-UK Equities	4.0%	6.0%	8.0%	10.0%	16.0%	16.0%
US Equities	12.0%	17.0%	21.0%	25.0%	21.0%	16.0%
Japan Equities	-	4.0%	6.0%	7.0%	7.0%	9.0%
Emerging Markets ex-China	4.0%	6.0%	9.0%	11.0%	16.0%	21.0%
Pacific ex-Japan	-	-	-	3.0%	3.0%	4.0%
China		3.0%	4.0%	5.0%	6.0%	8.0%
Asia Pacific ex-Japan Equities	-	-	-	-	-	-
Emerging Markets Equities	-	-	-	-	-	-
Non-GBP Equities	20.0%	36.0%	48.0%	61.0%	69.0%	74.0%
Property	-	-	-	-	-	-
Alternatives	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Changes	**Risk Profile 1**	**Risk Profile 2**	**Risk Profile 3**	**Risk Profile 4**	**Risk Profile 5**	**Risk Profile 6**
GBP Cash	+6.0%	+7.0%	+4.0%	+2.0%	-	-
Government Bonds	+2.0%	-1.0%	-1.0%	-	-	-
Corporate Bonds	-3.0%	-5.0%	-3.0%	-4.0%	-	-
High Yield Bonds	-	-1.0%	+1.0%	+2.0%	-2.0%	-7.0%
GBP Cash & Bonds	**+5.0%**	**0.0%**	**+1.0%**	**0.0%**	**-2.0%**	**-7.0%**
Government Bonds	-2.0%	-3.0%	-	-	-	-
Corporate Bonds	-8.0%	-7.0%	-7.0%	-7.0%	-	-
High Yield Bonds	-	-	-	-	-	-
Emerging Market Bonds	+6.0%	+6.0%	+3.0%	+1.0%	-	-
Non-GBP Bonds	-4.0%	-4.0%	-4.0%	-6.0%	0.0%	0.0%
UK Equities	-	-	-2.0%	-2.0%	-4.0%	+1.0%
GBP Equities	0.0%	0.0%	-2.0%	-2.0%	-4.0%	+1.0%
Europe ex-UK Equities	+4.0%	+3.0%	+5.0%	+5.0%	+9.0%	+7.0%
US Equities	+5.0%	+8.0%	+11.0%	+9.0%	+1.0%	+7.0%
Japan Equities	-5.0%	-3.0%	-1.0%	-	+1.0%	+6.0%
Emerging Markets ex-China	+4.0%	+6.0%	+9.0%	+11.0%	+16.0%	+21.0%
Pacific ex-Japan	-	-	-	+3.0%	+3.0%	+4.0%
China	-	+3.0%	+4.0%	+5.0%	+6.0%	+8.0%
Asia Pacific ex-Japan Equities	-	-	-7.0%	-8.0%	-10.0%	-17.0%
Emerging Markets Equities	-5.0%	-9.0%	-12.0%	-14.0%	-17.0%	-27.0%
Non-GBP Equities	+3.0%	+8.0%	+9.0%	+11.0%	+9.0%	+9.0%
Property	-4.0%	-4.0%	-4.0%	-3.0%	-3.0%	-3.0%
Alternatives	-4.0%	-4.0%	-4.0%	-3.0%	-3.0%	-3.0%

Tactical Asset Allocation

The resulting Level 2 allocations from the optimisation stage were assessed by the Investment Team, which was looking to identify clear room for improvement either in terms of expected return or risk. The team also took the opportunity to assess the tactical decisions made at the 2024 SAA. Of the decisions made in 2024, only one remained relevant following the optimisation.

In January 2024, the decision was made to reduce what was a relatively sizeable position in high yield bonds, and instead allocate more capital to investment grade bonds. We proved too early in our assessment of the risks posed by tight credit spreads, and they have since tightened even more. However, the portfolios continued to benefit from a healthy allocation through 2024. Going into 2025 we remain cautious regarding high yield credit spreads, and so we're content to leave this allocation where it stands. We're taking a prudent approach here, as we see the compensation on these bonds as being a little low for the potential risks involved.

Moving on, the turning of the interest rate cycle has led many to think about the risks of not having enough duration in portfolios. We're always mindful of needing to think one step ahead in markets, and the recent ebb in the rate of inflation brings with it interesting dynamics. Our assessment is that there are burgeoning risks to the upside in the UK and US inflation figures, predominantly owing to what appears to be sticky service-led inflation. If goods prices start to rise faster, it's not difficult to envisage inflation significantly above central bank targets. For fixed income markets, we feel this presents a risk to long duration positioning. We've therefore lowered duration from our 'neutral' range of 5-6 years towards 3-4 years, depending on which portfolio you look at.

As shown in Table 3, this is done via short duration gilts and US Treasuries, short duration US TIPS (Treasury Inflation Protected Securities) and a ballast of cash which, in contrast to pre-2022, offers a competitive yield. Essentially, what we're saying here is the compensation for duration is no longer worth the downside risk potential, with the certainty of cash returns particularly appealing for more cautious clients where the capacity for loss is lower.

Table 3

2025 AJB Positions	Risk Profile 1	Risk Profile 2	Risk Profile 3	Risk Profile 4	Risk Profile 5	Risk Profile 6
Standard duration gilts	6.0%	3.0%	-	-	-	-
Short duration gilts	6.0%	3.0%	-	-	-	-
Short duration US TIPS	6.0%	3.0%	4.0%	-	-	-
GBP & GBP Hedged Cash & Bonds	**18.0%**	**9.0%**	**4.0%**	**-**	**-**	**-**
Short duration US Treasuries	3.0%	-	-	-	-	-
Non-GBP Government Bonds	3.0%	-	-	-	-	-

Implementation

All these funds align to the six actively managed core asset allocations mentioned above. For 2025 we've introduced several changes to the end implementations. The major changes are summarised below, and you can see all the end implementations in the attached portfolio grids.

US

The Funds use market capitalisation equity products to fulfil their asset allocations as standard. Throughout 2024 there was a lot of talk about concentration risk within equity markets, particularly in the US. To reduce this risk at the margin, we've used the January update as an opportunity to tactically introduce exposure to the iShares S&P 500 Equal Weight ETF, which will be held alongside the SPDR S&P 500 ETF. We're firm believers in limiting tactical intervention to areas that present a clear risk, and here we see one building within markets. Rather than expose the portfolios to too much timing risk and tracking error at a particular point in time, we have started the position at a low level and are committed to reviewing the risk as 2025 unfolds.

2025 AJB Fund Positions	Risk Profile 1	Risk Profile 2	Risk Profile 3	Risk Profile 4	Risk Profile 5	Risk Profile 6
SPDR S&P 500 ETF	10.0%	14.0%	18.0%	21.0%	18.0%	14.0%
iShares S&P 500 Equal Weight ETF	2.0%	3.0%	3.0%	4.0%	3.0%	2.0%
US Equities	12.0%	17.0%	21.0%	25.0%	21.0%	16.0%

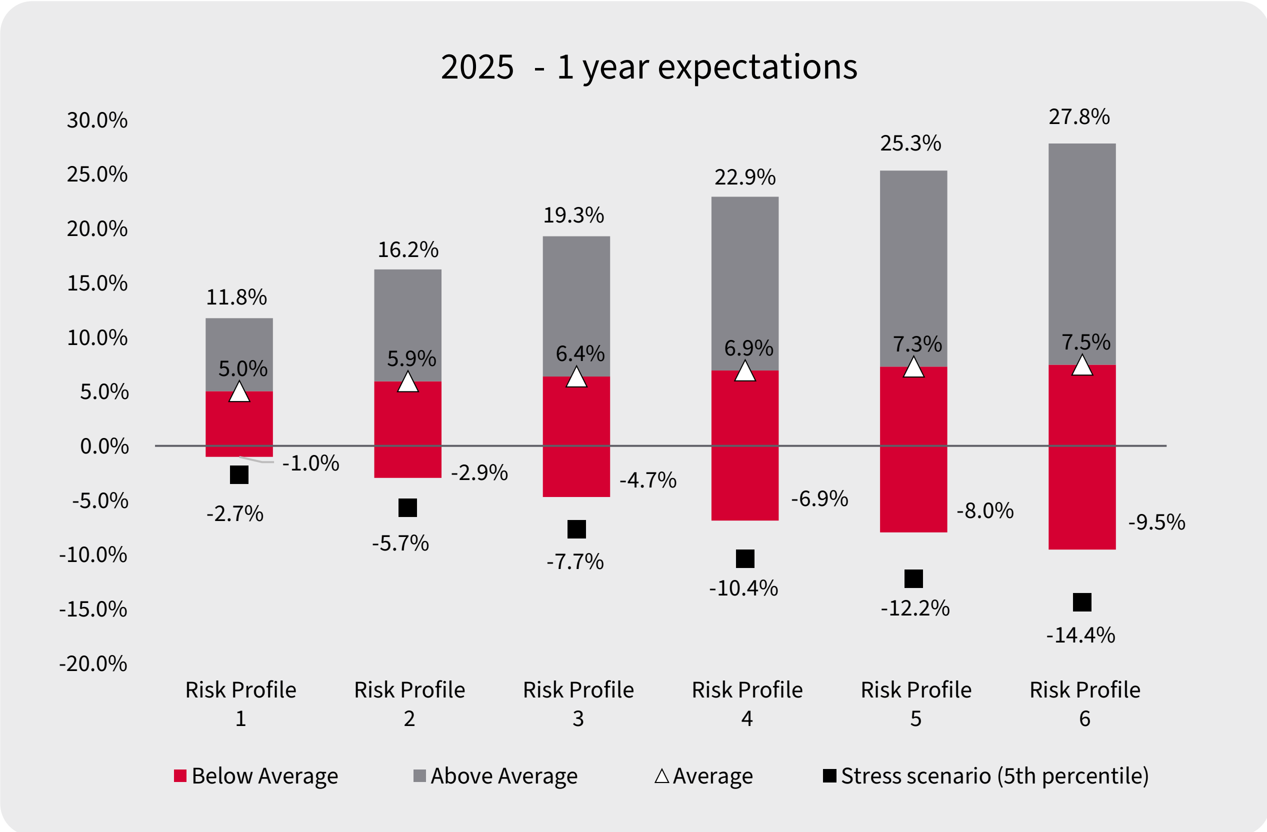
Emerging Markets ex-China, Asia ex-Japan and China

The other major change as part of the split to a standalone China position has been the introduction of two synthetic ETFs; the Amundi MSCI China ETF and the Amundi MSCI Emerging Markets ex-China ETF. In order to lower costs, physically replicating ETFs have largely moved to securities lending operations. We've been observing the counterparty risk inherent in these arrangements, and in some cases we feel it may be higher for a physical ETF than it is for a synthetic equivalent. This is because physical funds often take collateral that's in an entirely different asset class to that of the intended ETF exposure, whereas the swap arrangements of a synthetic ETF tend to have much tighter collateral controls. Additionally, a synthetic ETF offers the opportunity to improve tracking error by reducing frictional costs and taxes (such as withholding tax or capital gains tax). For example, in India, physically backed ETFs pay a high level of capital gains tax, which is negated by a synthetic ETF.

The Income funds retain some exposure to broader Emerging Market funds, given the need to generate a yield and the current availability of income-orientated EM ex-China funds.

Managing expectations – a range of outcomes

Each of the AJ Bell Funds are designed to maximise the return for a specific level of risk. However, returns will vary over time as the market moves. The chart below shows the long-term expected returns alongside the variability of these returns based on the 2025 asset allocation.



Summary

2024 proved that, despite a lot of noise and fears for volatility, markets can be resilient. With such a focus on political events in 2024, going into 2025 we feel that attention has unduly shifted away from inflation, and that managing the risk in bond markets is paramount.

The global economy also proved to be more resilient than many had expected at the start of 2024, and the recent spell of interest rate cuts are aimed at maintaining that momentum. However, with equity markets so focused on AI – a theme apparently unhinged from economic growth in traditional sectors – it is difficult to tell how monetary policy will impact equity markets directly. As always, we approach equities from the standpoint of diversification and risk management. This leaves our portfolios seeking returns from a diverse range of countries, sectors and investment styles.

Looking ahead, there is no telling what will capture the markets' attention in 2025. The new US administration is surely high up on the watchlist for many, however thinking ahead in markets is always useful and it is often the unexpected that matters most for shaping returns throughout the year.

Thank you for your support.

Ryan Hughes
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Paul Angell
Head of Investment Research

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Head of Investment Solutions

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Head of Investment Partnerships

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This report provides general information about the AJ Bell Funds. It should not be read or construed as investment advice. It is your responsibility to assess your circumstances and make sure it is suitable for your needs.

The value of investments can go down as well as up and you may not get back your original investment.

Past performance is not a guide to future performance and some investments need to be held for the long term.

Target yields are not guaranteed and can fluctuate.

AJB/SAA2025/20250619