UK: Suitable for retail and professional clients.

Monthly Income Portfolios April 2022

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The portfolios delivered modest losses as equities and bonds retreated

The UK was the top-performing regional market

Funds with smaller company exposure were especially hard hit

Market review

Equity and bond markets fell in April as investors fretted over the ongoing course of interest-rate rises and the expanding economic consequences of the war in Ukraine.

With central banks wrestling to bring record levels of inflation under control while reducing their support for financial markets (by 'shrinking' their balance sheets) and an energy crisis raging, the outlook for growth soured.

This saw the marked rotation into more defensive 'value' stocks (which pay high dividends) and away from 'growth' stocks, continue in April; the MSCI World Growth Index plummeted 7.6% while the MSCI World Value Index was down just 0.3%.

Due to its bias toward growth companies, the MSCI USA Index was the worst-performing regional equity market in April, down 4.6%. Its heavy weighting to technology stocks was costly in a month when the MSCI Information Technology Index was down more than 7.5%.

Meanwhile, US annual inflation reached a 40-year high of 8.5% in March. In the UK, the Consumer Prices Index (CPI) rose by 7% from a year earlier. The sharp rise in western inflation had been stoked by increased demand as economies come out of lockdown, an ongoing energy crisis and renewed lockdowns in China due to its 'zero-covid' policy.

Elsewhere, the UK equity market's extensive weighting to energy stocks was a major positive for the local indices as was its sizeable exposure to more defensive sectors such as consumer staple and healthcare stocks. This helped the UK indices to deliver small positive returns with the FTSE 100 Index gaining 0.8% while the broader FTSE All-Share nudged up 0.3%.

European equities lost further ground but notably outperformed the US market. Recent corporate earnings releases have generally been better than expected, helping temper negative investor sentiment as the knock-on consequences of the sanctions on Russia are expected to hit the region particularly hard. Consequently, the MSCI Europe ex UK Index declined by 1.7%.

In bond markets, the rapid sell-off continued in April. The suggestion of 0.75% interest-rate hikes from one US Federal Reserve (Fed) board member caused panic while

expectations also grew for the European Central Bank (ECB) to cease its bond-buying programme over the summer and begin raising interest rates.

Corporate bonds declined more than US Treasuries with the Bloomberg Global Aggregate Corporate Index (sterling hedged) falling 4.4% in April while the Bloomberg Global Aggregate Government Treasuries Index (sterling hedged) declined 2.3%.

In currencies, the Fed's commitment to reining-in inflation with interest-rate rises, coupled with the broader risk aversion sweeping financial markets, buoyed the US dollar. It strengthened around 4.5% versus sterling.

The weakness of the Japanese yen this year also remains a major story. Despite the significant recent weakness of sterling, the yen is still more than 5% down against the pound since the start of March, when its rapid depreciation began. Consequently, although the MSCI Japan Index retreated 4.4% for sterling investors in April, around half of this loss was the result of the yen's painful decline.

** Currency hedging of foreign investments dampens the effect of currency fluctuations on returns and reduces the volatility of your investment. Under most circumstances, we currency hedge foreign currency bond holdings, except in cases where the foreign currency exposure is an explicit return driver (eg emerging market local-currency debt exposures).*

(All performance figures in sterling terms and rounded to one decimal point, unless otherwise stated.)

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Performance review

Both income portfolios delivered modest losses in April as equity and bond markets retreated. The Quilter Investors Monthly Income Portfolio declined by 1.8%, in line with its Investment Association (IA) Mixed sector performance comparator. The Quilter Investors Monthly Income and Growth Portfolio fell 1.5%, outperforming its IA Mixed sector comparator by 0.7%.

Within this, the UK equity market was a bright spot. The large cap FTSE 100 index was up almost 1% thanks to its extensive weighting in oil, energy and commodity companies. The weakness of the pound also helped; it boosted the sterling value of overseas earnings which account for around three quarters of all FTSE 100 company earnings. Likewise, the fall in sterling also helped insulate UK investors from the worst losses suffered by overseas equity markets.

Consequently, the Monthly Income Portfolio's overweight to UK equities, was positive for relative performance, even though its modest overweight to equities overall detracted from relative performance.

Even so, it was another difficult month for active managers who invest further down the market cap spectrum. Consequently, the Montanaro UK Income Fund struggled. The iShares UK Dividend ETF also took back some recent gains as its overweight to financial stocks and an underweight to healthcare dragged on returns.

The top-performing UK holdings were the City of London trust (held in the Monthly Income Portfolio) and the iShares FTSE 100 ETF, with both delivering modest gains.

US equities sold-off aggressively, led by technology and consumer discretionary stocks. However, a stronger US dollar noticeably reduced losses for sterling investors. The portfolios' underweight to US equities was a relative positive, as too was the holding in the Fidelity US Quality Income ETF which outperformed the broad US market.

Elsewhere, the Quilter Investors Global Equity Value Fund (managed by Redwheel) delivered modest positive returns and is still ahead in 2022; an impressive feat given the weakness in global equities year to date.

There were few positive returns to report in the fixed-income portfolios although several of our actively managed funds such as the Quilter Investors Bond 2 (Fidelity), the Allspring US Short Term High Yield and the Quilter Investors Bond 1 (Twentyfour) funds, outperformed their respective benchmarks.

Our alternative fixed-income holdings, Blackstone GSO Loan Financing and the Fair Oaks Income Fund (held in the Monthly Income portfolio) delivered small positive returns thanks to their floating-rate exposure (which means they benefit from rising interest rates).

Within alternatives, the Foresight Solar Fund had another strong month, with the share price up over 3%.

Over the month, we increased our US investment-grade bond exposure at the expense of UK holdings given the strong expected rise in US interest rates at a time when US inflation appears to be peaking. Inflationary forces are likely to persist for longer in the UK.

Elsewhere, we trimmed some recent strong performers, such as Foresight Solar, while gradually increasing exposure to the JO Hambro UK Dynamic Fund. This was funded by a reduction to the Montanaro UK Income Fund.

Outlook

The economic outlook is clouded by elevated levels of inflation and very weak consumer confidence. The war in Ukraine has driven energy and food prices higher still, while renewed lockdowns in China mean supply-chain bottlenecks that had started to ease may worsen again.

One of the biggest risks is that central banks increase interest rates too far and too fast, tipping economies into recession. However, we do not see this as the most likely outcome as households still have much of their pandemic savings to spend. If economic growth weakens too much we expect central banks to step back from interest-rate hikes.

We still expect to see solid company earnings growth, albeit at lower rates than last year. In this environment, equities can still perform positively, although a backdrop of rising interest rates and inflation will tend to favour 'value' segments of the market and stocks that pay dividends, both of which are positives for income strategies.

The notable government bond sell-off so far this year has restored some of the former 'hedging' properties that such bonds offered in the event of an equity market sell-off, so we are becoming less negative on the asset class.

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