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Quilter Investors

Caerus Select monthly August 2021

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With the notable exception of China, global equity markets made strong progress in August

The developed markets portfolio lagged its benchmark due to the Blackrock Gold & General Fund

The fixed-income portfolio outperformed its benchmark to deliver modest positive returns

Market review

Rising coronavirus infections around the world, notably in the US, did little to dent investor risk appetite in August as global equities continued their rally. Japanese and US markets led the way with developed markets generally outperforming emerging markets.

The UK was one of the weaker performing major markets during August but the average fund in the Investment Association (IA) UK All Companies sector still delivered 3.2%.

Early in the month, the Bank of England Monetary Policy Committee (MPC) voted to continue its existing quantitative easing programme, although there were also hints towards a slightly earlier first interest-rate hike than previously indicated.

Purchasing Manager Index (PMI) survey data in the UK continued to moderate but remained strong for both manufacturing and services sectors, suggesting that while peak growth is likely behind us, the outlook remains favourable.

Inflation also ticked lower as July's reading came in at 2% year-on-year, a welcome decline from June's reading of 2.5%. However, fears as to UK inflation have not abated; although it expects it to be temporary, the Bank of England now predicts inflation to peak at 4% by the year's end.

In the US, equity markets surged higher once more with the average fund in the IA North America sector delivering 3.6% even as coronavirus cases rose.

Longer-term growth prospects were also improved as the Senate passed the bipartisan infrastructure package, which includes $550bn of new spending over the next eight years.

Towards the end of the month, US Federal Reserve (Fed) chairman, Jerome Powell, delivered his address at the annual Jackson Hole symposium, where he acknowledged the strong employment gains recorded in recent months but set this against the clear downside risks posed by the Delta variant of the coronavirus.

His comments suggested that the Fed's asset purchases will start to taper before the end of the year, which was in line with market expectations. Of more interest to investors were his efforts to separate the timing of the end of quantitative easing (Fed asset purchases) from interest-rate hikes; this suggests that near-zero rates could be maintained for even longer.

As the vaccine roll-out continued apace across the continent, European stocks once again made solid gains with the average fund in the IA Europe ex UK sector adding 3.6%, marginally ahead of the UK sector. Sterling weakness over the month also helped boost foreign equity returns.

The Chinese equity market was the worst-performing of the major markets over the month, with the average fund in the IA China/Greater China sector up just 0.4%. Investor sentiment in the region has been soured by the regime's ongoing regulatory crackdown to further its political agenda and foster "common prosperity".

Meanwhile, Chinese economic data points towards slower growth as the country continues to employ very stringent lockdown measures at the first signs of an outbreak. Services PMI data in August suffered, dropping to 47.5 (below the reading of 50 which indicates economic expansion).

China's technology stocks also fell during the month, following the publication of new rules in the country limiting the amount of time children can play online video games to three hours a week.

Meanwhile, the average fund in the IA Global Emerging Markets sector posted a 2.8% return for the month, despite China's large weighting in regional indices.

Indian equities were particularly strong performers amid reports that India's real GDP growth rate hit a record 20.1% year-on-year in the second quarter.

Government and investment-grade bond returns were modestly negative in sterling-hedged terms in August, with the average fund in the IA UK Gilts sector delivering a small loss of 0.1%. Meanwhile, high-yield bonds, which tend to perform better during rising equity markets, delivered modest positive returns.

Elsewhere, the oil price fell in August as concerns over slowing demand from China and the spread of the Delta variant trumped the supply disruptions caused by Hurricane Ida in the US.

(All performance figures in sterling terms and rounded to one decimal point.)

Continued overleaf

Performance review

August was another positive month for global equity markets which were pushed higher, in large part, by an effervescent US market where local indices hit a succession of new record highs thanks to the Federal Reserve (Fed) striking a cautious tone over when it might begin to reduce asset purchases. The Fed also commented that the US economy continues to recover well and that employment rates are strong.

Other developed markets also made gains supported by the ongoing global economic recovery and rising vaccination levels, which helped to offset concerns around the Delta variant, the US withdrawal from Afghanistan and the impact of Hurricane Ida, which wreaked havoc in the US.

In this environment, the Caerus Select Managed Portfolios all made worthwhile gains with the higher-risk portfolios in the range outperforming in line with their higher weightings to equities.

The UK equity element of the portfolio outperformed its benchmark index. On an absolute basis, the UK market was weaker than many of its peers due to ongoing concerns as to how Brexit was impacting supply chains, however, our underlying holdings performed well.

In particular, the Jupiter Merian UK Equity Income Fund outperformed due to its utilities sector exposure while the Blackrock UK Equity Fund managed a similar feat due to its overweight to the communication services sector coupled with some solid earnings news from several holdings.

Out of the five holdings in the UK portfolio, only the Artemis Income Fund underperformed its benchmark index. This was attributable to some poorly performing industrial and consumer discretionary stock picks.

The developed market equity component of the portfolio lagged its global benchmark index despite the positive market backdrop. This segment was held back by the performance of the Blackrock Gold & General Fund.

The fund enjoyed a strong July thanks to rising gold prices but it fell back to earth by nearly 5% in August. It was the only fund in this part of the portfolio to suffer a loss during the month and this naturally detracted from top line returns.

Leading performers in August included the Jupiter Merian Asia Pacific Equity Fund, which outperformed its benchmark in a month when local indices were supported by the re-opening of shops, bars and restaurants in large parts of the region.

The BNY Mellon US Equity Income Fund also outperformed its benchmark index, helped by its exposure to financials and, in particular, Morgan Stanley which was a top contributor.

Elsewhere, the Allianz Continental European Fund stood out thanks to an overweight to the information technology sector, which outperformed.

Meanwhile, the Invesco Perpetual Asian Fund lagged due to its overweight to the energy sector, which struggled on the back of falling oil prices while the Fidelity Asia Opportunities Fund also underperformed its regional benchmark index.

The emerging market equity component of the portfolio also lagged its benchmark index, although the asset class returned to positive territory after a very weak July.

Even so, there was notable performance from the JPMorgan Emerging Markets Equity, the Quilter Investors Emerging Markets Equity Income (run by Wells Fargo) and the Jupiter Merian Global Emerging Markets Focus funds, which were all ahead of their benchmark index.

However, the Janus Henderson China Opportunities Fund was materially weaker; it lost 1.8% during the month. This offset some of the gains seen elsewhere in the emerging markets portfolio as China continued to underperform on concerns as to stringent new government regulations across numerous sectors.

The fixed-income basket of the portfolio was a positive contributor to returns in August and ahead of its benchmark index. Within this, the Fidelity Strategic Bond Fund, which gained 0.3%, was the standout performer. It was closely followed by the Fidelity Moneybuilder Income, the Invesco Perpetual Corporate Bond, the Premier Corporate Bond Monthly Income and the Invesco Perpetual Corporate Bond funds, which all made positive ground during the month.

The alternatives basket was weaker in August and while losses were modest, they were still sufficient to detract from top line portfolio returns. In particular, the Allianz Fixed Income Macro Fund suffered a loss of 0.5%. Meanwhile, the PIMCO Dynamic, the Jupiter Global Equity Absolute Return (GEAR) and the Janus Henderson Absolute Return Fund were flat for the month.

Outlook

While it's easy in the good times to celebrate and to convince oneself that the risks have abated and valuations are justified, it's prudent, as we have in the past, to stay disciplined and maintain balance in the portfolios.

Monetary and fiscal policy overlaid with supply-side bottlenecks and significantly increased demand through the continued re-opening of global economies has stoked inflation and, while there are undoubtedly transitory elements to this current spike, we need to maintain a close watch on future prints and the impact this will have on policies going forward.

As we roll towards autumn and winter there is also heightened risk of volatility from further coronavirus developments – new variants, vaccine rollout programmes or heightened stress through healthcare systems with traditional winter illnesses – and how governments deal with these setbacks if they arise.

With the current positioning of the portfolios, we have been participating in the market upside but not fully capturing it. This will, no doubt, be disappointing for some investors. However, we remain committed to our investment discipline which requires us to trim into strength so that we can be prepared in case another unexpected event rattles markets.

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