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Quilter Investors

Cirilium monthly August 2021

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The portfolio delivered robust performance in August thanks to strong gains in global equity markets

Leading performers included the Montanaro stable of funds and our sustainable funds

The Mercantile Trust, the Premier Miton and Polar Capital UK Value Opportunities funds also outperformed

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 as the MSCI World Index generated a return of 3.6%.

The UK was one of the weaker major markets during August but the FTSE All-Share Index still delivered a total return of 2.7%, while the large cap FTSE 100 Index returned 2.1%.

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.

The MSCI USA Index surged higher to generate a 4% return over the period, 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 gains as the MSCI Europe ex UK Index returned 2.8%, just outperforming the UK. 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, up just 1%. Investor sentiment in the region has been soured by the regime's on-going 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.

Despite having more than a 30% weighting to China, the MSCI Emerging Markets Index still posted a 3.7% return for the month. 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. The Bloomberg Barclays Global Aggregate Government - Treasuries Index fell by 0.3% while the Bloomberg Barclays Global Aggregate Corporate Index declined a similar amount.

High-yield bonds, which tend to perform better during rising equity markets, delivered a positive return with the sterling-hedged Bloomberg Barclays Global High Yield Index up 0.8%.

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.

** 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 debt exposures).*

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

Continued overleaf

Performance review

Global re-opening continued apace in August, with a number of developed markets further lifting restrictions, despite a pick-up in coronavirus infection rates. Economic growth was generally strong, although it looks as though much of the developed world has already witnessed the strongest part of the recovery, with August's flash purchasing managers' indices (PMIs) moderating, yet still at high levels.

On the virus front, it's much ado about vaccines. Specifically, the Delta variant has continued to spread and daily cases have picked up across the globe, but importantly, this has not led to a significant rise in hospitalisations for countries that have implemented a successful roll-out of vaccination programmes, including the UK and Europe.

Whereas in the US, hospitalisations have increased more sharply, raising some concerns that the link between infections and hospitalisations has not been as effectively broken there due to lower vaccination take-up.

Against this backdrop, the Cirilium portfolios delivered strong performance for the month; a stark contrast to the more moderate returns seen in July. Equities did the heavy lifting as they have done in the year to date, although listed private equity also played its part for the higher-risk portfolios.

We have long been a supporter of listed private equity and it was great to hear the manager of Pantheon say that "none of our portfolio companies missed a beat during the pandemic" in a recent meeting. Elsewhere, returns were broadly flat across our alternative and fixed-income managers.

There were some exceptional performances across our equity managers during the month, especially the Montanaro stable of funds, which benefited from the strong investor demand for quality-growth companies.

The same demand helped to lift the sustainable funds that were added earlier in the year. Funds such as Jupiter Global Sustainable, Premier Miton European Sustainable Leaders and Regnan Global Impact all performed especially well in August.

Elsewhere, the strength of the domestic re-opening in the UK helped the FTSE All-Share Index to gain 2.7% over the month, but this return was far overshadowed by the more domestically-focused FTSE 250 Index, which delivered a particularly robust 5.3%.

This was reflected in the strong performance of the Mercantile Trust and the Premier Miton UK Value Opportunities and Polar Capital UK Value Opportunities funds, all of which (selectively) fish in those waters. It was a similar story in Europe with small and medium-sized (SMID) businesses leading the charge. This resulted in strong performance for the Montanaro European Income and the Premier Miton European Opportunities funds, among others.

It's also pleasing to report a stronger period for our Japan managers. We remain optimistic that there is more to come and it is encouraging to see some analysts start to share our view, including the Bank of America which now has a 'buy' rating on Japan.

If there was an area of the portfolios that we would have expected more from, it would be the US. Interestingly, while SMID cap outperformed large cap in Europe and the UK, it underperformed in the US. Consequently, our wider focus across US businesses translated into returns that lagged the broader index but, according to our underlying managers, their portfolio companies are outperforming operational targets and we are already starting to see stronger performance in September.

General portfolio maintenance aside, the main investment activities of the month were tactical and opportunistic strategies.

Tactical meant trimming positions that have performed well. This included the HarbourVest Private Equity, the Polar Capital Automation & AI and the Sands Global Leaders funds. We also reduced credit by trimming our holding in Hermes Unconstrained Credit, for example.

It should be noted that there has been no change to our conviction in these managers and we would happily buy back on weakness.

Opportunistic moves included adding to our Asia and emerging market managers following weakness in the same spirit as highlighted last month. This included adding to the Fidelity China Consumer, the Pacific North of South Emerging Markets Equity and the Wells Fargo Emerging Market Equity Income funds. These purchases were financed with the proceeds from the reductions listed above.

Outlook

Economic data releases in August highlighted the inevitable, in our opinion; namely, that the global re-opening (and recovery) has continued, but that countries first out of the blocks are now seeing the pace of their recoveries start to slow.

This may, to some degree, reflect supply bottlenecks following the disruption caused by the pandemic shutdown, but it may also suggest that consumers have bought all of what they need and are no longer prepared to chase prices higher for cars, houses and appliances, for example.

Recent inflation data has been topping Wall Street estimates, raising the narrative of monetary tightening. However, data continue to be mired by post-March 2020 after-effects. Although they should not be extrapolated into the basis of a new regime, they may be here for a few quarters longer than previously anticipated.

More important will be the handoff from government transfer payments to the private sector re-booting, for two key reasons. First, employment, for the likely speed of monetary policy change, and second, wages, which will help us to understand the influence on corporate margin pressures and the continued ability of consumers to absorb, thus far, one-off price shocks.

While the Delta variant continues to pose a risk to the global outlook, for developed economies this is likely to be in the form of supply disruptions and/or mobility restrictions. In response, we have already seen a number of countries announce booster programmes to deliver third doses to those most at risk.

For financial markets, August's data releases in September may simply provide confirmation that the easiest part of the recovery is behind us as we suggested last month. That does not mean there is no upside for risk assets – we still expect economic and corporate earnings growth, but investors will need to be more selective moving forward, have a little more patience and acknowledge there may be a few bumps along the way.

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