UK: Suitable for retail and professional clients.

Quilter Investors

Caerus Select monthly commentary October 2021

Stuart Clark
Portfolio Manager

Our international equity exposure benefitted performance

Strong stock picking from underlying managers helped boost returns

UK Gilts were the highlight in the traditional fixed-income space

Market review

Inflation and how central banks will respond remained the most important story in October, as data showed US consumer prices growing at their fastest pace since the early 1990s. This meant that much of the action during the month was in bonds rather than stock markets.

Rising prices in the US have dented consumer confidence in recent months and while activity indicators remain elevated it is likely these will move lower in future months. However, this hasn't stopped the Federal Reserve (Fed) from edging towards the exit of its pandemic era policy support and bond markets have also moved to indicate earlier interest rate hikes than the Fed projects itself.

Despite the expected withdrawal of monetary policy support, the Investment Association (IA) North America sector delivered an average return of 3.6% as corporate earnings releases in the third quarter were strong across all sectors.

The IHS Markit/CIPS composite Purchasing Managers' Index (PMI), in the UK rose again in October to 57.8 while the input prices series hit new all-time highs, indicating building inflationary pressures in the UK economy. In the month the IA UK All Companies sector produced an average return of 0.3%.

The Bank of England has strongly hinted recently that an interest rate hike is imminent, although Governor Bailey has also noted that raising rates will do nothing to help alleviate the supply chain bottlenecks that are driving much of the higher inflation experienced across the world.

In Europe, ECB president Christine Lagarde remained confident that inflation is a temporary issue and would return below the 2% target in the medium term, however she declined to comment on market pricing of a rate increase by the end of 2022. Consequently, yields spiked on euro area debt, but the IA Europe ex UK sector returned an average 2.2%.

October's bond markets were choppy and, despite the UK 2-year yield ending the month 0.3% higher than it started, overall, the UK market delivered solid positive returns as yields on longer dated bonds fell.

Sterling, meanwhile, had a strong October, rising 1.5% against the US dollar and 1.8% against the euro.

Japan elected a new government in the Liberal Democrat Party, which was widely expected despite the eventual reduced majority. This will, however, make it more difficult for Prime Minister Fumio Kishida to implement his economic package. Over the month, the IA Japan sector lost on average 4.6%, but this was mostly down to currency weakness as the yen was 3.8% lower versus sterling.

The real estate sector continued to drag on returns from Chinese markets and economic activity was hampered by power rationing in some regions. The IA China/Greater China sector index returned on average 1.1% in October.

Finally, the oil price continued to march higher in October, with US crude oil topping $80 a barrel for the first time since November 2014. It's not likely to revert lower soon due to support from tight supply. Natural gas and coal also rallied during October due to shortages affecting Europe and Asia.

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

Continued on next page

Performance review

The Caerus Managed Portfolios all posted positive returns for the month as equity markets (excluding Japan) were broadly positive in local currency terms. Although returns for our unhedged international equity positions were slightly lowered by the strength of sterling in October.

During the month our positioning in favour of international equity, relative to our peers, helped drive performance. However, the overweight exposure to emerging markets continued to weigh on returns.

Our underweight exposure to fixed income, relative to our peers, was again beneficial with a preference for cash and alternatives. The portfolios' thematic exposure to the BlackRock Gold & General Fund, as well as to the Quilter Investors Natural Resources Equity Fund (Janus Henderson) also helped boost performance, although the remainder of our underlying managers had a relatively poor month.

Strong stock picking was the key driver among the standout performers during the month. The Invesco Perpetual Asian Fund was helped by its China stock picks. Meanwhile, the Quilter Investors Emerging Markets Equity Fund (Jupiter) benefitted from its choices in the financials and IT sectors, while the Allianz Continental European Fund benefitted from stock picking in the industrials and IT sectors.

The new holding in the PIMCO Dynamic Multi-Asset Fund, which we added in the latest rebalance, performed well in October. They remain cautious, overall, but its exposure to some of the 'green-related' equities has been increased and a decreased weighting towards mining helped relative performance.

During the month our more value orientated managers did struggle. But, having reviewed those names we still believe they are performing in-line with our expectations given the prevailing market conditions.

Equally disappointing was the performance of our alternative holdings – aside from the PIMCO Dynamic Multi-Asset Fund. In particular, the Allianz Fixed Income Macro Bond Fund struggled, thanks to a short position in UK inflation that was particularly painful as energy prices moved up. Having reduced the position somewhat to finance the new holding in the PIMCO fund, the damage was lessened but we have arranged a follow up call with the management team to fully understand the current positioning and to assess the holding's weight within the portfolios.

In the traditional fixed-income space, the iShares UK Gilts All Stocks Index Fund was an exception to the rule as the asset class showed a positive return. This compared favourably to small losses in other large government bond markets, as well as the impact of some outsized movements in the emerging market bond space.

Outlook

The start of the earnings season was good in the US, which helped support markets. However, we still question the current level of valuations and the requirement for continued earnings strength going into 2022.

The US dominance of returns again, meant the growth factor was back at the forefront in October, so it will be interesting to see if growth and value remain on an equal footing going forward, or if one factor will start to dominate again.

Elsewhere, questions over inflation gaining traction, combined with some larger wage growth numbers, is starting to cause issues for central banks and their views on policy tightening and rate hikes. We continue to maintain a close watch on the impact this will have on markets going forward.

For now, we believe it is prudent to stay disciplined and maintain balance in the portfolios. Therefore, we remain of the view that the approach we have adopted of trimming into strength and trying to be prepared in case another unexpected event rattles markets is the right one in the current environment.

Important information

Past performance is not a guide to future performance and may not be repeated. Investment involves risk. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested. Because of this, an investor is not certain to make a profit on an investment and may lose money. Exchange rate changes may cause the value of overseas investments to rise or fall.

This communication is issued by Quilter Investors Portfolio Management Limited (trading as 'Quilter Investors'), Senator House, 85 Queen Victoria Street, London, England, EC4V 4AB. Quilter Investors Portfolio Management Limited is registered in England and Wales under number 03056894. Registered office at Senator House, 85 Queen Victoria Street, London, England, EC4V 4AB. Quilter Investors Portfolio Management Limited is authorised and regulated by the UK Financial Conduct Authority with FCA register number 175524.

This communication is for information purposes only. Nothing in this communication constitutes financial, professional or investment advice or a personal recommendation. This communication should not be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the document.

Any opinions expressed in this document are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or companies within the same group as Quilter Investors as a result of using different assumptions and criteria. This communication is for investment professionals only and should not be relied upon by retail investors.

QIL-239-21/221-1334/SK20730/Nov 21