UK: Suitable for retail and professional clients.

Cirilium Portfolios

Monthly commentary – Review of February 2024

Marcus Brookes
Chief Investment Officer

Our market summary

While global equities delivered robust gains in February, bond markets retreated as investors pared back expectations for interest-rate cuts in the face of stronger than expected inflation and economic data. Buoyed by the same resilient economic data, strong US company earnings numbers and a sharp bounce in Chinese equities following the latest raft of policy initiatives, global equities delivered 5%. China was the top-performing regional equity market. Its return of 9.1% boosted Asian and emerging markets. Meanwhile, US Treasuries gave up 1.3% in the face of persistent US inflation while UK gilts declined 1.2%.

Equity markets

Despite US inflation remaining higher than expected, with five of the Magnificent Seven reporting earnings, and exceptional share-price gains for the likes of Meta and Nvidia, major US equity indices continued to register new all-time highs. US equities gained 6.1% in a month when 75% of US companies to report earnings, beat analysts' expectations. Consumer discretionary and industrial stocks led the market while defensive sectors trailed.

Europe's equity markets trailed developed markets but still returned 2.7%. Along the way, European market indices passed new record highs, surpassing those set more than two years ago. The renewed excitement toward AI stocks helped to lift Europe's technology stocks late in the period. Consumer discretionary and industrial stocks also outperformed while more interest-rate sensitive areas, such as real estate and utilities, trailed.

UK equities eked out a 0.4% gain in the face of a technical recession after UK GDP shrank 0.3% in the last quarter of 2023 (to deliver two consecutive quarters of decline). Meanwhile, UK inflation remaining steady at 4%, and strong wage growth, deterred hopes of interest-rate cuts while analysts cut their UK profit forecasts. Industrial, financial and consumer discretionary stocks made modest gains while consumer staples, real estate and materials stocks declined.

Chinese equities bounced back from five-year lows to deliver 9.1%, thanks to Chinese New Year spending, cuts to mortgage rates, curbs on short selling and major stock purchases by state-owned entities. This boosted emerging markets, which gained 5.5%. Korea, Taiwan, and Saudia Arabia were among the top performers as were Peru, Chile, and Poland. India, Brazil, South Africa, Greece, and Turkey all underperformed the broader emerging market index.

Fixed income

Although annual US consumer price inflation (CPI) dropped to 3.1% in January, from 3.4% a month before, the smaller than expected decline piled more pressure on government bonds as investors re-appraised the outlook for interest-rate cuts. US Treasuries fell 1.4% while UK gilts retreated 1.2% in the face of robust UK wage growth, which likewise impacted the likelihood of interest-rate cuts. Meanwhile, sterling-denominated corporate bonds declined 0.6%.

Source: Quilter Investors as at 29 February 2024. Total return, percentage growth in pounds sterling except where shown, rounded to one decimal place. The performance shown for global equities is represented by the MSCI AC World Index; developed market equities by the MSCI World Index; US equities by the MSCI USA Index; European equities by the MSCI Europe ex UK Index; UK equities by the MSCI United Kingdom All Cap Index; UK smaller companies by the MSCI United Kingdom Small Cap Index; emerging markets by the MSCI Emerging Markets Index; US Treasuries by the ICE BofA US Treasury (GBP Hedged) Index; UK government bonds by the ICE BofA UK Gilt Index; and sterling-denominated corporate bonds by the ICE BofA Sterling Corporate Index.

Performance review

The Cirilium Portfolios delivered modest gains in February with returns rising in line with increased risk. While the Cirilium Conservative Portfolio was flat over the month, both the Cirilium Dynamic and the Cirilium Adventurous Portfolios gained 2.1%. Against their Investment Association (IA) performance comparators, both the Cirilium Conservative and Moderate Portfolios matched their comparators, whilst the remaining portfolios all outperformed in February.

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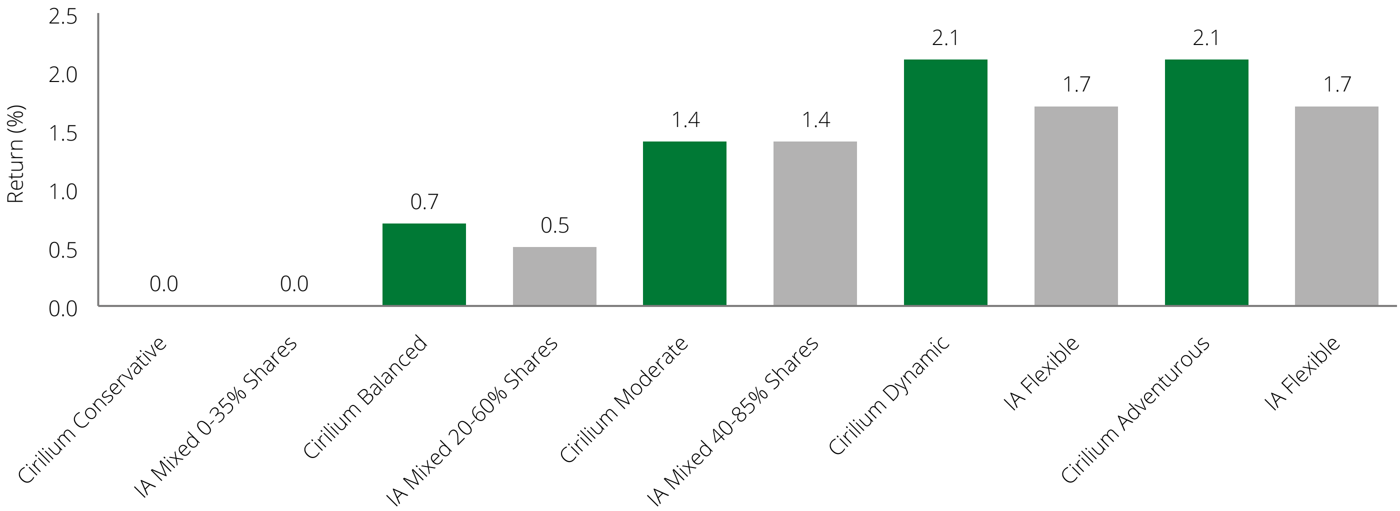
Monthly performance (%)



Performance summary (%)

	Cumulative performance						*Discrete annual performance to end of February*				
	1 month	*YTD*	*1 year*	*3 year*	*5 year*	*Since launch*	*2023 - 2024*	*2022 - 2023*	*2021 - 2022*	*2020 - 2021*	*2019 - 2020*
Cirilium Conservative	**0.0**	**-0.4**	**1.3**	**-6.5**	**2.8**	**41.8**	**1.3**	**-6.1**	**-1.7**	**6.8**	**2.9**
IA Mixed 0-35% Shares	0.0	-0.5	4.1	-1.4	7.4	41.9	4.1	-5.6	0.4	3.5	5.2
Cirilium Balanced	**0.7**	**0.2**	**2.7**	**-2.2**	**11.4**	**121.0**	**2.7**	**-3.4**	**-1.5**	**10.6**	**3.0**
IA Mixed 20-60% Shares	0.5	0.1	4.7	3.1	14.9	83.4	4.7	-3.0	1.6	6.6	4.6
Cirilium Moderate	**1.4**	**1.1**	**3.5**	**-0.1**	**18.3**	**172.3**	**3.5**	**-1.9**	**-1.6**	**15.4**	**2.6**
IA Mixed 40-85% Shares	1.4	1.3	6.3	9.5	27.7	122.0	6.3	-1.1	4.2	10.9	5.2
Cirilium Dynamic	**2.1**	**2.0**	**3.8**	**0.6**	**21.8**	**183.2**	**3.8**	**-1.5**	**-1.6**	**18.5**	**2.2**
IA Flexible	1.7	1.7	6.2	9.8	30.2	119.4	6.2	-0.2	3.7	13.4	4.6
Cirilium Adventurous	**2.1**	**1.9**	**4.5**	**3.2**	**23.1**	**26.9**	**4.5**	**-1.2**	**-0.1**	**21.2**	**-1.6**
IA Flexible	1.7	1.7	6.2	9.8	30.2	32.9	6.2	-0.2	3.7	13.4	4.6

Source: Quilter Investors as at 29 February 2024. Total return, percentage growth, net of fees, rounded to one decimal place of the R (GBP) accumulation shares. The Cirilium Conservative Portfolio launched on 30 March 2012, the Cirilium Balanced Portfolio, the Cirilium Moderate Portfolio, and the Cirilium Dynamic Portfolio launched on 2 June 2008, and the Cirilium Adventurous Portfolio launched on 1 June 2017.

How our equity holdings performed

US equities drive returns

The US was the top-performing developed market with returns enjoying an additional boost from the renewed strength of the US dollar. Although the Magnificent Seven continued to bask in AI-related excitement, US smaller companies also rallied significantly. This saw the Granahan US SMID Select Fund gain close to 10% in February. Meanwhile, Warren Buffet's Berkshire Hathaway gained over 7% to be the biggest contributor to portfolio returns.

Investment trusts leap higher in February

Riverstone Energy, part of our energy transition allocation, announced a tender offer to buy back a portion of its shares, which are trading at a significant discount to their net asset value. This helped push shares in the trust 10% higher in February. Meanwhile, Monks Investment Trust, which focuses on high-growth global equities, and is managed by Baillie Gifford, was another strong performer. It was up over 5% during the month.

UK holdings struggle

OFebruary was another challenging month for the domestic stock market. Larger companies eked out minor gains, but smaller companies suffered declines. This translated into modest losses for most of our UK holdings, with both the Premier Miton UK Value Opportunities and the Montanaro UK Income funds down a little over 2%. The Liontrust UK Growth Fund was the bright spot. It gained almost 1%.

How our fixed-income holdings performed

Fixed-income holdings retreat

Our fixed-income holdings lost ground as government bond yields moved higher, meaning their prices fell. The Janus Henderson Strategic Bond and the Allianz Strategic Bond funds were down around 2% and 3%, respectively. Thanks to the Bank of Japan's reticence towards hiking interest rates, the Vanguard Japan Government Bond Index Fund delivered just over 1%. Riskier corporate bonds continued to outperform government bonds, but returns were muted, with the Premier Miton Financials Capital Securities Fund gaining a modest 0.5%.

How our alternative holdings performed

Systematic, hedge fund and carry strategies outperform

In aggregate, returns were positive thanks to some strong individual performances. The top performer was the AQR Managed Futures Fund, a systematic strategy which looks to profit from persistent trends in equity, bond, commodity, and currency markets, regardless of their direction. It returned 7% in February. Meanwhile, the Cooper Creek North America Long Short Equity Fund was up over 3%. Infrastructure and real estate investment trust (REIT) holdings were hampered by the interest-rate outlook but our carry strategies performed as intended, with the Janus Henderson Asset Backed Securities Fund and the UBS Commodity Carry ETF both up almost 1%.

Portfolio activity

We reviewed our overweight to high-yield bonds and decided to halve our target weight here. With the additional yield offered by high-yield bonds over government bonds at the low end of its historical range, we saw only modest upside potential in the event of a strong economic backdrop, but more significant downside risk if the US economy deteriorates. Consequently, we prefer to take equity-market risk instead. Elsewhere, we continued to build positions in the Schroder Alternative Secured Income Fund, as it should generate a strong and stable income in a range of different market environments, and we exited the R&M European Change for Better Fund in favour of the M&G European Strategic Value Fund.

Investment outlook

We expect the global economy to experience a soft landing. Inflation has been trending lower across the world for the past year and, while labour markets are weakening, unemployment is still surprisingly low. Inflation has fallen faster than wage growth, which is improving real incomes and restoring household purchasing power. This is insulating economies from more material slowdowns in growth. The backdrop of slowing inflation, still positive growth (in the US at least), and the potential for interest-rate cuts, should be good for most financial assets, but much of this good news already appears to be priced-in to markets.

1. Inflation sticking around for now

A strong US employment report in early February, coupled with hotter than expected inflation in both the US and eurozone, has raised doubts over further progress in lowering inflation. There are several likely statistical quirks in the data, but expectations of imminent interest-rate cuts have been dialled back, and bond markets have retreated. Even so, equity markets continue to set new highs amid solid numbers from the latest US corporate earnings season.

2. Interest-rate cuts delayed

Although we think the path of least resistance is for equity indices to continue hitting new highs, with sentiment looking stretched, this raises the risk of a short-term market pullback. We expect to see further progress on the inflation front in the coming months, which should pave the way for central bank rate cuts. Even so, the pace of interest-rate cuts baked into bond prices looks fair to us, which doesn't present a clear buying opportunity for now.

3. What if we are wrong?

The biggest risk to our soft-landing view is that it develops into a hard landing. This would hurt equity markets, but provided we avoid stagflation, where ailing growth is accompanied by elevated inflation, bonds should perform well. Although recent economic numbers might have suggested a re-acceleration of growth and inflation, we think this is unlikely (without a clear policy misstep) due to the delayed economic effects of the interest-rate rises to date.

Thank you for investing with us

Keep an eye out for your next Cirilium Portfolios quarterly report available in April.

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