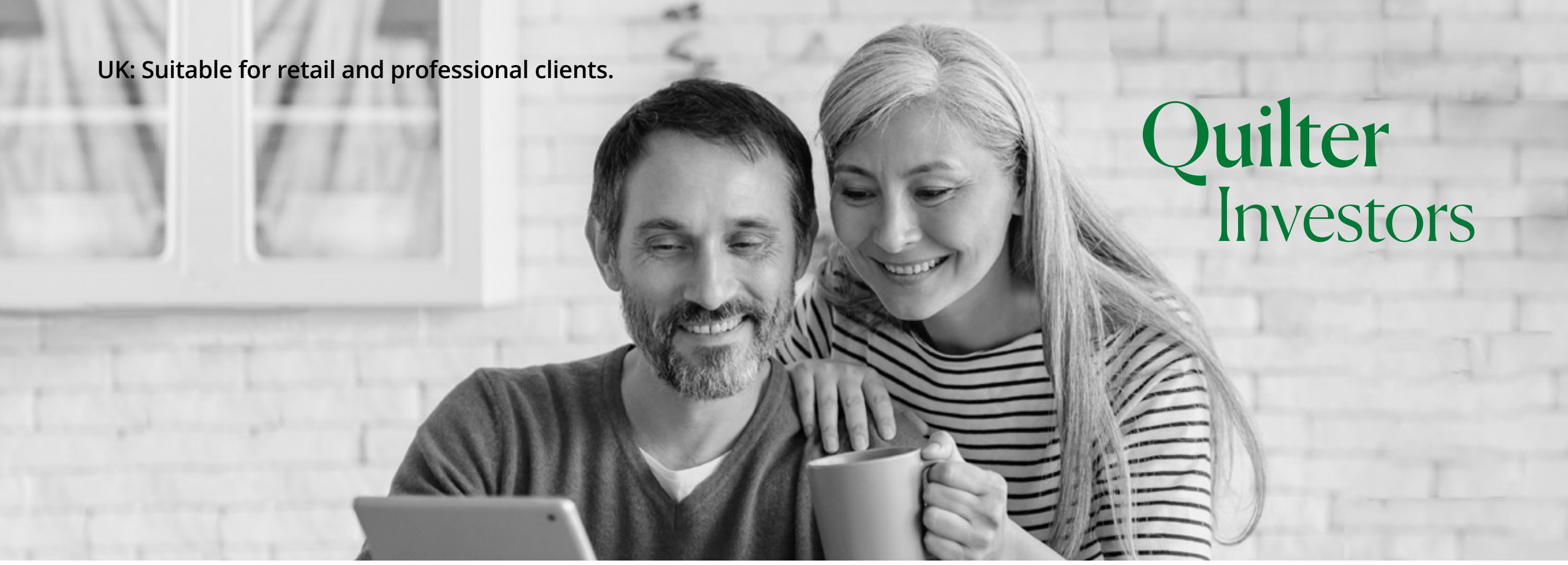

UK: Suitable for retail and professional clients.

Monthly Income Portfolios

Monthly commentary review of January 2023

Marcus Brookes
Chief Investment Officer

Our market summary

Markets were upbeat in January due to improving inflation data in the US and expectations that the US Federal Reserve (Fed) may shift towards lowering interest rates later in 2023. Positive sentiment surrounding China's re-opening, following the end of its zero-covid policy, helped lead emerging market equities higher, while sectors within Europe and the UK also benefitted. Interest-rate rises from central banks remain on the cards, but at a much slower rate than witnessed throughout 2022.

Equity markets

January was a positive month for US stock markets with US equities rising by 4.1%. Improving investor sentiment continued from the last quarter of 2022, particularly regarding inflation, which continued to fall. This, paired with expectations of less aggressive interest-rate rises from the Fed, buoyed investor confidence, with growth sectors, such as technology, performing strongly during the month.

European stock markets continued their strong run with European (excluding UK) equities up by 6.9%. Europe was one of the top regional markets thanks to China's re-opening. Its luxury goods and consumer discretionary sectors (non-essential products and services that consumers tend to purchase when consumer confidence is positive) both added value. Meanwhile, inflation continued to fall, although further interest-rate rises are still expected.

The UK followed other regional stock markets higher, albeit to a lesser degree, with UK equities gaining 4.5% over the month. Better-than-expected economic data helped allay fears of a deeper recession, although growth remains muted relative to other developed economies. Domestically-focused companies were strong performers throughout January, while defensive sectors such as healthcare lagged the market.

China remained the big story for emerging markets, which continued to react positively to the former's re-opening. In January, Chinese equities rose by 9.2%, while emerging market equities gained 5.4%. Outside of China, the Czech Republic, Mexico, South Korea and Taiwan were among the top contributors to performance. Meanwhile, Brazil continued to drag on performance, due to political unrest and rising inflation.

Fixed income

Global bonds enjoyed a largely positive month in January due to improving inflation data coming out of the US and Europe, alongside expectations of less aggressive interest-rate rises from central banks. UK corporate bonds (issued by companies) rose by 4.1% and gilts (UK government bonds) climbed 2.8% during the month. Meanwhile, US Treasuries (US government bonds) gained 2.4%.

Total return, percentage growth in pounds sterling. Each return figure is represented by an appropriate market index.

Helen Bradshaw
Portfolio Manager

CJ Cowan
Portfolio Manager

Performance review

Against the positive market backdrop, the Monthly Income Portfolio delivered 2.8% while the Monthly Income and Growth Portfolio gained 3.0%, with both narrowly behind their respective Investment Association (IA) sector performance comparators.

Performance summary (%)

	Cumulative performance					*Discrete annual performance*		
	1 month	*YTD*	*1 year*	*3 year*	*Since launch*	*31 Jan 22 - 31 Jan 23*	*31 Jan 21 - 31 Jan 22*	*31 Jan 20 - 31 Jan 21*
Monthly Income	**2.8**	**2.8**	**-3.6**	**1.1**	**6.2**	**-3.6**	**5.4**	**-0.4**
IA Mixed 20-60% Shares	3.0	3.0	-3.9	2.4	6.1	-3.9	3.3	3.1
Monthly Income and Growth	**3.0**	**3.0**	**-1.3**	**7.1**	**13.6**	**-1.3**	**8.1**	**0.4**
IA Mixed 40-85% Shares	3.4	3.4	-2.5	9.3	13.9	-2.5	6.2	5.5

Source: Quilter Investors as at 31 January 2023. Total return, percentage growth, net of fees of the U1 GBP Acc share class rounded to one decimal place. The Monthly Income Portfolios launched on 26 June 2019.

How our equity holdings performed

UK holdings drive portfolio returns

Our UK equity allocation was the top contributor to returns, partly due to its weight in the portfolios, but also thanks to some notable performance from funds like Montanaro UK Income, which made strong gains as small-cap stocks outperformed. Meanwhile, the iShares UK Dividend ETF was up over 6%, driven by its exposure to homebuilders and mining stocks, the latter of which were another beneficiary of the 'China re-opening' story.

Europe rebounds on improved global growth outlook

Europe was the next best contributor to portfolio returns after the UK, as falling gas prices and the improving global growth outlook boosted sentiment towards European companies, which are highly geared towards global trade. The SPDR Euro Dividend Aristocrats ETF was the top performer thanks to its overweight positions in materials and industrial stocks.

When a fund is 'overweight', it holds a larger position in a particular stock, sector, or region than the index or asset allocation against which it's benchmarked. 'Underweight' means the opposite.

'Hoppy' New Year

As China ushered in both the year of the rabbit and the end of 'zero-covid', its equity market bounced. While our Asian and emerging market holdings typically carry an underweight to China, they still enjoyed a very strong January. The Schroder Oriental Income Fund, held in the Monthly Income and Growth Portfolio, was the standout performer although the Schroder Asian Income Fund wasn't far behind.

How our fixed income holdings performed

Corporate bonds outperform government bonds

Government bonds rallied in January while improving investor sentiment helped riskier corporate and high-yield bonds (issued by companies) to outperform. This appears to have been driven by markets pricing-in a benign economic scenario whereby inflation quickly moderates, central banks pause their rate hikes, and recession is avoided. Consequently, all our fixed-income holdings made gains in January with the standout being Blackstone Loan Financing Limited, which announced a shareholder consultation regarding plans to help narrow the discount between the share price of the trust and the net asset value (NAV) of the loans in its portfolio.

A portfolio's net asset value (NAV) is the sum of its assets (e.g. shares, bonds, loans, real estate, etc) minus its liabilities (e.g. debt). When the share price of an investment trust is worth less than its NAV, it is at a 'discount'. When the opposite is the case, it is at a 'premium'.

How our alternative holdings performed

'Real' asset strategies chug higher

Falling bond yields (meaning rising prices) were a benefit to real-estate investment trusts (REITs) and our holding here, Assura, which leases properties to GPs and other primary care providers, rose over the month. Our renewable energy infrastructure holdings also made modest gains. The Hipgnosis Songs Fund was the only alternative holding to suffer a loss. It was a casualty of September's mini budget and the ensuing gilt sell-off but, unlike other asset classes, it hasn't recovered these losses. While this has been disappointing, our position is small, and we continue to be attracted to its uncorrelated income stream.

The Hipgnosis Songs Fund is a UK investment trust which pays investors an income derived from the licensing of musical intellectual property rights.

Portfolio activity

We exited from two holdings in January. We sold the Neuberger Berman Monthly Income Fund, a flexible fixed-income strategy with exposure to loans, high-yield, and investment-grade bonds, as it's being wound down and we were keen to avoid our capital being tied up. We also disposed of Princess Private Equity Holdings after losing faith in the board's commitment to its dividend following its cancellation in November. We topped up our preferred equity and bond holdings with the proceeds. Late in the month, we tactically reduced our bond exposure following the rally seen since October as we think it is unlikely the interest-rate cuts priced-in by the end of 2023 will be delivered as we expect inflation to fall slowly.

Investment outlook

January provided further relief for equity and fixed-income investors and was a useful reminder that opportunities for gains still exist following a difficult 2022. That said, we are mindful that many of last year's key questions remain unanswered, namely the likely path for corporate earnings, inflation, and monetary policy.

1. Earnings and valuations

Equity valuations tumbled in 2022 and stocks now trade at lower levels compared to their expected future earnings. Even so, it is still difficult to describe equities as 'cheap' while only modest cuts in expected future earnings seem at odds with the widespread belief that a recession lies ahead. Reassuringly, a more challenging environment should suit active managers as it will present more opportunities to add value, even if overall market returns are muted.

2. How fast is inflation falling?

While it appears that inflation has peaked in the US, Europe, and the UK, financial markets are pricing-in a quick return to central bank targets of 2%. Although the inflation picture is improving, labour markets remain very strong, which could fuel further wage growth and still more inflation. The same is true of the likely pick-up in Chinese consumer demand. Consequently, we expect high inflation to linger, limiting central banks' ability to ease interest rates soon.

3. What's hot and what's not?

The interest rates paid on UK cash deposits are now the highest they've been since 2008, so it may be tempting for many embattled investors to take the 'risk-free' option. However, with inflation still at multi-decade highs, all that holding cash guarantees is a loss of spending power. High interest-rate environments typically favour dividend-paying stocks while bond markets also now offer more attractive income levels, so it quite literally 'pays' to be diversified these days.

Thank you for investing with us

Keep an eye out for your next Monthly Income Portfolios monthly commentary in March.

Want more updates about your portfolio?

Please visit our website at *www.quilter.com* for all the latest news, views, and portfolio information.

Your financial adviser is on hand to discuss anything related to your investment decisions or the suitability of the products mentioned in this document.

If you are a financial adviser and you have any questions or want to find out more about our solutions, please speak to one of our investment directors on +44 (0)207 167 3700, email us at *enquiries@quilter.com*, or visit our website at *www.quilter.com*.

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