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Compass Portfolios

Monthly commentary – Review of July 2023

Marcus Brookes
Chief Investment Officer

Our market summary

Global equities rose by 3.4% in July as positive economic data from the United States and other developed market economies pushed stocks higher. July was most notable for the outperformance of emerging markets, which had lagged their developed market counterparts for much of the year. Chinese equities were the chief driver of this, with the government moving to address some of the key domestic issues that had faced the country since its re-opening.

Equity markets

US equities rose 3.4% in July, as stocks within the energy, financials and technology sectors outperformed. The US Federal Reserve (Fed) enacted what many analysts now believe to be its final interest-rate rise of the cycle, nudging US rates higher by 0.25%. While Fed messaging suggested it remained open-minded to further rate rises, positive economic data paired with plateauing inflation were enough to lift investor sentiment throughout the US.

While the European Central Bank raised interest rates by 0.25% in July, analysts see the bank as nearing the end of its tightening cycle as inflation continues to recede. The prospect of falling rates paired with positive economic growth data helped power European equities to a 3.0% uplift in July, with real estate and energy stocks among the top performers. Corporate earnings appeared to hold up well as earnings season began mid-month.

Domestically-focused stocks helped deliver a positive month for UK equities, which gained 3.8% in July. This came in response to analysts having softened their forecasts for further interest-rate rises throughout 2023, as inflation appeared to relent. This was particularly welcome news for domestic companies which rallied throughout the month, with a 6.0% rise for UK small cap equities. Property stocks were notable outperformers.

Emerging markets equities delivered a 6.3% gain in July, outperforming developed markets in the process. A rally in Chinese equities helped drive performance for the index, with China rising 10.9% over the month after local authorities pledged economic support to the beleaguered domestic real-estate sector. Following a difficult June, Turkey was the top-performing emerging market while Egypt, Taiwan and India were among the main detractors.

Fixed income

The prospect of interest-rate hiking cycles coming to an end in Europe and the US were largely supportive to credit markets, although US Treasuries were marginally down in July by 0.4%. Suggestions that the US may avoid recession this year underpinned much of the optimism in markets.

Total return, percentage growth in US dollars except where shown, rounded to one decimal place. The performance shown for global equities is represented 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; emerging markets by the MSCI EM (Emerging Markets) Index; and US Treasuries by the ICE BofA US Treasury Index.

Sacha Chorley
Portfolio Manager

Performance review

The Compass Portfolios generated positive returns ranging from 2.3% for the Compass 3 Portfolio to 4% for the Compass 5 Portfolio thanks to the greater equity exposure in the higher-risk portfolios. Rising stock markets meant that equities were the primary driver of returns although our overweight allocation to high-yield bonds also added to returns, as did our inflation-linked alternatives holdings.

Performance summary (%)

	Cumulative performance						*Discrete annual performance to end of July*				
	1 month	*YTD*	*1 year*	*3 year*	*5 year*	*Since launch*	*2022 - 2023*	*2021 - 2022*	*2020 - 2021*	*2019 - 2020*	*2018 - 2019*
Compass 3	2.3	7.8	5.0	8.5	11.3	24.0	5.0	-12.0	17.4	2.2	0.4
Compass 4	3.1	10.8	7.8	16.4	19.4	40.9	7.8	-13.4	24.6	2.5	0.1
Compass 5	4.0	14.6	11.0	21.6	24.8	55.7	11.0	-17.2	32.3	2.8	-0.1

Source: Quilter Investors as at 31 July 2023. Total return, percentage growth, net of fees, rounded to one decimal place of the A (USD) Accumulation shares. The Old Mutual Compass Portfolios were launched on 19 April 2016 as a sub-fund of Merian Global Investors Series PLC and were merged on 7 June 2019 into the Quilter Investors Compass Portfolios. The performance history shown includes the performance of the of the Old Mutual Compass Portfolios from 19 April 2016 to 7 June 2019 until the portfolios merged.

How our equity holdings performed

Stock pickers standout in US

It was a strong month for global equity markets with the MSCI AC World Index up by over 3.5%. Although market returns from the US were more modest, several of our underlying managers delivered significant alpha. The Sands Capital US Select Growth Fund, which gained 5.4%, was among the most notable here.

Alpha relates to a given fund manager or an investment strategy's ability to beat the market. It is often described as the additional return generated above and beyond that of a relevant market index or benchmark.

Asia and emerging markets outperform

The strongest regional market was China, which was buoyed by promises of economic support from the government. Holdings such as the Fidelity China Consumer Fund, which gained 10.3%, and the Pacific North of South Emerging Market Equity Fund, which gained 6%, were the main beneficiaries of this.

Market ignores bleak US earnings data

The second quarter US earnings season showed only modest revenue growth and continued weakness in corporate earnings. In spite of this, companies traditionally considered to be 'quality growth' were not rewarded over the month. This was reflected in funds such as Liontrust UK Growth, which gained just 2.8%, and our healthcare holding, AllianceBernstein International Healthcare, which added a modest 1.7%.

Quality growth companies are generally regarded as those with the strongest balance sheets. They tend to exhibit higher margins and lower debt alongside high levels of cashflow stability and return on equity (RoE). Such attributes mean quality growth companies can reinvest profits in their business and so compound their earnings over time.

How our fixed-income holdings performed

Credit allocations drive alpha

With more positive risk appetite in markets, our corporate bond holdings (issued by companies) were the dominant driver of returns among our fixed-income allocations in July. Our small overweight to lower-rated corporate bonds relative to our strategic asset allocation (SAA) model, was the highlight. The Federated Hermes Unconstrained Credit Fund added almost 1% more than broader global bond markets which were mostly flat over the month.

Credit is a generic term for bonds that are issued by companies, not governments or government-backed institutions. The latter are often referred to as sovereign bonds.

How our alternative holdings performed

Inflation-linked assets continue to rally

Within the alternatives portfolios, the funds in the inflation-linked sleeve were the standout performers in July. The WisdomTree Enhanced Commodity ETF delivered a 6% return over the month while the Lyxor US$ 10Y Inflation Expectations ETF was up 1.5%. Performance elsewhere was more mixed with fixed-income strategies generally outperforming equity-based strategies. For example, while the Brevan Howard Absolute Return Government Bond Fund gained 0.8%, the Sandbar Global Equity Market Neutral Fund declined 1.1%.

Market neutral funds are strategies that are not closely correlated to the movements of a given index benchmark. In general, they aim to generate consistent returns regardless of whether markets are rising or falling.

Portfolio activity

In July we began work to realign the alternatives portfolios by building out new positions in the AQR Managed Futures Fund and the Jupiter Strategic Absolute Return Bond Fund. These holdings sit within the four style-focused sleeves within our alternatives allocation and will help to deliver the right shape of portfolio returns over time.

Investment outlook

Recent data have continued to show a similar trend to that of the past few months: while inflation is certainly declining from its recent highs, the composition and pace of those declines make us wary that inflation levels in the UK at least, will take a long time to return to the Bank of England's 2% target. We've also continued to see employment and wage growth rising which supports the argument for a potential 'soft landing' against a backdrop of economic growth.

1. Will inflation ever return to target levels?

Globally, inflation has continued to fall with declines in 'core inflation' also apparent. Meanwhile, although UK inflation has relented, it remains far higher than in other major economies. While UK headline inflation is generally declining, there is a risk of higher structural inflation thanks to wage increases that are now running above inflation. This is a 'second round effect' of steep interest-rate hikes and one that's likely to keep the pressure on central bankers to continue to raise rates.

Core inflation is a measure of the rise in prices, which excludes the (more volatile) changes in the price of food and energy. It is most often calculated using the consumer price index (CPI), a measure of prices for goods and services.

2. A near-term muddle

In tandem with the still-resilient employment picture, expectations for global economic growth in 2023 continue to indicate a 'muddle through' – namely, no recession this year, but a moderate level of economic activity. Even so, we're wary that the full impact of substantially higher interest rates has yet to feed through into economic activity while economic data are still generally indicating a contraction and signs of consumer weakness are increasing.

3. Corporate earnings continue to decline

Recent corporate earnings reports have shown another year-on-year decline in company profits, while revenues were basically flat. The combination of this weaker fundamental story, combined with what appears to be a finely balanced economic picture leads us to remain much in line with our strategic asset allocation (SAA) model, with a small overweight to high-yielding corporate bonds to take advantage of the restrained, but positive, economic activity.

The strategic asset allocation (SAA) is our long-term model asset allocation. It establishes how much of each portfolio should be invested in different asset classes such as equities, bonds, property, alternatives and cash.

Thank you for investing with us

Keep an eye out for your next Compass Portfolios monthly report available in September.

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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The ICAV has appointed KBA Consulting Management Limited as manager of the ICAV (the "Manager"). The Manager was incorporated on 4 December 2006 as a limited liability company in Ireland under number 430897. The Manager's main business is the provision of fund management services to collective investment schemes such as the ICAV.

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Where the shares are acquired by persons who are relevant persons specified in Section 305A of the SFA, namely:

A corporation (which is not an accredited investor (as defined in Section 4A of the SFA) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

A trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor, the shares, debentures and units of shares and debentures of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust shall not be transferred within 6 months after that corporation or that trust has acquired the shares pursuant to an offer made under Section 305 of the SFA except:

(1) to an institutional investor or to a relevant person as defined in Section 305(5) of the SFA, or which arises from an offer referred to in Section 275(1A) of the SFA (in the case of that corporation) or Section 305A(3)(i)(B) of the SFA (in the case of that trust);

(2) Where no consideration is or will be given for the transfer;

(3) Where the transfer is by operation of law;

(4) As specified in Section 305A(5) of the SFA; Or

(5) As specified in Regulation 36 of the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 of Singapore.

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