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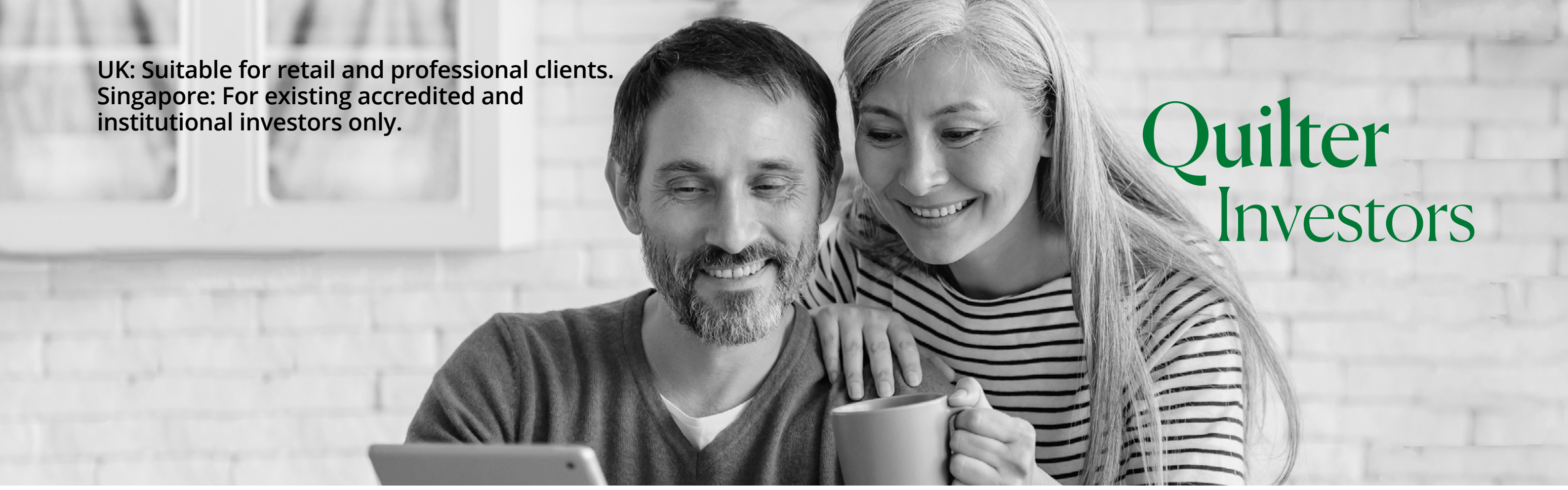

Quilter Investors

Compass Portfolios

Monthly commentary – Review of May 2023

Marcus Brookes
Chief Investment Officer

Our market summary

Global equities posted a minor loss of 0.9% in May. An impasse over the mounting US debt-ceiling crisis fuelled investor concerns as the deadline approached, although optimism returned towards the end of the month as an agreement was finally reached. Equity markets in the UK, Europe, and China declined while the US and Japan made gains, chiefly due to semiconductor and other technology stocks, which boomed thanks to the sudden appetite for artificial intelligence companies.

Equity markets

In May, the US news cycle was dominated by the prospect of a debt default as the deadline to raise the nation's borrowing threshold loomed large. Investor jitters were eventually allayed as President Biden reached a consensus with the Republican-controlled House of Representatives to raise the debt ceiling in time for the next round of repayments. US equities ultimately gained 0.7%, powered in the main by surging technology stocks.

After strong progress in the first four months of the year, European equities fell by 5.4% in May. Investor sentiment was soured by negative economic data, which included news that Germany had entered recession over the winter period. Even so, inflation fell in both Germany and France. Technology stocks were the one positive area as semiconductor manufacturers rallied on the sudden appetite for stocks exposed to artificial intelligence.

The UK declined more than Europe in May, with UK equities sinking 6.6%. Much like in the US and Europe, technology stocks were the only notable positives, although the UK's extensive financials sector was relatively flat for the month. While inflation fears eased elsewhere, the Bank of England continued to grapple with higher-than-expected inflation in the UK, and subsequently raised interest rates to 4.5%.

Emerging markets equities declined very modestly in May, with a fall of 1.7%. Greece was the top-performing emerging market due to a decisive vote for the New Democracy Party in the national election, easing concerns over a coalition government. South Africa was the worst-performing market, dogged by a tumbling currency and accusations of supplying weapons to Russia. China and the Czech Republic also declined notably.

Fixed income

Global bond markets were a mixed bag as investors responded to a raft of economic data from the various central banks and processed the continued rise in interest rates across developed economies. This resulted in a 2.7% loss for US Treasuries (US government bonds), a 5.1% loss for gilts (UK government bonds), and a 3.8% fall in sterling corporate bonds. European bond markets generally outperformed, while the UK struggled as inflation proved more resilient than elsewhere.

Total return, percentage growth in US dollars except where shown, rounded to one decimal place. Global equities are represented by the MSCI World Index; US equities by the MSCI US Index; European (excluding UK) equities by the MSCI Europe ex UK Index; UK equities by the MSCI UK Index, emerging market equities by the MSCI EM (Emerging Markets) Index; Chinese equities by the MSCI China Index; UK corporate bonds by the ICE BofA Sterling Corporate Index; gilts by the ICE BofA UK Gilt Index; and US Treasuries by the ICE BofA US Treasury (GBP hedged) Index.

Sacha Chorley
Portfolio Manager

Performance review

The Compass Portfolios delivered modest losses of between 0.5% and 0.3%, with the higher-risk portfolios faring better over the month. Returns from fixed-income markets were challenging due to negative sentiment which led to increased yields for both government and corporate bonds (issued by companies), meaning their prices fell. However, it was a fruitful period for stock pickers as well as for certain markets such as the US and Japan, which helped to mitigate losses, especially for the higher-risk portfolios.

Performance summary (%)

	Cumulative performance						*Discrete annual performance to end of May*				
	1 month	*YTD*	*1 year*	*3 year*	*5 year*	*Since launch*	*2022 - 2023*	*2021 - 2022*	*2020 - 2021*	*2019 - 2020*	*2018 - 2019*
Compass 3	-0.5	3.3	-1.1	10.5	7.0	18.8	-1.1	-9.3	23.3	-0.7	-2.5
Compass 4	-0.4	4.4	-0.9	18.3	13.3	32.7	-0.9	-9.9	32.5	-0.4	-3.8
Compass 5	-0.3	5.8	-0.9	23.7	16.5	43.9	-0.9	-12.4	42.5	-1.3	-4.6

Source: Quilter Investors as at 31 May 2023. Total return, percentage growth, net of fees of the A USD Acc share class rounded to one decimal place. 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 funds merged.

How our equity holdings performed

US debt ceiling weighs on sentiment

Stock market jitters until late in the month undermined returns from most markets as risk appetite waned as the US approached its federal debt ceiling and as their potential debt default and government shut down loomed. More cyclical markets, such as the UK and Europe, were especially hard hit and were among our worst performing holdings in May. The Liontrust UK Growth Fund was down over 5.5% in May.

'Cyclicality' refers to cyclical companies. These are companies whose fortunes are closely linked to the economic cycle. This means their revenues generally rise during periods of economic expansion and fall during recession.

Technology stocks provide respite

The bright spot for markets was the strong performance of information technology stocks which, notably, pushed US and Japanese markets into positive territory. This benefitted funds such as Sands US Select Growth, which gained 8%, Quilter Investors US Equity Growth Fund (JP Morgan), which gained 6% and M&G Japan, which was up 1%. Our private equity holdings also benefitted with the HarbourVest Global Private Equity International trust gaining 2.2%.

Private equities are investments into the shares of private companies that aren't yet listed on a stock exchange.

Challenges for managers in volatile markets

The range of performance across markets and sectors increased the range of outcomes from active managers. Weaker European markets allowed for strong benchmark outperformance from funds like the Quilter Investors Europe ex UK Equity Fund (Janus Henderson), which was 3% ahead of its benchmark, while the narrow market leadership in Japan stymied funds like Baillie Gifford Japan Income Growth, which was 5% adrift of its benchmark.

Active management is a traditional investment approach where the investment manager 'actively' trades the holdings in their portfolios, such as equities, bonds, or property assets to take advantage of investment opportunities or to minimise potential losses. It is the opposite of 'passive' management.

How our fixed income holdings performed

Interest rates rise

Bond yields rose (meaning their prices fell) as investors priced-out the prospect of interest-rate cuts. This impacted our fixed-income allocations with broad global bond markets down by 0.4%. It was a challenging environment given the declining investor sentiment in equity markets also undermined corporate bonds (issued by companies). Hence, the iShares $ TIPS ETF fell 1.1% while risk aversion meant that credit-focussed holdings such as the Federated Hermes Unconstrained Credit Fund, lost 1.4%.

How our alternative holdings performed

Mixed performance across alternatives

Performance across the alternatives portfolio was generally positive, with notably strong returns from the long/short equity manager Cooper Creek, which delivered a 2.4% gain, thanks to strong returns from its 'short' book. Elsewhere, returns were more modest across the absolute return fixed income line up. Other, more interest-rate sensitive, holdings fared worse, with the Allianz Fixed Income Macro Fund down by 2% as interest rates rose once more.

A long/short equity fund is a strategy based on buying, or going 'long', on equities that are expected to rise in value and selling 'short' equities that are expected to fall in value.

Portfolio activity

Portfolio activity this month centred around the removal of the Quilter Investors Global Dynamic Equity Fund (managed by Quilter Investors) from the portfolio and the reallocation of the capital to other favoured managers. We added a new holding in the Fidelity China Consumer Fund, which complements our existing emerging market exposures and adds a China-specific allocation.

Investment outlook

May's market moves included the repricing of bond markets to remove any expectations of interest-rate cuts before the end of the year. We still need to see that inflationary data points are truly cooling before having confidence that central bankers are ready to pause their rate hikes. The extent to which interest rates and central bank policy normalisation is feeding into the real economy is also uncertain and we remain focused on data points that confirm how spending and investment are progressing at a corporate level.

1. Inflation remains challenging

Although US inflation has been the most responsive to higher interest rates, the latest data release saw a higher than expected reading in the 'core' components of US inflation. Meanwhile, the last few data points in the UK have remained stubbornly higher than expectations. The persistence of this inflation keeps the pressure on central banks to continue to raise interest 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. Markets repricing central bank policy

The higher inflation numbers have caused a reaction in fixed-income markets: interest-rate expectations for the next six months have been increased as the prospect of the cuts previously priced-in for the end of the year, dissipated. Given that inflationary pressures appear 'stickier' than we had expected, we are mindful that there remains scope for further increases in interest rates from here.

3. Focus on corporate earnings

While bond markets are pricing-in a tighter central bank policy setting, equity markets have somewhat shrugged off such concerns. Although we have seen positive moves from stocks overall this year, market leadership is narrow with only a handful of equities driving index returns. Our focus will continue to be on the earnings that companies deliver and ensuring that the companies in which we are invested are able to grow their profits over time.

Thank you for investing with us

Keep an eye out for your next Compass Portfolios quarterly report available in July.

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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